



Mises – Rothbard – Hoppe

LIBERALISMUS UND GESELLSCHAFTLICHE ORDNUNG – WS 2018-19
FÜR MASTER-STUDIERENDE IWG UND ECONOMICS, 13 – 14 DECEMBER 2018

DOZENTEN: PROF. DR. MARTIN LESCHKE AND HON. PROF. DR. THORSTEN POLLEIT

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Updated: 12 December 2018

Schedule

Thursday, 13 December 2018

1	11:00	11:45	The 'Austrians' – a brief overview
2	11:45	12:30	Fundamentals of epistemology
3	13:30	14:15	On the scientific method of economics
4	14:15	15:00	Mises's praxeology (I)
5	15:15	16:00	Mises's praxeology (II)
6	16:00	16:45	Capitalism – the natural form of cooperation
7	16:45	17:30	The impossibility of socialism

Friday, 14 December 2018

8	09:30	10:15	Mises' liberalism
9	10:15	11:00	Interventionism – a critique
10	11:00	11:45	Rothbard's ethics of liberty – and the state
11	12:00	12:45	The devolution of money – the <i>progression theorem</i>
12	12:45	13:30	Hoppe's critique of classical-liberalism
13	13:30	14:00	Hoppe's private property society

Introduction

- Purpose of the seminar is *threefold*. I would like:

(1) to make you familiar with contributions of Ludwig von Mises (1881 – 1973), Murray N. Rothbard (1926 – 1995) and Hans-Hermann Hoppe (1949*) to classical-liberal/libertarian thinking;

(2) to highlight the importance of the *scientific method proper* in the debate about the classical-liberalism-libertarianism; and

(3) to point out the relevance of (1) and (2) in terms of safeguarding individual freedom, prosperity and peaceful cooperation among men, nationally and internationally.

- By no means less important: I do hope that we'll have extensive discussions and a great time!



Thorsten Polleit

Königstein i. T., November 2018

1. The 'Austrians' - an overview

THE PURPOSE OF THIS SESSION:

(1) Informing you about the birth of the 'Austrian School', (2) making you familiar with the Austrian School's main representatives, and (3) highlighting their major contributions to (political) economics.

READINGS:

"15 Great Austrian Economists" (1999), Holcombe, R. G. (ed.), Ludwig von Mises Institute, Auburn, US Alabama.

Carl Menger



IMPORTANT WORKS:

Principles of Economics (1871),
Investigations into the Method of the Social Sciences with Special Reference to Economics (1883),
The Errors of Historicism in German Economics (1884).

- Born 28 February 1840, died 26 February 1921.
- In 1871, published Menger his path-breaking *Grundsätze der Volkswirtschaftslehre (Principles of Economics)*.
- Together with the Léon Walras (1834 – 1919) and William Stanley Jevons (1835 – 1882), Menger spelled out the *theory of marginal utility* – which has become the cornerstone of value and price theory.
- Menger also put forward a theory of the origin of money: Money emerged spontaneously from free market activities, and out of a commodity.
- In 1872, Menger became a *Privatdozent* in the Faculty of Law and Political Science at the University of Vienna.
- In 1873, he was promoted to the position of a paid, full-time associated professor.
- In 1876, Menger became a tutor for economics to Rudolf von Habsburg (1858 – 1889), the Crown Prince of Austria.
- In 1879, Menger was appointed to the Chair of Political Economy in Vienna's Law Faculty as a professor ordinarius or full professor.
- With his *Investigations* (1883), Menger battled the *German Historical School*, which considered historicism as the appropriate method of economics and rejected any notion of *economic laws*.
- In 1884 Menger published *The Errors of Historicism in German Economics*, thereby kicking off the infamous *Methodenstreit*, which basically established the *Austrian School of Economics*.

Eugen von Böhm-Bawerk



IMPORTANT WORKS:

History and Critique of Interest Theories (1884), *Positive Theory of Capital* (1889) (second volume of *Capital and Interest*), *Value and Price* (part of the second volume), *Further Essays on Capital and Interest* (1921) (third volume), *Karl Marx and the Close of His System* (1896).

- Born 12 February, 1851, died 27 August 1914.
- From 1881 to 1889, Böhm-Bawerk taught at the University of Innsbruck and became professor in 1884.
- In his *History and Critique of Interest Theories* (1884), Böhm-Bawerk reveals the fallacies in the history of thought concerning the interest rate.
- In *Positive Theory of Capital* (1889), he argues that capital is not homogeneous but an intricate and diverse structure that has a time dimension. A growing economy is not just a consequence of increased capital investment, but also of longer processes of production (*roundaboutness*).
- Böhm-Bawerk argues that the interest rate is determined by three factors: (1) Current needs are typically less well satisfied than future needs; (2) human beings tend to underestimate future needs; (3) a technical factor that determines *time preference*: higher physical productivity of *roundabout* methods of production.
- Böhm-Bawerk engages in an intellectual battle with the Marxists over the exploitation theory of capital (*Karl Marx and the Close of His System* (1896)). He refutes the socialist doctrine of capital and wages (actually long before the communists came to power in Russia) by demonstrating that capitalists save money, pay labor, and wait until the final product is sold to receive profit.
- Böhm-Bawerk held a regular seminar that would later become the model for Mises's Vienna *Privatseminar*.
- He was Austrian Minister of Finance in 1895, 1897 – 1898 and 1900 – 1904.

Ludwig von Mises

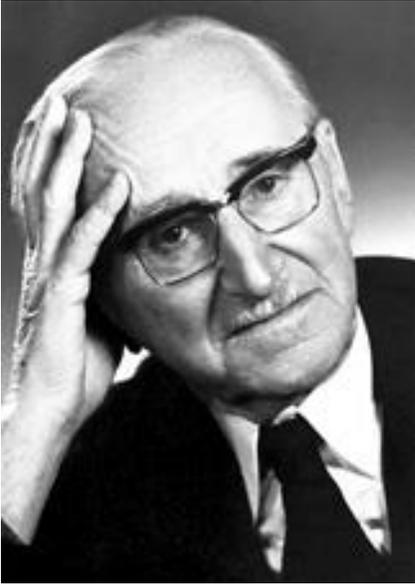


IMPORTANT WORKS:

The Theory of Money and Credit (1912), *Socialism* (1922), *Liberalism* (1927), *Interventionism* (1940), *Omnipotent Government* (1944), *Bureaucracy* (1944), *Human Action* (1949), *Anti-Capitalistic Mentality* (1956), *Theory of History* (1957), *Ultimate Foundation of Economic Science* (1962).

- Born 29 September 1881, died 10 October 1973.
- In *The Theory of Money and Credit* (1912), Mises extended Austrian marginal utility theory to money, and he developed the *regression theorem*, showing that money must have emerged from a commodity.
- In 1920, Mises proved, based on economic science, that socialism was impossible and doomed to fail.
- In his magnum opus *Human Action* (originally published as *Nationalökonomie* in 1940), Mises reconstructed the science of economics along the line of the *axiom of action*, logically deducing economic truths from a self-evident *axiom*.
- From 1913 to 1934, he was an unpaid professor at the University of Vienna, working as an economist for the Vienna Chamber of Commerce. In this capacity he served as the principal economic adviser to the Austrian government.
- Fleeing the German National Socialism regime, Mises left for Geneva in 1934, where he was a professor at the Graduate Institute of International Studies until he emigrated to New York City in 1940. He was a visiting professor at New York University as from 1945 until he retired in 1969.

Friedrich August von Hayek



IMPORTANT WORKS:

Monetary Theory and the Trade Cycle (1929), *Prices and Production* (1931), *Pure Theory of Capital* (1941), *The Road to Serfdom* (1944), *The Constitution of Liberty* (1960), *Denationalisation of Money* (1976).

- Born 8 May 1899, died 23 March 1992.
- Hayek is perhaps the most widely known representative of the Austrian School of Economics.
- At the University of Vienna, Hayek attended the lectures of Friedrich von Wieser and Othmar Spann and joined Mises's *Privatseminar*.
- The *Hayekian triangles* (*Prices and Production* (1935)) provided a highly stylized way of describing (interest rate induced) changes in the intertemporal pattern of the capital structure. He identified the trade cycle as an intertemporal *discoordination*.
- He provided a sharp and devastating critique of J. M. Keynes' *The Theory of Employment, Interest and Money* (1936).
- In the late 1930s and early 1940s, his research focused on the role of *knowledge and discovery in market processes*, and on the methodological underpinnings of the Austrian tradition, particularly *subjectivism* and *methodological individualism*.
- He received the 1974 *Nobel Memorial Prize in Economics* (together with Gunnar Myrdal).
- Hayek became famous with his book *The Road To Serfdom* (1944), in which he warned against the *tyranny* that inevitably results from government control of the economy.
- He argued for a *denationalisation of money* (1976), making a case for free market money.

Murray N. Rothbard

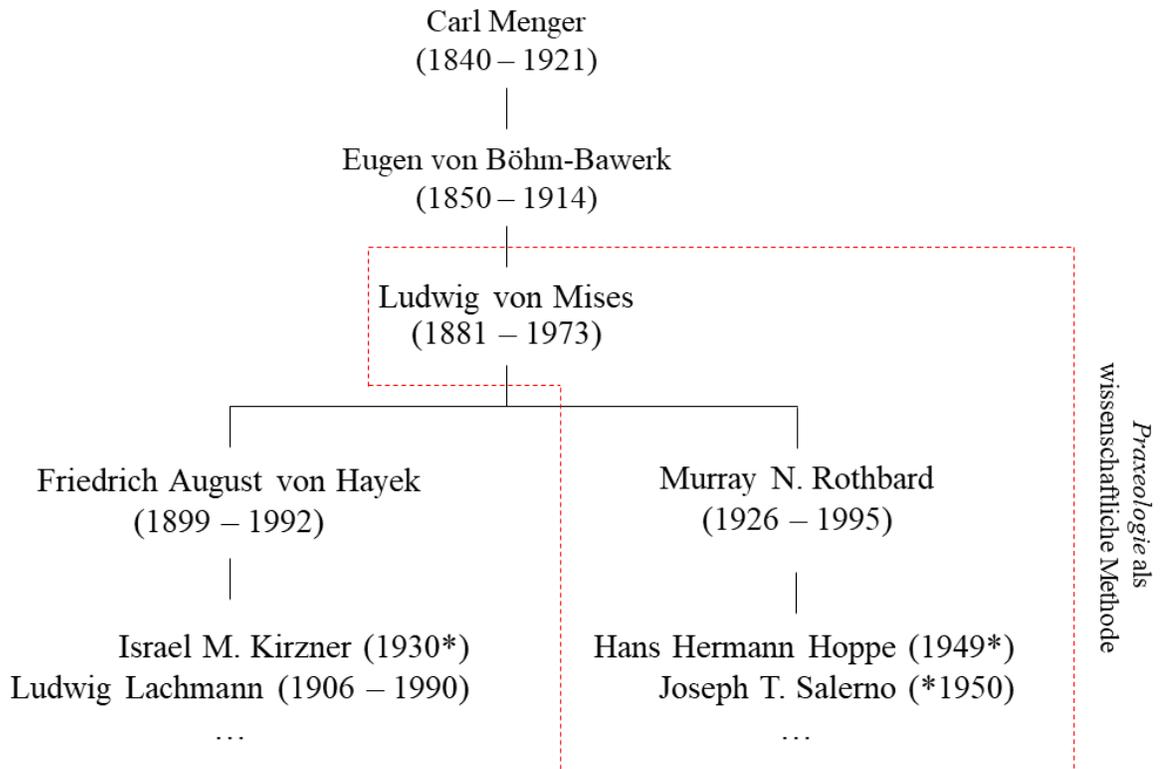


IMPORTANT WORKS:

Man, Economy, and State (1962), *Americas Great Depression* (1963), *What Has Government Done to Our Money?* (1963), *Power and Market* (1970), *For a New Liberty* (1973), *The Ethics of Liberty* (1982), *The Mystery of Banking* (1983), *An Austrian Perspective on the History of Economic Thought* (1995).

- Born 2 March 1926, died 7 January 1995.
- Murray N. Rothbard was an exponent of the *rationalist branch of the Austrian School of Economics*, a critic of all variants of social relativism: historicism, empiricism, positivism, falsificationism, and scepticism.
- As a highly original thinker, Rothbard made important contributions to economics, history, political economy and philosophy; Rothbard is the latest and most comprehensive system-builder within Austrian economics.
- Rothbard developed and extended the Austrian economics of Ludwig von Mises, in whose seminar he had participated for many years.
- In his textbook *Man, Economy, and State* (1962), Rothbard explained Mises's *Human Action* in a fashion suitable for college students.
- In *What Has Government Done to Our Money*, (1963) Rothbard explained, on a praxeological basis, why and how the state replaces commodity with fiat money.
- In *The Ethics of Liberty* (1982), Rothbard (re)integrated economics and ethics, providing the basis for *rationalist ethics*.
- His unique contribution is (i) the rediscovery of property and property rights as the common foundation of both economics and political philosophy, and (ii) the systematic reconstruction and conceptual integration of marginalist economics and natural-law political philosophy into a unified moral science: *libertarianism*.

The Austrians



2. Fundamentals of epistemology

THE PURPOSE OF THIS SESSION:

(1) Introducing rationalism and empiricism, (2) outlining Kant’s intellectual project, and (3) explaining Kant’s idea of *a priori* knowledge.

READINGS:

Tetens, H. (2006), Kants “Kritik der reinen Vernunft. Ein systematischer Kommentar”, Philipp Reclam jun. Stuttgart. Kant, I. (2007), Critique of Pure Reason [first published in Germany in 1781, 1787], New Translation, Penguin Classics; foreword by M. Weigelt, pp. xv – lxxvi.



- When Immanuel Kant (1724–1804) had established himself academically, *empiricism* had become state of the art in science, *rationalism* was on the retreat.
- *Empiricism* holds that our knowledge comes from, and is validated on the basis of, observation (sensory experience).
- *Rationalism* holds that our (highest) knowledge stems from our *reason*.
- The rise of empiricism poses a problem for Kant, who is an advocate of *enlightenment*: He holds dear the idea of *autonomy of reason*.
 - ▶ *Autonomy of reason* means, according to Kant, that (1) the individual can live according to rules and laws of action determined by himself; and that (2) he can justify these rules and laws through *sound reasoning*.
- Kant says, however, that we can justify the idea of the *autonomy of reasons* only if we stick to three *metaphysical* assumptions:
 - ▶ The metaphysical assumptions are: (1) God is the ultimate cause of the universe; (2) man has an immortal soul; and (3) man has a free will.

- *Metaphysics* is a branch of philosophy, attempting to answer the final questions (such as *ultimately, what is there?*, and *what is it like?*).
- Empiricism basically says that metaphysics is *unscientific* (as it goes against its core idea that “science is measurement”).

- Kant, in an attempt to defend the idea of *autonomy of reason*, wants to explore whether metaphysics can qualify as a science.
- It is certainly true that, on the one hand, the *laws of nature* cannot be based on *pure reason*, on mere deductive logical thinking. It is, for instance, by no necessity of reason that water freezes at zero degree Celsius. Such knowledge is gained through experience.



Immanuel Kant, taken from P. Carus, Kant's Prolegomena, 1949

- On the other hand, the empiricist doctrine implies an *intolerable scepticism*: It claims that (a large number of) our beliefs about the natural world would be either simply false or at least unjustified – such as, for instance, the idea of God, the unchanging morality determined by reason, the concept of free will, etc. –, none of which could be proved if sensory experience would be accepted as the sole basis of our knowledge.
 - ▶ For instance, empiricists surrender the *principle of causality*, which says that *all alterations take place according to the law of the connection of cause and effect*. They would say that for all the human eye ever *observes* when things change is a *succession* of their different states. Causality, the necessity in this succession, is *merely assumed*.
- Kant tried to solve the *epistemological dispute between rationalism and empiricism* by showing that our knowledge of objects (*natural reality* in general) does *not* depend on the objects themselves, but that *empirical objects depend on our knowledge of them*.

„Daß alle unsere Erkenntnis mit der Erfahrung anfangt, daran ist gar kein Zweifel; denn wodurch sollte das Erkenntnisvermögen sonst zur Ausübung erweckt werden, geschähe es nicht durch Gegenstände, die unsere Sinne rühren und teils von selbst Vorstellungen bewirken, teils unsere Verstandestätigkeit in Bewegung bringen, diese zu vergleichen, sie zu verknüpfen oder zu trennen, und so den rohen Stoff sinnlicher Eindrücke zu einer Erkenntnis der Gegenstände zu verarbeiten, die Erfahrung heißt? Der Zeit nach geht also keine Erkenntnis in uns vor der Erfahrung vorher, und mit dieser fängt alle an.

Wenn aber gleich alle unsere Erkenntnis mit der Erfahrung anhebt, so entspringt sie darum doch nicht eben alle aus der Erfahrung. Denn es könnte wohl sein, daß selbst unsere Erfahrungserkenntnis ein Zusammengesetztes aus dem sei, was wir durch Eindrücke empfangen, und dem, was unser eigenes Erkenntnisvermögen (durch sinnliche Eindrücke bloß veranlaßt) aus sich selbst hergibt ...“

—Immanuel Kant (1781), Kritik der reinen Vernunft, Kapitel 6, Einleitung.

- Kant’s *transcendental investigation* deals with the *conditions of our knowledge*: It investigates the *principles of reason* insofar as they provide the rules which govern our experience and knowledge of objects.
 - ▶ In his *transcendental idealism*, Kant goes far beyond the alternatives of rationalism and empiricism, and remains equidistant from both. It is Kant’s idea that on the basis of a transcendental investigation we can establish a pure science, which formulates *absolutely true laws of empirical nature contained in the principles of reason*.
 - According to Kant, metaphysical propositions must be *a priori* – in contrast to experience-based propositions (which can be found in natural sciences), which are *a posteriori*.
 - ▶ *A priori* judgements (*Urteile*, or propositions) express true (self-evident) knowledge that is acquired prior to, or independently of, experience.
 - ▶ *A posteriori* judgements express knowledge acquired on the basis, and as result of, experience.
 - Kant distinguishes between *analytical* and *synthetic* judgements, which are the form in which we express our knowledge (these declarative sentences establish objectively valid relations with objects).
 - ▶ An *analytical judgement* is a judgement whose content is restricted to what is already contained in the definition of the concept. Example: “All bachelors are unmarried”. We do not need to go beyond the concept which we connect with “body” in order to find that they are extended.
- Analytical judgements should be *a priori*.

Self-evident propositions

“Things which are equal to the same thing are equal to each other.”

It is impossible to think correctly and avoid evident self-contradiction unless we observe what are called the *Laws of Thought*:

1. Law of identity: *Whatever is, is.*
2. Law of contradiction: *Nothing can both be and not be.*
3. Law of excluded middle: *Everything must either be or not be.*

▶ A *synthetic judgement* is a judgement about an object that provides information which is not contained in the concept of that object. Example: “Water freezes at zero degree Celsius.” We learn this from empirical observation. The *predicate* adds information which was not thought in the concept.

→ Synthetic judgements should be *a posteriori*.

► “Propositions are analytic whenever the means of formal logic are sufficient in order to find out whether they are true or not; otherwise propositions are synthetic ones. And propositions are a posteriori whenever observations are necessary in order to establish their truth or at least confirm them. If observations are not necessary then propositions are a priori.”

—Hoppe (2007), *The Austrian Method*, pp. 17-8.

- We come up with the following matrix:

	Analytic	synthetic
a priori	(1)	(3)
a posteriori	(2)	(4)

(1): Analytic judgements are *a priori*.

(2): Analytic judgements *a posteriori* are impossible.

(4): Synthetic judgements are *a posteriori*.

(3): Kant holds that metaphysical assumptions represent *synthetic propositions a priori*.

- Kant’s *transcendental investigation* (the philosophical self-reflection of ourselves as knowing subjects) is about (i) spelling out synthetic a priori judgements and (ii) explaining how they should be possible.
- Kant claims that there are judgements which are both *synthetic* and *a priori*: “[T]he features that the mind possesses *a priori* to confront all sensory experience and to shape all empirical knowledge can be expressed in such judgments, and they tell us something about the nature of the empirical world as the result of reason investigating itself.”
—Weigelt M. (2007), Introduction, p. xxxvi.
- How can we discover a synthetic a priori judgement, then? The answer is that a synthetic a priori judgement must fulfil two requirements:
 - *First*, it must be possible to demonstrate that the judgements is *not derived from experience* (observational evidence), as the latter can only reveal things as they happen; there is nothing in it that would indicate why things must be the way they are – observational evidence cannot establish universally valid laws (*necessity requirement*).
 - *Second*, reflective understanding must yield judgements as *self-evident material axioms*. What makes a self-evident material axiom is the fact that no one can deny its validity *without self-contradiction*, for attempting to deny them one already presupposes its validity (*universality requirement*).
- Mises reconstructed the science of economics, making it an *a priori science of human action* (in German: *a priori Handlungswissenschaft*).

“It is this assessment of economics as a priori science, a science whose propositions can be given a rigorous logical justification, which distinguishes Austrians, or more precisely Misesians, from all other current economic schools.”

—Hoppe (2007), *Economic Science and the Austrian Method*, p. 8 – 9.

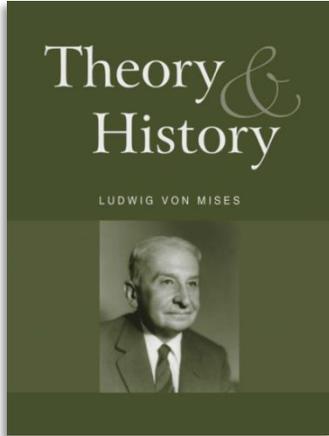
3. On the scientific method of economics

THE PURPOSE OF THIS SESSION:

(1) Positivism, empiricism and falsificationism – which characterize the scientific method of ‘mainstream economics’ – will be explained, and it will be argued that (2) they suffer from severe logical inconsistencies.

READINGS:

Mises, L. v. (1957), *Theory and History*, Ludwig von Mises Institute, Auburn, US Alabama.

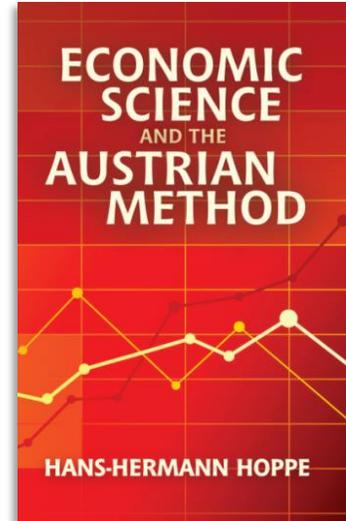


- The term *scientific method* denotes the approach taken by the scientist to acquire and validate knowledge.
- Let us start with a *key insight*: “Facts per se can neither prove nor refute anything. Everything is decided by the interpretation and explanation of the facts, by the ideas and the theories.”
—Mises (1981), *Socialism*, p. 459.
- Now you may ask: *What is the correct economic theory?*
 - ▶ In mainstream economics, you would acquire and validate knowledge by using data.
 - ▶ More precisely: You set up a hypothesis (“if-when” statement), and then you test its truth value (on the basis of data).
 - ▶ The ‘Misesian’ approach is fundamentally different: According to Mises, the correctness (or falseness) of an economic theory must be proven at the *a priori* theoretical level; it *cannot* be tested.

→ Ludwig von Mises identified a *key problem* in social sciences: *Once you remove the idea that humans act, you open up the door for anti-freedom social doctrines.*
- Mainstream economics follows the lines of *positivism-empiricism-falsificationism*. Let us explain and *critique* this approach in what follows.

POSITIVISM

- *Positivism* is closely associated with *Auguste Comte* (1798–1857), who was, at least initially, a follower of Count *Henri de Saint-Simon* (1760–1825).
 - ▶ Positivism is a *philosophy of science*. It holds that (1) sense experience is the only (and measurable) source of human knowledge; (2) that knowledge can come only from affirmation of theories through the *scientific method*; and that (3) the validity of metaphysical speculation must be rejected.
- In the early 20th century, *logical positivism* sprang up in Vienna and grew to become one of the dominant movements in American and British philosophy. It is an absolutist way of looking at statements and labelling them as either *true*, *false* or *meaningless*. A central element of logical positivism is that it rejected statements about *ethics* and *aesthetics* as being unverifiable, and therefore not a part of serious philosophical thinking.
- The positivist view is sometimes referred to as a *scientistic ideology*, and is often shared by *technocrats* who believe in the *necessity of progress through scientific progress*, and by naturalists, who argue that any method for gaining knowledge should be limited to natural, physical, and material approaches.



EMPIRICISM

- *Empiricism* (as applied in the field of *social sciences*) considers *natural sciences* to be its model and, when applied to economics, can be characterised as follows:
 - ▶ Empiricism maintains that economic propositions have the same logical status as *laws of nature*, and that they state *hypothetical relationships* between two or more events, essentially in the form of *if-then statements*.
 - ▶ It maintains that economic propositions require continual testing vis-à-vis experience. They can never be validated once and for all with certainty, as the economic hypothesis is forever subject to the outcome of contingent, future experience.
- If data testing *confirms* the hypothesis, empiricism would say that it is *not validated* (once and for all), as there remains the possibility that the relationship(s) under review might be *falsified* by future experience (using new data and/or including explanatory variables which were hitherto “uncontrolled” for).

→ If, however, data testing suggests a rejection of the hypothesis, it would not prove that the hypothesised relationship could never be observed through future testing, so it is *not falsified* either.

- Empiricism is expressive of *scepticism*, which can be formulated as: *nothing can be known with certainty, and anything might be possible in the realm of economics*; it leads to a philosophy of *social and economic relativism*.
 - ▶ Perhaps most prominently, David Hume (1711–1776) rejected the notion of *causality*. He stated that even if we observe one event continually following another, we cannot conclude a *necessary connection* between the two (*post hoc, ergo propter hoc fallacy*).
- There is an even more severe problem with empiricism. Upon closer examination it can be shown that *empiricism* is a *self-contradictory doctrine*:
 - ▶ The empiricist proposition that *all economic events are only hypothetically related* is contradicted by the message of the basic empiricist proposition itself.

→ If we assume that the empiricist claim is *categorically true*, it would belie its own thesis, namely that empirical knowledge must invariably be hypothetical knowledge – thereby making room for a discipline as economics claiming to produce a priori valid (empirical) knowledge.

→ If, however, this proposition is regarded as itself being *hypothetically true*, it would not qualify as an epistemological pronouncement. Empiricism would not provide any justification whatsoever for its claim that economic propositions are not, and cannot be, *categorically* (or *a priori*) true.

▶ Empiricism conceives of economic data as *objective data*, extending in time and space and being subject to quantifiable *measurement*. Note, however, that measuring cannot be observed in the first place. One has to know what measuring is before one can actually do something called measuring.

→ One cannot observe someone making an observation or measurement as such in the first place. In fact, one must first *understand* what observations and measurements are, and only *thereafter* one is in a position to interpret these phenomena accordingly.

→ As a result, empiricism must acknowledge that there is empirical knowledge which is based on *understanding* – something which does not, and cannot, rest on empiricism itself.

CONSTANCY PRINCIPLE

- There is another important reason why empiricism is a *self-contradictory*, self-defeating *doctrine*: It tacitly assumes the existence of non-empirical knowledge as *non-hypothetical knowledge about reality*, and that is the *constancy principle*.

Periods	Hypothesis: $M \uparrow \rightarrow P \uparrow$		Results
	Observations:		
	M	P	
t_1	\uparrow	\uparrow	confirmed
t_2	\uparrow	\uparrow	confirmed
t_3	\uparrow	\downarrow	falsified
t_4	\uparrow	unchanged	falsified

► The *constancy principle* says that observable phenomena are in principle determined by causes which are *constant* and *time-invariant* in the way they operate. It is a prerequisite for being able to falsify or confirm a theory:

“Only if the constancy principle is assumed to be valid does it follow from any failure to reproduce a result that there is anything wrong with the original hypothesis.”

—Hoppe (2006), *Is Research Based on Causal Scientific Principles Possible in the Social Sciences?*, p. 298.

- Experience only reveals that two or more observations regarding the temporal sequence of events can be classified as “repetition” or as “non-repetition”. To either confirm or falsify a hypothesis, one has to assume that there are *constant causes* which operate in *time-invariant ways*. Without assuming the *constancy principle*, the observations are, and remain, non-repetitive registered experiences, not in any way related events.
- The constancy principle cannot be derived from experience, nor can it be disproved by experience:
 - The *constancy principle* cannot be derived from experience (as empiricism would need to claim). There is simply *no observable link* that would connect events (and this has been known since David Hume). Even if such a *link* were observable, one could not conclude from this whether or not the link was *time-invariant*.
 - The *constancy principle* cannot be disproved by experience. Any event which might appear to disprove it (such as a failure to duplicate some experience) could be interpreted as if experience had shown that merely one *particular* type of event was not the cause of another (otherwise the experience would have been successfully repeated). However, to the extent that experience cannot exclude the possibility that *another* set of events might be found which would turn out to be time-invariant in its way of operating, the validity of the constancy principle cannot be disproved.

A NOTE ON KARL R. POPPER'S *CRITICAL RATIONALISM*

- Karl Raimund Popper (1902 – 1994) rejects *induction* as a scientific method for gaining knowledge. He proposes a continuous process of conjecture and refutation; this is what he calls *critical rationalism*.

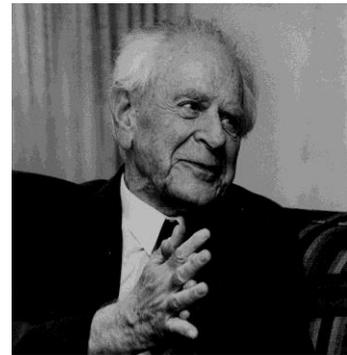
▶ Note that the fundamental *problem of induction* is this: For logical reasons, there is no valid inference from particular to general. If your observations tell you that *all* swans are white, you *cannot* conclude that there are *only* white swans in this world.

→ Induction cannot be justified *a priori* or *a posteriori*.

- Popper's *falsificationism* claims that (i) knowledge about reality comes from observation; (ii) that the truth claim of theories has to be validated on the basis of observation, and (iii) that all knowledge of reality is only hypothetically true (thereby denying *a priori* knowledge of reality).
- Critical rationalism maintains that *one can never verify a hypothesis, at best one can falsify it*. Scientific progress is achieved by “trial and error”, that is replacing falsified theories with non-falsified theories:

▶ “The way in which knowledge progresses, and especially our scientific knowledge, is by unjustified (and unjustifiable) anticipations, by guesses, by tentative solutions to our problems, by conjectures. These conjectures are controlled by criticism; that is, by attempting refutations, which include severely critical tests. They may survive these tests; but they can never be positively justified: they can be established neither as certainly true nor even as ‘probable’ (in the sense of the probability calculus).”

—Popper (2002 [1963]), *Conjectures and Refutations*, p. xi.



Karl Raimund Popper
1902 – 1994

CRITIQUE

▶ Falsificationism is grounded in *empiricism* – and as such subject to criticism levelled against empiricism (except for the *induction problem*). Such a criticism concerns, for instance, the view that all knowledge comes from sensory experience.

→ It is an indisputable insight that there is no “pure” observation, or experience. Any observation is (and must be) *theory dependent*. As theory pre-determines observation, the question arises: *How do (or can) we know that the theory, which (pre-)determines observation, is correct?*

→ To make it even more difficult: Given that (correct) *theories change over time* (something falsificationists wouldn't deny), observations must change over time, too. Observations are therefore not time-invariant if and when theories change.

→ Repeatable experiments (Popper calls them *protocol sentences*), which are possible to conduct in natural sciences, are impossible in the field of human action. There are simply no repeatable (homogeneous) human actions.

→ How can the truth claim be justified that one cannot verify a hypothesis but only fail to falsify it? Popper makes use of *modus tollens* (which means: If *p*, then *q*. Not-*q*. Therefore, not-*p*). Isn't this an *a priori*, something Popper's falsificationism would deny?

▶ Hoppe places Popper(ianism) right in the positivistic-empiricist camp:

“Popper is in complete agreement with the fundamental assumptions of empiricism (...) and explicitly rejects the traditional claims of rationalism, i.e. of being able to provide us with a priori true empirical knowledge in general and an objectively founded ethic in particular.”

“In fact, it is only fair to say that it is Popper who contributed more than anyone else to persuading the scientific community of the modernistic, empiricist-positivist worldview.”

—Hoppe (1989), In Defence of Extreme Rationalism ..., footnote 18, p. 208.

HISTORICISM

- *Historicism* was the (pseudo-)scientific method of the (*younger*) *historical school*, and “Whoever has undertaken to present the teachings of historicism in a coherent form has generally been unable to avoid revealing, at some point in the process, the impossibility of systematically developing the doctrine.”
—Mises (2003), *Epistemological Problems of Economics*, p. 7.
- ▶ “The fundamental thesis of historicism is the proposition that, apart from the natural sciences, mathematics, and logic, there is no knowledge but that provided by history. There is no regularity in the concatenation and sequence of phenomena and events in the sphere of human action. Consequently the attempts to develop a science of economics and to discover economic laws are vain.”
—Mises (2007), *Theory and History*, p. 199.
- Historicism can be characterized as *subjectively interpreting a literary text*. It basically says that nothing in the historical account, and nothing in the sequence of historical events, is governed by *constant, time-invariant relations*. Economic events are whatever economists or historians (taking a subjective view) express or interpret them to be.
- ▶ According to historicism, human actions (economic phenomena) and their interpretation are not constrained by any kind of *regularity*, of *objective law* (such as, for instance, the law of diminishing marginal utility).

- Claiming that economic and historical events – which are sequences of subjectively perceived events – are not governed by any constant, time-invariable relations, historicism cannot claim to say anything constantly true about economics and history. In fact, historicism leads to *arbitrary statements* that have a *fleeting value*.

▶ The historicist proposition is that a certain historically observed historical or economic relation may be true on one occasion, yet it may possibly be false one another occasion. If this is the case, however, historicism must be assumed to be constrained by something outside the realm of arbitrary subjective creations:

→ If the historicist proposition is assumed to be *invariably true*, then such a proposition about historical or economic phenomena would contradict its own doctrine – which actually denies any such constant relationships.

→ If, however, historicism holds that economic phenomena are *not* governed by constant, time-invariable relations, then this very proposition cannot claim to say anything constantly true about history and economics.

HISTORICAL MATERIALISM

- Historical materialism is a methodological approach to the study of human societies and their development first articulated by Karl Marx (1818–1883); it is a materialist conception of history.
- “The essential concept of Marxian materialism is "the material productive forces of society." These forces are the driving power producing all historical facts and changes.”
- “It is not the consciousness (the ideas and thoughts) of men that determines their being (existence) but, on the contrary, their social being that determines their consciousness.”
- In Marx’s doctrine the tools and machines are the ultimate thing, a material thing, viz., the material productive forces. Everything else is the necessary superstructure of this material basis. This fundamental thesis is open to three irrefutable objections.
 - ▶ First, a technological invention is not something material. It is the product of a mental process, of reasoning and conceiving new ideas.
 - ▶ Second, “[t]he production relations are thus not the product of the material productive forces but, on the contrary, the indispensable condition of their coming into existence.”
 - ▶ Third, “[i]t must be remembered that the utilization of machines presupposes social cooperation under the division of labor.”

—Mises (1957), *Theory and History*, pp. 102 – 112.

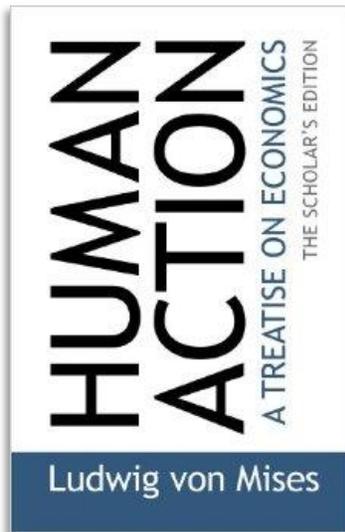
4. Mises's praxeology (I)

THE PURPOSE OF THIS SESSION:

(1) Learning about the difference between natural and social sciences, (2) understanding Mises's call for *methodological dualism*, and (3) outlining the logical categories of human action.

READINGS:

Mises, L. v. (1998), *Human Action. A Treatise on Economics*, The Scholar's Edition, Ludwig von Mises Institute, Auburn, US Alabama, Part One, pp. 11 – 142; Rothbard, M. N. (2009), *Man, Economy, and State*, Ludwig von Mises Institute, Auburn, US Alabama, Chapter 1, pp. 1 – 77.



„It is this assessment of economics as an a priori science, a science whose propositions can be given a rigorous logical justification, which distinguishes Austrians, or more precisely Misesians, from all other current economic schools.”

—Hoppe (2007), *Economic Science and the Austrian Method*, pp. 8-9.

- “Action without thinking, practice without theory are unimaginable. The reason may be faulty and the theory incorrect; but thinking and theorizing are not lacking in any action.”
—Mises (1998), *Human Action*, p. 177.

► Question: *What is the correct economic theory?*

Let us assume you make the following observation: From 1900 to 2015, income taxes rose from, say, zero to 40 percent; in the same period, income per capita rose from, say, 10 to 200. Did income per capita rise *because* or *despite* the rise in income tax?

- The key question is: *What is the scientific method proper for economics?*
- According to Mises, the scientific method of economics must be different from the scientific method of natural sciences (this is what Mises calls *methodological dualism*).

Natural sciences	Science of human action
<ul style="list-style-type: none"> ▪ Deals with unanimated elements (stones, atoms, animals etc.). ▪ It is <i>possible</i> to test hypotheses by checking against homogenous bits of events. ▪ The cause of events is <i>unknown</i>: We try to find <i>causal theories</i> by taking recourse to empirical data. ▪ ... 	<ul style="list-style-type: none"> ▪ Deals with acting humans (who have preferences, values, and act purposefully). ▪ It is <i>impossible</i> to test by checking against homogenous bits of events (for there are no such events). ▪ The cause of events is <i>known</i>, namely the primordial fact that human beings have goals and act to attain them; human action is the <i>ultimate given</i>. ▪ ...

- Mises’s scientific method of economics is *praxeology*: the *logic* of human action.
 - ▶ Human action means substituting a more satisfactory state of affairs for a less satisfactory state of affairs
- The starting point of praxeology is an irrefutably true proposition, namely that *humans act*; it is also called *the axiom of human action*.
 - ▶ You cannot argue that humans don’t act without running into an intellectual contradiction. For if you say “humans don’t act”, you act, thereby contradicting what you have just said.
 - ▶ What is the *epistemological status* of the axiom of human action?
 - Is it an *analytical priori*?
 - Is it a *synthetic a priori*?
 - ...



Immanuel Kant
1724 – 1804

HUMAN ACTION AS THE *ULTIMATE GIVEN*

- It is irrefutably true that humans act.
- Human action is driven, or caused, by *ideas*.
- As long as we cannot establish definite relations between ideas and physical/chemical events that determine ideas, human action must be considered the *ultimate given*.

“Even the most fanatical champions of the “Unified Science” sect shrink from unambiguously espousing this blunt formulation of their fundamental thesis. There are good reasons for this reticence. So long as no definite relation is discovered between ideas and physical or chemical events of which they would occur as the regular sequel, the positivist thesis remains an epistemological postulate derived not from scientifically established experience but from a metaphysical world view. The positivists tell us that one day a new scientific discipline will emerge which will make good their promises and will describe in every detail the physical and chemical processes that produce in

the body of man definite ideas. Let us not quarrel today about such issues of the future. But it is evident that such a metaphysical proposition can in no way invalidate the results of the discursive reasoning of the sciences of human action. The positivists for emotional reasons do not like the conclusions that acting man must necessarily draw from the teachings of economics. As they are not in a position to find any flaw either in the reasoning of economics or in the inferences derived from it, they resort to metaphysical schemes in order to discredit the epistemological foundations and the methodological approach of economics.”

—Mises (1957), *Theory and History*, pp. 3–4.

- From the irrefutably true *axiom of human action*, a number of true sentences (categories) can be deduced.
 - ▶ Deduction in the form of:
 - (1) We assert *A* (the axiom of human action).
 - (2) If *A*, then *B*, if *B*, then *C*, if *C*, then *D*, etc. (rule of logic).
 - (3) As a result, if *A* is true, we assert the truths of *B*, *C* and *D*.

- The *prerequisites* of any human action are: (1) uneasiness, or dissatisfaction, with the current situation; (2) an image of a more satisfactory state of affairs; and (3) the expectation that purposeful behavior has the potential to remove felt uneasiness.

- In what follows, we will present a number of *categories* of human action:
 - Human action is, and can only be done, by *individual actors* (*methodological individualism*)
 - ▶ “Group”, “state” or “collective” are metaphors. They don’t have any reality apart from the acts of various individuals.

 - Human action is purposeful
 - ▶ Purposeful (conscious) action versus reflexive (unconscious) action.

 - Means and ends
 - ▶ Means must be employed to achieve ends.

 - Scarcity
 - ▶ Means are scarce.

 - Causality
 - ▶ Human action presupposes the category of *causality* (the categories *means* and *ends* presuppose the category of cause-and-effect).

 - Time
 - ▶ Action takes place in time; there is no timeless action.

- The law of diminishing marginal utility
 - ▶ A larger supply of goods is preferred over a smaller supply of goods; and the greater the supply of a good, the lower is its marginal utility.

 - Time preference
 - ▶ An earlier satisfaction of wants is preferred over a later satisfaction of wants.

 - The originary interest rate
 - ▶ A good available in the future is valued less highly than good available in the present.

 - Uncertainty
 - ▶ If we knew the future events completely, we would never act, as acting couldn't change the course of things. Action signifies that the future is uncertain.

 - Private property
 - ▶ Human action pre-supposes self-ownership (and the right to sustain one's body).

 - ...
- These categories of human action are (in the Kantian sense) *the conditions of the possibility of correct economic theories*.

 - Examples (of *a priori* theories):
 - (1) Voluntary exchange is mutually beneficial for the parties concerned (other things being equal).

 - (2) If the supply of a good increases by one additional unit, the value attached to this unit must decrease. For this additional unit can only be employed as a means for the attainment of a goal that is considered less valuable than the least valued goal satisfied by a unit of such good if the supply were one unit shorter.

 - (3) The rise in the quantity of money reduces the purchasing power of each money unit (compared to a situation in which there had been no rise in the quantity of money).

 - (4) Whenever a minimum wage is set above the existing market wage, involuntary unemployment will result.

 - (5) ...

5. Mises's praxeology (II)

THE PURPOSE OF THIS SESSION:

(1) Learning about the difference between natural and social sciences, (2) understanding Mises's call for *methodological dualism*, (3) outlining the logical categories of human action.

READINGS:

Mises, L. v. (1998), *Human Action. A Treatise on Economics, The Scholar's Edition*, Ludwig von Mises Institute, Auburn, US Alabama, Part One, pp. 11 – 142; Rothbard, M. N. (2009), *Man, Economy, and State*, Ludwig von Mises Institute, Auburn, US Alabama, Chapter 1, pp. 1 – 77.

(1) On the mathematical method in economics

- Albert E. H. Dingler (1881 – 1954) on the starting point of any scientific undertaking: *das ansetzende Denken*
 - The starting point of any science is *nonmathematical*: Before we can, say, formulate an equation, we must already know about the factors that enter the equation. This knowledge, however, is not derived from mathematics.
 - The *first step* for the scientists is therefore to form an *understanding* about the object of investigation. In a *second step*, the scientists has to decide whether or not the mathematical method can or cannot be applied.
- Natural sciences versus economics
 - In *natural sciences* we seek *constantly* operating causes (natural laws), and for this purpose the mathematical method can be applied.
 - In *economics*, however, things are different. Human action is the *ultimate given*, is the starting point of scientific investigation.
 - There is *no constancy* as far as human action is concerned, as people change their preferences and value judgements, they learn:
 - ▶ “The fundamental deficiency implied in every quantitative approach to economic problems consists in the neglect of the fact that there are no constant relations between what are called economic dimensions. There is neither constancy nor continuity in the valuations and in the formation of exchange ratios between various commodities. Every new datum brings about a reshuffling of the whole price structure.”
 - Mises (1998), *Human Action*, p. 118.

► If there were such a thing as constant behavior, human action would be *predictable* – which, however, negates the possibility of human action, and which is, praxeologically speaking, impossible to think (as one would run into self-contradiction by arguing that humans do, or could, *not* act).

► Example: The quantity theory of money

“Those who hold the mechanical version of the Quantity Theory will be the more inclined to believe that the increase in the quantity of money must eventually lead to a uniform increase in the prices of all economic goods, the less clear their concept is of the way in which the determination of prices is affected by it. Thorough comprehension of the mechanism by means of which the quantity of money affects the prices of commodities makes their point of view altogether untenable. Since the increased quantity of money is received in the first place by a limited number of economic agents only and not by all, the increase of prices at first embraces only those goods that are demanded by these persons; further, it affects these goods more than it afterwards affects any others. When the increase of prices spreads farther, if the increase in the quantity of money is only a single transient phenomenon, it will not be possible for the differential increase of prices of these goods to be completely maintained; a certain degree of adjustment will take place. But there will not be such a complete adjustment of the increases that all prices increase in the same proportion. The prices of commodities after the rise of prices will not bear the same relation to each other as before its commencement; the decrease in the purchasing power of money will not be uniform with regard to different economic goods.”

—Mises (1953), *The Theory of Money and Credit*, p. 140.

“Actually, mathematical methods necessarily introduce many errors and inanities The use of the calculus, for example, that has been endemic in mathematical economics assumes infinitely small steps. Infinitely small steps may be fine in physics where particles travel along a certain path; but they are completely inappropriate in a science of human action, where individuals only consider matter precisely when it becomes large enough to be visible and important. Human action takes place in discrete steps, not in infinitely small ones.”

—Rothbard (2009), *A Note On Mathematical Economics*.

- The case for *verbal logic*: ‘Austrians’ reject the mathematical method in economics and adopt *verbal logic*.

“The mathematical economists are therefore framing assumptions which are admittedly false or partly false, but which they hope can serve as useful approximations, as they would in physics. The important thing is not to be intimidated by the mathematical trappings.”

—Rothbard (2009), *A Note On Mathematical Economics*.

(2) On theory and history

- THEORY. – A *theory* is an attempt to achieve some form of systematic understanding of (an aspect of the world) of *experience*. Human actors always employ some kind of theory:

“Thinking and acting are inseparable. Every action is always based on a definite idea about causal relations. He who thinks a causal relation thinks a theorem. Action without thinking, practice without theory are unimaginable.”

—Mises (1996), *Human Action*, p. 177.

“There is no such thing as a mere recording of unadulterated facts apart from any reference to theories. As soon as two events are recorded together or integrated into a class of events, a theory is operative.”

—Mises (1996), *Human Action*, p. 647.

- HISTORY. – “History is the record of human action. Human action is the conscious effort of man to substitute more satisfactory conditions for less satisfactory ones. Ideas determine what are to be considered more and less satisfactory conditions and what means are to be resorted to alter them. Thus ideas are the main theme of the study of history.”
—Mises (2007), *Theory and History*, pp. 224-5.
- ON THE RELATION BETWEEN ECONOMICS AND HISTORY. – The subject matter of *economics*, which is a subdivision of praxeology, is human action. Economics is the scientific discipline that deals with the logic of human action.
- The subject matter of *history* is the past. History describes how the acting person perceived the situation in which he had to act, what he aimed at, what he believed to be the means at his disposition. For history, actions and value judgments are not ultimate “givens”. In fact, actions and value judgments are, in Mises’s words, “the starting point of a specific mode of reflection, of the specific understanding of the historical sciences of human action.”
—Mises (2007), *Theory and History*, p 310.

Economics	History
<i>Economics and history</i> deal with individual choices of ends and the judgements of value underlying them.	
Branch of praxeology.	No branch of praxeology.
Value judgements and choices are taken as given data.	Value judgements and choices are <i>not</i> taken as given; they are the starting point of reflection, the specific understanding of the historical science of human action.
Restricts itself to logically inferring from value judgements the laws governing the valuing and pricing of goods.	The historian, with the <i>method of understanding</i> , tries to understand, when faced with individuals’ value judgements and resulting action, how they originated in the mind of the actor.

Source: Salerno (2005), pp. 13.

- “Economic history is possible only because there is an economic theory capable of throwing light upon economic actions. If there were no economic theory, reports concerning economic facts would be nothing more than a collection of unconnected data open to any arbitrary interpretation.”

—Mises (1996), *Human Action*, p. 51.

- “History can neither prove nor disprove any general statement in the manner in which the natural sciences accept or reject a hypothesis on the ground of laboratory experiments. Neither experimental verification nor experimental falsification of a general proposition is possible in its field.”

—Mises (1996), *Human Action*, p. 31.

(3) Praxeology and individual freedom

- Praxeology (the science of human action) is *wertfrei*:

“[W]e speak of the subjectivism of the general science of human action. ... [I]t is in this subjectivism that the objectivity of our science lies. Because it is subjectivistic and takes the value judgments of acting man as ultimate data not open to any further critical examination, it is itself above all strife of parties and factions, it is indifferent to the conflicts of all schools of dogmatism and ethical doctrines, it is free from valuations and preconceived ideas and judgments, it is universally valid and absolutely and plainly human.”

—Mises (1998), *Human Action*, p. 21.

- Praxeology puts *methodological individualism* and *subjective individualism* at the centre of economics (or social sciences, for that matter), making the case for *methodological dualism*:

▶ The scientific method of economics must differ from the scientific method of natural sciences.

- On the basis of praxeology, Mises builds a *theory of individual freedom*: The theory of individual freedom has its ultimate foundation in the praxelological insight that humans act.

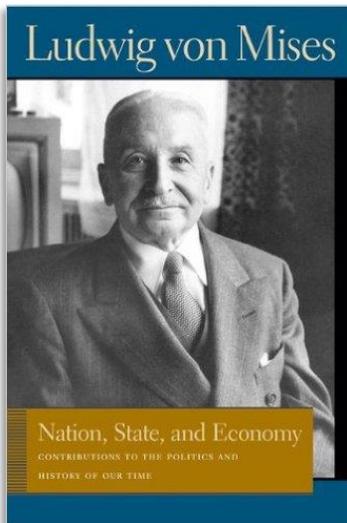
6. Capitalism – the natural form of cooperation

THE PURPOSE OF THIS SESSION:

(1) Explaining how/why social cooperation comes about; (2) outlining what capitalism really means; and (3) reflecting about today's "capitalism world".

READINGS:

Mises, L. v. (1998), *Human Action. A Treatise on Economics*, Ludwig von Mises Institute, Auburn, US Alabama.



- Why is there *social cooperation*?
 - ▶ Because of a miraculous interference of some divine power?
 - ▶ Or an innate urge toward association?
 - ▶ ...

- The *law of comparative costs* (David Ricardo (1772 – 1823))
 - ▶ Ricardo shows that the *division of labor* between two areas (unequally endowed by nature) will increase the productivity of labor and is therefore advantageous to *all* concerned, even if the physical conditions of production for any commodity are more favorable in one of these two areas than in the other.

 - ▶ It is advantageous for the better endowed area to concentrate its efforts upon the production of those commodities for which its superiority is greater, and to leave to the less endowed area the production of other goods in which its own superiority is less.

 - ▶ Example: The producer who has lower *opportunity cost* of producing a good has a *comparative advantage* in producing that good. The Farmer has lower opportunity costs in producing potatoes (1/2 pound of meat) than the rancher (8 lbs meat). The rancher has lower opportunity costs of pro-

ducing meat (1/8 lb potatoes) than the farmer (2 lbs potatoes). That said, the farmer has a comparative advantage in growing potatoes, the rancher in producing meat.

	1 pound of meat	1 pound of potatoes
Farmer	2 lbs potatoes	½ lb meat
Rancher	1/8 lb potatoes	8 lbs meat

Source: Mankiw, p. 54.

- The *law of association*
 - ▶ Mises credits Ricardo with having understood that the law of comparative costs, which is expounded mainly in order to deal with a special problem of international trade, is a particular instance of the more universal *law of association*.
- Praxeology (*a priori* theory) makes us understand that human action tends towards cooperation and association:

▶ “The law of association makes us comprehend the tendencies which resulted in the progressive intensification of human cooperation. We conceive what incentive induced people not to consider themselves simply as rivals in a struggle for the appropriation of the limited supply of means of subsistence made available by nature. We realize what has impelled them and permanently impels them to consort with one another for the sake of cooperation. Every step forward on the way to a more developed mode of the division of labor serves the interests of all participants. In order to comprehend why man did not remain solitary, searching like the animals for food and shelter for himself only and at most also for his consort and his helpless infants, we do not need to have recourse to a miraculous interference of the Deity or to the empty hypostasis of an innate urge toward association. Neither are we forced to assume that the isolated individuals or primitive hordes one day pledged themselves by a contract to establish social bonds. The factor that brought about primitive society and daily works toward its progressive intensification is human action that is animated by the insight into the higher productivity of labor achieved under the division of labor.

Neither history nor ethnology nor any other branch of knowledge can provide a description of the evolution which has led from the packs and flocks of mankind’s nonhuman ancestors to the primitive, yet already highly differentiated, societal groups about which information is provided in excavations, in the most ancient documents of history, and in the reports of explorers and travelers who have met savage tribes. The task with which science is faced in respect of the origins of society can only consist in the demonstration of those factors which can and must result in association and its progressive intensification. Praxeology solves the problem. If and as far as labor under the division of labor is more productive than isolated labor, and if and as far as man is able to realize this fact, human action itself tends toward cooperation and association; man becomes a social being not in sacrificing his own concerns for the sake of a mythical Moloch, society, but in aiming at an improvement in his own welfare. Experience teaches that this condition—higher productivity achieved under the division of labor—is present because its cause—the inborn inequality of men and the inequality in the geographical distribution of the natural factors of production—is real. Thus we are in a position to comprehend the course of social evolution.”

—Mises (1996), *Human Action*, p. 160-1.

- Although Karl Marx (1818 – 1883) scarcely used the term *capitalism* (he used ‘capitalist system’ and ‘capitalist production’), it was Marx who, according to Werner Sombart (1863 – 1941), ‘virtually discovered the phenomenon’.
 - ▶ “The advocates of totalitarianism consider “capitalism” a ghastly evil, an awful illness that came upon mankind.”
—Mises (1998), *Human Action*, p. 265.
- *Capitalism* means that the means of production are privately owned.
 - ▶ The (rightful) owner of the means of production can employ them freely as he sees fit – provided that he does *not aggress* against the *physical* integrity of other peoples’ private property.

Note: Smearing someone’s reputation (regrettable as it might be) would *not* qualify as a property rights violation by libertarian standards. Values, beliefs etc. are in the minds of people, and as such they can in no way legitimately owned or controlled by an actor.

- ▶ Producers engage in *time-consuming*, multi-stage production processes.

Consumer goods are goods readily available for consumption. *Production goods* (or: *capital goods*) are goods which are used up for producing consumer goods.

Producing capital goods comes *at the expense* of present consumption, but it allows *greater consumption* in the future (or consuming consumers’ goods which otherwise wouldn’t be available at all).

Any actor must answer the following: *Does the utility yielded by an increase in consumers’ goods in the future outweigh the sacrifice I must make of present goods to acquire consumers’ goods in the future?*

Due to the universal fact of *time-preference*, an actor must balance his desire to acquire more satisfaction of wants in the future against giving up satisfaction in the present.

- ▶ Under capitalism, there is *monetary economic calculation*.
- Capitalism results in *mass production* of goods destined for *mass consumption*.
- The *profit system* makes entrepreneurs prosper who succeed in filling the wants of the people in the best possible and cheapest way.
- Under capitalism, income and wealth are acquired by serving consumers’ needs.

▶ ”In a daily repeated plebiscite in which every penny gives a right to vote the consumers determine who should own and run the plants, shops and farms. The control of the material means of production is a social function, subject to the confirmation or revocation by the sovereign consumers.”

—Mises (2008), *Anti-Capitalist Mentality*, p. 2.

▪ “The system of market economy has never been fully and purely tried.”

—Mises (1998), *Human Action*, p. 265.

▶ Do you think that under capitalism there would be:

—Central banks?

▶ „Die kommunistische Revolution ist das radikalste Brechen mit den überlieferten Eigentumsverhältnissen [...]. Für die fortgeschrittensten Länder werden [...] die folgenden [Maßnahmen, a. d. V.] ziemlich allgemein in Anwendung kommen können:

...

5. Zentralisation des Kredits in den Händen des Staates durch eine Nationalbank mit Staatskapital und ausschließlichem Monopol.“

—Karl Marx, Friedrich Engels, *Manifest der Kommunistischen Partei*.

—Paper money inflation?

—Boom & bust cycles?

—Involuntary unemployment?

—Taxation?

—Wars?

—...

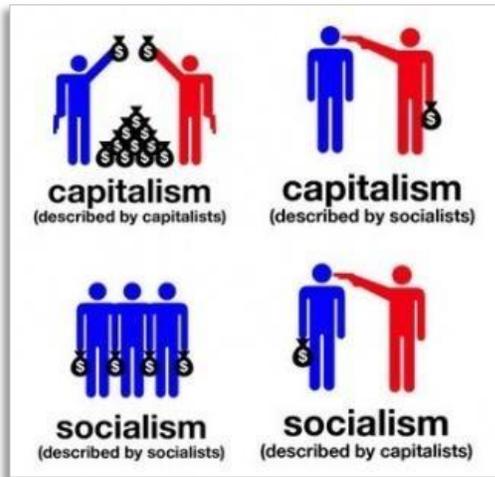
7. The impossibility of socialism

THE PURPOSE OF THIS SESSION:

(1) Making you understand what socialism is all about, (2) explaining why socialism *must* fail, and (3) outlining that socialism is entirely irreconcilable with liberty/the concept of liberalism.

READINGS:

Mises, L. v. (1981), *Socialism. An Economic and Sociological Analysis*, Liberty Fund, Indianapolis;
Hoppe, H.-H. (2010), *A Theory of Socialism and Capitalism*, Ludwig von Mises Institute, Auburn, US Alabama.



- *Socialism* means the collective ownership of the means of production. (Its antipode is *capitalism*, meaning the private ownership of the means of production.)
 - ▶ “The essential mark of socialism is that *one will* alone acts.”
—Mises (1998), *Human Action*, p. 695.
- As early as 1919, Ludwig von Mises (1881 – 1973) gave a presentation in which he made the scientific case that socialism would be impossible.
 - ▶ In 1920, it was published as *Die Wirtschaftsrechnung im sozialistischen Gemeinwesen*. The latter became a central argument in Mises’s *Die Gemeinwirtschaft. Untersuchungen über den Sozialismus*, published in 1922.
- In a *nutshell*, Mises’ argument why socialism *must* fail runs as follows:
 - Under socialism, there is no *private property* (of the means of production)
 - If there is no private property, buying and selling in the market place is impossible
 - If market trading is impossible, there will be no prices of goods and services
 - If there are no prices, economic calculation will become impossible
 - If economic calculation is impossible, chaos will result

- Socialism Russian style
 - ▶ The means of production are nationalized, or socialized; there is *no* private property in the means of production.
 - ▶ Socialism Russian style is established by the *violent overthrow of the existing order*; by completely expropriating the capitalists; and by putting the *temporary dictatorship of the proletariat* in charge (until scarcity has been eradicated).
- Social-democratic socialism
 - ▶ Social-democratic socialism is a *gradualist approach*. It wants to establish socialism by parliamentary action rather than violent revolution.
 - ▶ Social-democratic socialism does not outlaw private ownership in the means of production. In fact, it accepts that *all* means of production are being privately owned – with the exception of education, traffic, central banking, police and courts.
 - ▶ It holds that no owner of the means of production rightfully owns *all* of the income that can be derived from employing his means of production – and that part of the income rightfully belongs to society.
- Hoppe (2010, p. 62) notes: “[T]he degree of expropriation of private producers’ income is a matter of expediency, which suffices to reduce the difference between both types of socialism—Russian and social-democratic style—once and for all to a difference only of degree.”
- The *principles of distribution* under socialism:
 - (i) Equal distribution per head
 - ▶ The hard working gets as much as the less or non-working
 - (ii) Distribution according to *service rendered*
 - ▶ Under socialism, it is impossible to determine the *economic* service rendered in an objective way ...
 - (iii) Distribution according to *needs*
 - ▶ This distribution principle is *meaningless* so long as it is not defined to what extent each individual is allowed to satisfy his need (at the expense of his fellow citizens).
 - (iv) Distribution according to *merit*
 - ▶ Someone has to decide about individual workers’ merits.

▪ Particular forms of socialism:

(1) State socialism

People do *not* want to do away with the state (as the Marxists do), but want to make the state the most powerful institution. This was the case, for instance, in *Prussian Germany*.

(2) Military Socialism

▶ Military socialism is state socialism in which all institutions are designated for the prosecution of war. Individuals' social status and incomes are determined by the position they hold in the fighting forces.

(3) Christian Socialism

▶ “Christian Socialism is governed by the idea that the economic system would be perfectly stationary if the desire for profit and personal gain by men directing their efforts solely to the satisfaction of material interests did not disturb its smooth course.”

—Mises (1981), *Socialism*, p. 223.

(4) The planned economy

▶ The planned economy is a more recent variety of socialism. It basically means the nationalization of the means of production.

(5) Guild socialism

▶ Guild socialism is another attempt to surmount the insoluble problem of a socialist direction of industry. Production is controlled by the workers of individual branches of production.

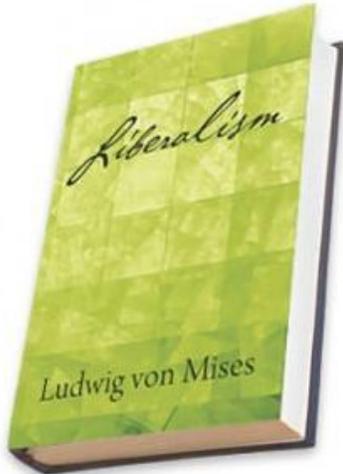
8. Mises's liberalism

THE PURPOSE OF THIS SESSION:

- (1) Explaining Mises's concept of liberalism, (2) understanding how it differs from classical-liberalism, and (3) applying Mises's idea on the European Union.

READINGS:

Mises, L. v. (2002 [1927]), *Liberalism, In The Classical Tradition*, 3rd ed., Institute for Humane Studies, Inc., Fairfax, Virginia.



- “Liberalism is not a completed doctrine or a fixed dogma. On the contrary: it is the application of the teachings of science to the social life of man. And just as economics, sociology, and philosophy have not stood still since the days of David Hume, Adam Smith, David Ricardo, Jeremy Bentham, and Wilhelm Humboldt, so the doctrine of liberalism is different today from what it was in their day, even though its fundamental principles have remained unchanged. For many years now no one has undertaken to present a concise statement of the essential meaning of that doctrine.”
—Mises (2002), *Liberalism*, p. 3.

- The fundamental principles of liberalism:

(1) Private property

“The program of liberalism, therefore, if condensed into a single word, would have to read: *property*, that is, private ownership of the means of production (for in regard to commodities ready for consumption, private ownership is a matter of course and is not disputed even by the socialists and communists). All the other demands of liberalism result from this fundamental demand.”

—Mises (2002), *Liberalism*, p. 19.

“It is not on behalf of property owners that liberalism favors the preservation of the institution of private property. It is not because the abolition of that institution would violate property rights that the liberals want to preserve it. If they considered the abolition of the institution of private property to be in the general interest, they would advocate that it be abolished, no matter how prejudicial such a policy might be to the interests of property owners. However, the preservation of that institu-

tion is in the interest of all strata of society. Even the poor man, who can call nothing his own, lives incomparably better in our society than he would in one that would prove incapable of producing even a fraction of what is produced in our own.”

—Mises (2002), *Liberalism*, p. 29.

(2) Freedom

“We liberals do not assert that God or Nature meant all men to be free, because we are not instructed in the designs of God and of Nature, and we avoid, on principle, drawing God and Nature into a dispute over mundane questions. What we maintain is only that a system based on freedom for all workers warrants the greatest productivity of human labor and is therefore in the interest of all the inhabitants of the earth.”

—Mises (2002), *Liberalism*, p. 22.

► *Mises's utilitarian ethics versus Rothbard's and Hoppe's rational ethics.*

(3) Peace

(4) Equality

“All human power would be insufficient to make men really equal. Men are and will always remain unequal. It is sober considerations of utility such as those we have here presented that constitute the argument in favor of the equality of all men under the law. Liberalism never aimed at anything more than this, nor could it ask for anything more.”

—Mises (2002), *Liberalism*, p. 28-9.

ON THE STATE

- “Life in society would be quite impossible if the people who desire its continued existence and who conduct themselves accordingly had to forgo the use of force and compulsion against those who are prepared to undermine society by their behavior. A small number of antisocial individuals, i.e., persons who are not willing or able to make the temporary sacrifices that society demands of them, could make all society impossible. Without the application of compulsion and coercion against the enemies of society, there could not be any life in society.”
—Mises (2002), *Liberalism*, p. 35.
- “One must be in a position to compel the person who will not respect the lives, health, personal freedom, or private property of others to acquiesce in the rules of life in society. This is the function that the liberal doctrine assigns to the state: the protection of property, liberty, and peace.”
—Mises (2002), *Liberalism*, p. 37.
- “We call the social apparatus of compulsion and coercion that induces people to abide by the rules of life in society, the state; the rules according to which the state proceeds, law; and the organs charged with the responsibility of administering the apparatus of compulsion, government.”
—Mises (2002), *Liberalism*, p. 28-9.

- “There is an inherent tendency in all governmental power to recognize no restraints on its operation and to extend the sphere of its dominion as much as possible. To control everything, to leave no room for anything to happen of its own accord without the interference of the authorities—this is the goal for which every ruler secretly strives. If only private property did not stand in the way! Private property creates for the individual a sphere in which he is free of the state.”
—Mises (2002), *Liberalism*, p. 67.

ON THE RIGHT OF SECESSION

- “It must always be possible to shift the boundaries of the state if the will of the inhabitants of an area to attach themselves to a state other than the one to which they presently belong has made itself clearly known.”
—Mises (2002), *Liberalism*, p. 108.
- “The right of self-determination in regard to the question of membership in a state thus means: whenever the inhabitants of a particular territory, whether it be a single village, a whole district, or a series of adjacent districts, make it known, by a freely conducted plebiscite, that they no longer wish to remain united to the state to which they belong at the time, but wish either to form an independent state or to attach themselves to some other state, their wishes are to be respected and complied with. This is the only feasible and effective way of preventing revolutions and civil and international wars.”
—Mises, *Liberalism*, p. 109.
- “However, the right of self-determination of which we speak is not the right of self-determination of nations, but rather the right of self-determination of the inhabitants of every territory large enough to form an independent administrative unit. If it were in any way possible to grant this right of self-determination to every individual person, it would have to be done. This is impracticable only because of compelling technical considerations, which make it necessary that a region be governed as a single administrative unit and that the right of self-determination be restricted to the will of the majority of the inhabitants of areas large enough to count as territorial units in the administration of the country.”
—Mises (2002), *Liberalism*, p. 109-10.

ON THE UNITED STATES OF EUROPE

- “The evils that those who champion the idea of a United States of Europe are trying to combat undoubtedly exist, and the sooner they are eliminated, the better. But the formation of a United States of Europe would not be an appropriate means to achieve this end.”
—Mises (2002), *Liberalism*, p. 143-4.
- “The nations must come to realize that the most important problem of foreign policy is the establishment of lasting peace, and they must understand that this can be assured throughout the world only if the field of activity permitted to the state is limited to the narrowest range. Only then will the size and extent of the territory subject to the sovereignty of the state no longer assume such over-

whelming importance for the life of the individual as to make it seem natural, now as in the past, for rivers of blood to be shed in disputes over boundaries.”

—Mises (2002), *Liberalism*, p. 144.

On migration under liberalism and socialism

▶ If trade was completely free, labor would settle around the centers where production can take place under the most suitable conditions.

▶ In a changing economy, men migrate continually from the places where conditions of production are less favorable to places where they are more favorable.

▶ Under *capitalism*, supply and demand directs labor and capital to the most suitable places. Under *socialism*, administrative decree would direct the movement of labor and capital.

▶ Migration has the closest bearing upon the condition of different nations. “If the conditions under which migration takes place are such that the immigrants are assimilated to their new surroundings then the nation from which they came is, to that extent, weakened in numbers. If they are such that the immigrants preserve their national identity in their new home – still more if they assimilate the original inhabitants – then the nation receiving them will find immigration a menace to its national position.”

—Mises (1981), *Socialism*, p. 202.

▶ “To be a member of a national minority involves multitudinous political disadvantages. The wider the function of the political authority the more burdensome are these disadvantages. They are the smallest in the state which is founded upon purely liberal principles. They are greatest in the state which is founded upon liberal Socialism.”

—Mises (1981), *Socialism*, p. 202.

▶ “The more the individual depended on the State – the more importance political decision had for the life of the individual – the more would the national minority feel the political impotence to which is was condemned.”

—Mises (1981), *Socialism*, p. 202.

▶ “[F]or under Socialism there must arise, even between members of one and the same nation, points of difference which make the division of the surface of the earth – which is a matter of indifference to Liberalism – a problem of cardinal importance.”

—Mises (1981), *Socialism*, p. 202.

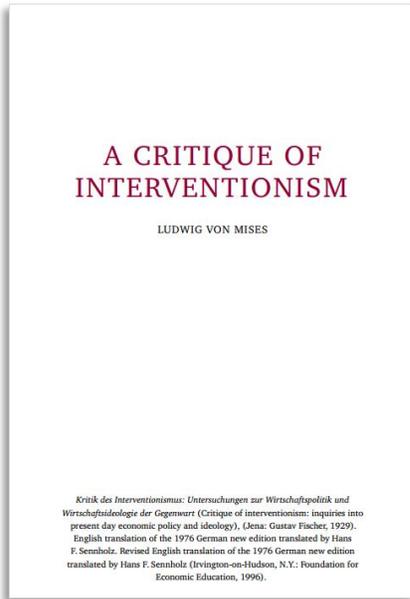
9. Interventionism – a critique

THE PURPOSE OF THIS SESSION:

(1) Illustrating the effects of intervening in free markets; (2) understanding the economic consequences of interventionism; (3) explaining that capitalism is the only form of permanent social cooperation.

READINGS:

Mises, L. v. (2011), *A Critique of Interventionism*, Ludwig von Mises Institute, Auburn, US Alabama.



- Example 1: The ‘cobra effect’
 - ▶ The British government was concerned about the number of venomous snakes in Delhi. To reduce its numbers, it offered a bounty for every dead cobra.
 - ▶ Eventually, people started breeding cobras for generating income.
 - ▶ When the British government became aware of this, the reward program was scrapped.
 - ▶ The cobra breeders set the now-worthless snakes free.
 - ▶ As a result, the wild cobra population increased further.
- Example 2: Minimum wage
 - ▶ The government wants to improve the standard of living for low income earners. It sets a minimum wage – which is *above* the market clearing wage level.

▶ At the minimum wage, the demand for labor falls (in comparison with the initial situation), lowering employment. The increase in labor costs makes firms substituting capital for labor.

▶ Assume the government wants to correct the negative impact on employment by, say, reducing firms' other input costs. It imposes a *maximum price* for energy (set below the market clearing price for energy).

▶ The maximum price reduces energy production, as the least efficient producer will stop producing. The lowering of the energy supply reduces firms' output further.

▶ If the government keeps interfering, it will have to control basically all prices and interest rates in the economy, thereby transforming a free market economy into a planned economy (socialism).



▪ Example 3: Boom & bust

▶ Assume the government replaces commodity money by its own fiat money/unbacked paper money, with the latter being produced by bank credit expansion.

▶ Issuing fiat money through bank credit expansion lowers the market interest rate to below its “natural level”, thereby setting into motion an artificial boom.

▶ The boom will be, and necessarily so, followed by bust, as the injection of new credit-produced fiat money makes the economy live beyond its means.

▶ To fend off the bust, the government-sponsored central bank lowers interest rates further by injecting more credit-produced fiat money.

▶ “Like the repeated doping of a horse, the boom is kept on its way and ahead of its inevitable comeuppance by repeated and accelerating doses of the stimulant of bank credit. It is only when bank credit expansion must finally stop or sharply slow down, either because the banks are getting shaky or because the public is getting restive at the continuing inflation, that retribution finally catches up with the boom. As soon as credit expansion stops, the piper must be paid, and the inevitable readjustments must liquidate the unsound over-investments of the boom and redirect the economy more toward consumer goods production. And, of course, the longer the boom is kept going, the greater the malinvestments that must be liquidated, and the more harrowing the readjustments that must be made.”

—Rothbard (2006), *For A New Liberty: A Libertarian Manifesto*, p. 237.

▪ What is *interventionism*?

- ▶ “It is necessary to ... prevent confusion of socialism and interventionism. The system of the hampered market economy, or interventionism, differs from socialism by the very fact that it is still market economy. The authority seeks to influence the market by intervention of its coercive power, but it does not want to eliminate the market altogether. It desires that production and consumption should develop along lines different from those prescribed by the unhindered market, and it wants to achieve its aim by injecting into the working of the market orders, commands and prohibitions for whose enforcement the police power and its apparatus of coercion and compulsion stand ready. But these are isolated interventions; their authors assert that they do not plan to combine these measures into a completely integrated system which regulates all prices, wages and interest rates, and which thus places full control of production and consumption in the hands of the authorities.
—Mises (1981), *Socialism*, pp. 485.
- Two *real life* episodes of interventionism:
 - (1) The *Hindenburg program* 1916 – 1918
 - (2) *Zwangswirtschaft* under German national socialism 1933 – 1945
- In *Kritik des Interventionismus* (1929), Mises exposed the fallacies of interventionism, that it would be an inherently unsustainable form of economic and societal organization:
 - ▶ “Interventionism is not an economic system, that is, it is not a method which enables people to achieve their aims. It is merely a system of procedures which disturb and eventually destroy the market economy. It hampers production and impairs satisfaction of needs. It does not make people richer; it makes people poorer.”
—Mises (1940), *Interventionism*, p. 77.
 - ▶ “The various measures, by which interventionism tries to direct business, cannot achieve the aims its honest advocates are seeking by their application. Interventionist measures lead to conditions which, from the standpoint of those who recommend them, are actually less desirable than those they are designed to alleviate. They create unemployment, depression, monopoly, distress. They may make a few people richer, but they make all others poorer and less satisfied. If governments do not give them up and return to the unhindered market economy, if they stubbornly persist in the attempt to compensate by further interventions for the shortcomings of earlier interventions, they will find eventually that they have adopted socialism.”
—Mises (1940), *Interventionism*, p. 91.
- Why is interventionism doomed to fail? Mises ((1996), *Human Action*, p. 858) gives *three reasons*:
 - ▶ “First: Restrictive measures always restrict output and the amount of goods available for consumption. Whatever arguments may be advanced in favour of definite restrictions and prohibitions, such measures in themselves can never constitute a system of social production.”

- ▶ “Second: All varieties of interference with the market phenomena not only fail to achieve the ends aimed at by their authors and supporters, but bring about a state of affairs which – from the point of view of their authors’ and advocates’ valuations—is less desirable than the previous state of affairs which they were designed to alter. If one wants to correct their manifest unsuitableness and preposterousness by supplementing the first acts of intervention with more and more of such acts, one must go farther and farther until the market economy has been entirely destroyed and socialism has been substituted for it.”

- ▶ “Third: Interventionism aims at confiscating the “surplus” of one part of the population and at giving it to the other part. Once this surplus is exhausted by total confiscation, a further continuation of this policy is impossible.”

- Sooner or later, however, a society following interventionism will be confronted with an inescapable choice: *either returning to capitalism or drifting towards full-scale socialism.*

10. Rothbard's ethics of liberty

THE PURPOSE OF THIS SESSION:

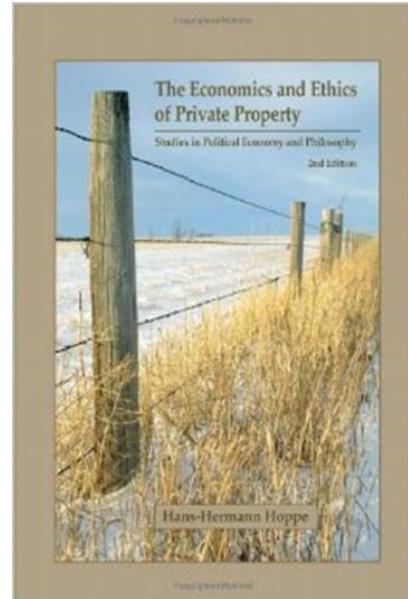
(1) Rationalizing the need for ethics; (2) explaining property acquisition by *non-aggressive* means; and (3) the natural and logical justification of ethics based on private property.

READINGS:

Rothbard, M. N. (1982), *The Ethics of Liberty*, New York University Press, New York and London; also the introduction to the book written by Hoppe, H.-H.; also Hoppe, H.-H. (2006), *On the Ultimate Justification of the Ethics of Private Property*, pp. 339 – 345.

ON PROPERTY

- If there was no *scarcity of goods* (like in the *Garden of Eden*, where there is *superabundance of goods*), no interpersonal *conflict* could arise. For my actions wouldn't have any repercussions neither with respect to *my* future supply of such goods nor regarding the present or future supply of the same goods for *you*.
- A conflict is only possible if goods are *scarce*. Only then will there arise the need to formulate rules (*norms*) that make orderly—conflict-free—social cooperation possible.
- ▶ From the diversity of individual interests and ideas alone it does not follow that conflicts must arise. For instance, I want it to rain, and my neighbor wants the sun to shine. Our interests are contrary. However, this does not result in a conflict: because neither I nor my neighbor controls the sun or the clouds, our conflicting interests have no practical consequences. Different interests and beliefs can lead to conflict only when they are put into action — when our interests and ideas are attached to or implemented in physically controlled objects, i.e., in economic goods –, and the latter implies scarcity.
- Even in the Garden of Eden two scarce goods exist: the *physical body* of a person and its *standing room*. Accordingly, even in the Garden of Eden rules of orderly social conduct must exist—rules regarding the ownership of bodies and the proper location and movement of human bodies. And outside the Garden of Eden, in the realm of scarcity, there must be rules that regulate not only the use of personal bodies but also of everything scarce so that all possible conflicts can be ruled out.
- Hoppe (2011) notes: “What is needed to avoid all conflict, then, is only a norm regarding the privatization of scarce things (goods). More specifically, in order to avoid all conflict *from the very beginning of mankind on*, the required norm must concern the *original privatization* of goods (the first transformation of nature-given "things" into "economic goods" and private property).”



CONFLICT-FREE ACQUISITION OF PROPERTY

- Property can be created and increased in three, and only three, non-aggressive ways:
 - (1) Perceiving nature-given things as scarce and actively bringing them into one's possession before anyone else has done so (homesteading, or first user-principle);
 - (2) producing goods with the help of one's labour and such previously appropriated resources; or
 - (3) acquiring a good through voluntary, contractual transfer from a previous appropriator or producer (including gifts).
- In the Garden of Eden, the solution is then provided by the simple rule stipulating that *everyone may place or move his own body wherever he pleases, provided only that no one else is already standing there and occupying the same space.*
- Outside of the Garden of Eden, in the realm of all-around scarcity, the solution is provided by this rule: *Everyone is the proper owner of his own physical body as well as of all places and nature-given goods that he occupies and puts to use by means of his body, provided that no one else has already occupied or used the same places and goods before him.*
- The ownership of "originally appropriated" places and goods by a person implies his right to use and transform these places and goods in any way he sees fit, provided that he does not thereby forcibly change the physical integrity of places and goods originally appropriated by another person.

ON THE ETHICS OF PROPERTY

- An ethical rule (*norm*) must meet two requirements:
 - (1) It must be generally and universally applicable, valid for everyone without exception (irrespective of time and place), as maintained by the Kantian *Categorical Imperative*: „Handle nur nach derjenigen Maxime, durch die du zugleich wollen kannst, dass sie ein allgemeines Gesetz werde.“
 - (2) An ethical rule must secure the survival of those adhering to the rule (otherwise you wouldn't be in need for any ethics).
- Rothbard provides a proof for showing that self-ownership and ownership of non-aggressively acquired goods are *just* (ethical) rules:

If a person A were not the owner of his physical body and all goods originally appropriated, produced or voluntarily acquired by him, there would only exist two alternatives. Either another person, B, must be regarded as the owner of A and the goods appropriated, produced, or contractually

acquired by A, or both parties, A and B, must be regarded as equal co-owners of both bodies and goods.

In the *first case*, A would be B's slave and subject to exploitation. B would own A and the goods originally appropriated, produced, or acquired by A, but A would not own B and the goods homesteaded, produced, or acquired by B. With this rule, two distinct classes of people would be created – exploiters (B) and exploited (A) – to whom different "law" would apply.

This rule fails the universalization test and is from the outset disqualified as even a potential human ethic, for in order to be able to claim a rule to be a law (just), it is necessary that such a rule be universally-equally-valid for everyone.

In the *second case* of universal co-ownership, the requirement of equal rights for everyone is obviously fulfilled. Yet this alternative suffers from another fatal flaw, for each activity of a person requires the employment of scarce goods (at least his body and its standing room). Yet if all goods were the collective property of everyone, then no one, at any time and in any place, could ever do anything with anything unless he had every other co-owner's prior permission to do what he wanted to do. And how can one give such permission if one is not even the sole owner of one's very own body (and vocal chords)? If one were to follow the rule of total collective ownership, mankind would die out instantly. Whatever this is, it is not a human ethic.

Thus, one is left with the initial principles of self-ownership and first-use-first-own, i.e., original appropriation, homesteading. They pass the universalization test – they hold for everyone equally – and they can at the same time assure the survival of mankind. They and only they are therefore non-hypothetically or absolutely true ethical rules and human rights.

THE A PRIORI OF PRIVATE PROPERTY

- Hoppe showed that a *private property ethic* can be justified using the concept of *a priori argumentation* – as argumentation presupposes private property.
- As noted earlier, *scarcity* is a necessary condition for the emergence of ethics, as it is scarcity that leads to conflict.
- The sufficient condition is that non-aggressive actors, who have conflicting ideas, must be capable of *argumentation*.
- Argumentation is an orderly exchange of ideas, where each party tries justifying his own thesis, and questioning, or refuting, the other party's thesis (*discourse*). It resolves an initial conflict of opinion by way of a critical discussion.
- Truth claims are made through argumentation, and it is in the course of argumentation that truth claims are decided. Political philosophy/ethics thus presupposes argumentation. This is, we can say, is irrefutably true.

- Denying that political philosophy/ethics presupposes argumentation is contradictory, as denying it would itself be an argumentation, and one cannot argue that one cannot argue. As a result, we have the *a priori of argumentation* (Karl-Otto Apel and Jürgen Habermas).
- Argumentation is a practical affair, and if argumentation is the presupposition of truth-claiming and possibly true propositions, then it follows that intersubjectively *meaningful norms* much exist, namely those which make an action argumentation. These intersubjectively meaningful norms must have a special cognitive status in that they are the practical preconditions of truth.
- This is a priori true: Denying the possibility of a rational ethics, and arguing that the acceptance/rejection of norms is an arbitrary affair, would invariably get caught in a practical contradiction. As for doing so, one has to presuppose the norms which underlie any argumentation as valid – simply in order to say anything at all.
- Argumentation is an action, and as such it requires an arguing person. The recognition of this undeniable fact, in turn, requires that a person must have exclusive control over the scarce resource of his body. And so, the right in one's own body must be said to be justified a priori.
- Any person who tried to deny this result (the right in his body) would run into a practical, self-defeating contradiction: as arguing in this way implies acceptance of the very norm which he is disputing.
- The right in one's own body, which is a priori true, extends to the right of ownership of other goods. By the virtue of being alive, property rights to other things must be presupposed to be valid.

11. *Digression*: the devolution of money – the progression theorem

THE PURPOSE OF THIS SESSION:

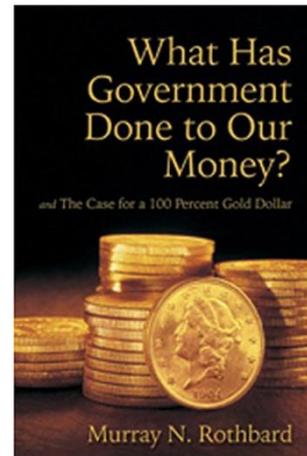
(1) Making you familiar with the *progression theorem*, and (2) revisiting the historical process of commodity money having been replaced by fiat money.

READINGS:

Rothbard, M. N. (2005 [1963]), *What Has Government Done to Our Money?*, 5th ed., Ludwig von Mises Institute, Auburn, US Alabama.

- In *What Has Government Done to Our Money?* (1963), Murray N. Rothbard provides an account of how government has, over a lengthy period of time, replaced free market money by fiat money.
- Rothbard formulates the *progression theorem*. It is derived from praxeology applied to human history and belongs to the aprioristic element of the “Austrian historical method”, with the latter resting on the “method of understanding”.

“The scope of understanding is the mental grasp of phenomena which cannot be totally elucidated by logic, mathematics, praxeology, and the natural sciences to the extent that they cannot be cleared up by all these sciences. It must never contradict the teachings of these other branches of knowledge.”
—Mises (1998), *Human Action*, p. 50.



- Rothbard demonstrates that, by the praxeological necessity, the state, or government (once established), will do all it can to take full control over money production.

“Government could never cement its power over a nation’s currency, if the people, when in need, could repudiate the fiat paper and turn to gold for their money. Accordingly, governments have outlawed gold holding by their citizens.”

—Rothbard (1990), *What has Government Done to Our money*, p. 81.

“The American economy has suffered from chronic inflation, and from destructive booms and busts, because that inflation has been invariably generated by the Fed itself. That role, in fact, is the very purpose of its existence: to cartelize the private commercial banks, and to help them inflate money and credit together, pumping in reserves to the banks, and bailing them out if they get into trouble.”

—Rothbard (1994), *The Case Against the Fed*, p. 145.

- To explain Rothbard’s argument, let us begin with the issue of *funding government spending*. – Any government that wants to spend must get hold of resources first (through expropriation). Two strategies are available: (i) *seizing goods in kind* or, in a monetary economy, (ii) *seizing money*.

- *Taxation* tends to be politically unpopular (be it in a monarchy or democracy). There is a politically much more convenient way: By creating new money out of thin air (*counterfeiting* money), the government can appropriate resources slyly and almost unnoticed (at least at the beginning), without rousing hostility among the electorate.
- To get hold of the money supply and use *counterfeiting as a source of revenue*, however, the government has to take a great many steps – for the government cannot simply invade a functioning free market and print its own paper money. People would simply refuse to accept any such money (as the *regression theorem* tells us).
- *STEP #1: Taking control of the minting business*. Minting coins is propagated as a prerogative of the ruler (emperor, king, etc.). This, in turn, reduces the variety of coins, and the mint can charge a high(er) price for minting precious metals. *Seigniorage* (the price charged by the ruler for minting coins) becomes a monopoly price.
- Having established the *minting monopoly*, the ruler (and later, governments) *re-names* the monetary unit, doing its best to separate its name from its underlying weight (in terms of precious metal). This, in turn, makes the currency national (US dollar, Euro, British Pound etc.), liberating the government from the necessity to abiding by an international (world) money.
- These interferences open the door to the government’s counterfeiting of coins: *debasement*. The government could secretly dilute gold and silver with base alloy, thereby producing shortweight coins. The mint would melt and recoin all the coins of the realm, giving back to the public the same number of “pounds” or “marks” but of a lighter weight. The leftover ounces are pocketed by the ruler.
- By establishing *bimetallism* the government (arbitrarily) sets the exchange value of one money (say, gold) in terms of the other money (say, silver) – thereby replacing the market chosen *parallel standard* of two (or more) currencies with freely fluctuating exchange rates.
- Under *bimetallism*, the government effectively places a maximum price on one type of money in terms of the other. If the official exchange rate deviates from the market ratio, the overvalued money will drive out the undervalued money (*Gresham’s Law*).
 - For instance, assume that the government establishes a silver-gold ratio of 20 to 1, while the market ratio is 21 to 1. In this case, people will bring their silver to the mint, exchanging 20 ounces of silver for one ounce of gold. With one ounce of gold, they will earn 21 ounces of silver. Silver (*overvalued*) will be the currency of circulation, while gold (*undervalued*) will be hoarded and/or exported.
 - However, the *market exchange ratio* of gold against silver changes due to changes in supply and demand, thereby deviating from the officially set exchange ratio. As a result, the fixed exchange ratio between gold and silver will lead to *economic problems*. The latter, in turn, are typically ascribed to a dysfunctional free market – rather than *government interference in free markets*.

- *Legal tender laws* also play a highly important role in governments achieving full control over monetary affairs. – With the money defined by *name* rather than by a specific weight of precious metal, contracts (for cash as well as for credit transactions) increasingly begin to pledge payment in the legal tender *money*.

→ As soon as the government decrees that a certain type of (credit) money is legal tender, *every creditor is bound to accept them in payment* at its face value. But why should, for instance, a lender accept repayment in a low-quality money?

→ Legal tender status had been given to money-substitutes (bank notes) at a time when they were fully backed with money proper. At that time, the decree had basically no market consequences. However, it started to have consequences when market agents no longer considered them *money-substitutes*.

→ As the government declared as legal tender a lower-quality money (pieces of paper, credit money) side-by-side with money proper (gold, silver), Gresham's Law kicked in, with bad (overvalued) money driving out good (undervalued) money out.

- *STEP #2: Permitting banks to refuse payments.* Governments' scope of counterfeiting became almost unlimited with the advent of money-substitutes such as bank notes and bank deposits, which were, at least originally, backed by pre-specified amounts of money proper (gold, silver).

→ On an ad hoc basis, governments granted commercial banks the *privilege of refusing to redeem their liabilities in money proper* (as promised to their clients) – in order to prevent *bank runs* and *bank failures* and potentially ensuing *political upheavals*.

→ *Mass suspensions of specie payment* typically occurred in times of financial stress, which were all too often the result of an over-issue of bank notes and bank deposits not backed by money proper. Economically speaking, suspension of specie payments amounts to an expropriation of the holder of money proper.

→ Commercial banks soon realized that they need not have to fear bankruptcy as a result of over-issuance (that is issuing money-substitutes in excess of money proper holdings). *Fractional reserve banking* became the norm by suspensions of commercial banks' obligation of specie payments – thereby removing traditional checks against inflation.

→ Under a system of *fractional reserve banking*, commercial banks can easily finance governments via extending *circulation credit* (that is credit expansion in excess of savings), thereby creating new money out of thin air.

→ However, financial crisis as a result of over-issue (inflation) tended to be sporadic and unpredictable, and the expectation that commercial banks could *never* pay back their obligations would have eroded the public's confidence in the monetary system sooner or later.

→ The way forward was to establish a *central bank*, serving as the *bankers' bank*. It does not matter whether such a central bank is nominally owned by private individuals/private banks (like the *US Federal Reserve*) or publicly owned (like, for instance, the *European Central Bank*), as it is always directed by government-appointed officials.

- *STEP #3: Establishing the central bank.* A central bank enjoys all the support of the government. It is armed, following constant pro central bank *propaganda*, with the almost unlimited confidence of the general public.

→ The central bank takes control of monetary affairs by assuming the *monopoly of the note issue* (the *unsung key* to the central bank's power). Commercial banks are no longer allowed to issue notes, they just create deposits (largely due bank credit expansion).

→ Commercial banks are required to hold *reserves* in central bank money, called *minimum reserve requirements* (deposits to be held in the form of demand deposits with the central bank or in the form of central bank notes, which can only be obtained from the central bank).

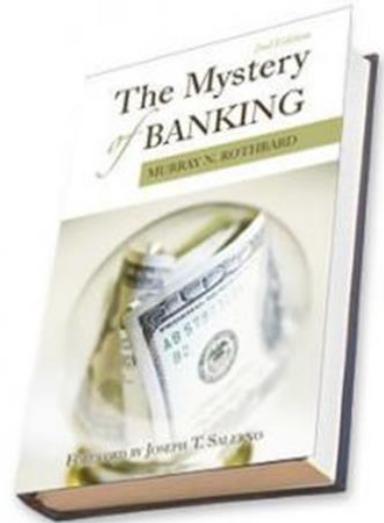
→ In the US, for instance, commercial banks were *compelled* to keep reserves with the US Fed and, since 1917, these reserves only consist of deposits at the Federal Reserve Bank. *Gold*, which was no longer accepted as part of commercial banks' legal reserves, *had to be deposited with the Fed*.

→ People became used to accepting bank notes as a means of payment, as there was great *confidence in the central bank* (with its gold holdings, its prestige and backed by the might of government, so that it could not fail).

→ The central bank invested private banks with the public's confidence, simply by making it public that it would stand ready to act as a *lender of last resort*: if running into financial trouble, the central bank could step in and provide banks with all the money they needed (be it in the form of bank notes or demand deposits).

→ By doing so, *bank runs* – which serve as a *check against inflation* (that is increasing fiduciary media in excess of money proper) – were discouraged or better: were made impossible.

- On 15 August 1971, the US administration under President Richard Nixon (1913 – 1994) ended the convertibility of the US dollar to gold. By doing so, the world monetary system was effectively put on a *Fiat-US-dollar-standard*.





Nixon closes Gold Window
August 15th, 1971

“I have directed Secretary Connally to suspend temporarily the convertibility of the dollar into gold or other reserve assets, except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States.”

...

“The effect of this action, in other words, will be to stabilize the dollar.”

*264 - Address to the Nation Outlining a New Economic Policy: "The Challenge of Peace."
August 15, 1971*

Price of gold (US dollar per ounce)



Source: Bloomberg.

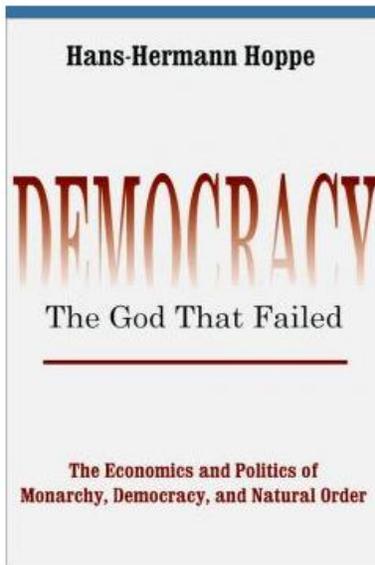
12. Hoppe's critique of classical-liberalism

THE PURPOSE OF THIS SESSION:

(1) Reviewing Hoppe's critique of classical-liberalism; (2) understanding the impact of the state on prosperity and civilization; and (3) arguing why libertarianism triumphs over classical-liberalism.

READINGS:

Hoppe, H.-H. (2001), On the Errors of Classical Liberalism and the Future of Liberty, in: Democracy – The God That Failed, Transaction Publishers, New Brunswick, New Jersey, pp. 221 – 238.



- Mankind being what it is, murderers, robbers, thieves, thugs, etc. will always exist.
 - ▶ The *possibility of aggression*: (1) Action takes place under scarcity; (2) the actor prefers more goods over fewer goods; and (3) the action prefers an earlier satisfaction of wants over a later satisfaction of wants.
- Life in society would be impossible if these *aggressors* are not threatened with (physical) punishment.
- From this correct premise classical-liberals conclude that the indispensable task of maintaining law and order is the essential, the unique, function of the state. Whether this conclusion is correct depends on the *definition of the state*.
- Classical liberals have a kind of state in mind that has two characteristics: (1) it possesses the compulsory territorial monopoly of decisionmaking and (2) the right to tax.

- The key question is: *Does it follow from the right and need for the protection of person and property that protection rightfully should, or effectively can, be provided by a monopolist of jurisdiction and taxation?*

- We know that private property logically and temporarily antecedes any state.
 - ▶ Was there a state *prior* to private property?
 - ▶ Did the state come into being by *social contract*?
 - ▶ Franz Oppenheimer (1864 – 1843) notes: “The State, completely in its genesis, essentially and almost completely during the first stages of its existence, is a social institution, forced by a victorious group of men on a defeated group, with the sole purpose of regulating the dominion of the victorious group over the vanquished, and securing itself against the revolt from within and attacks from abroad.”
—Oppenheimer (1914), *The State*, p. 15.

- Could private property owners possibly enter a contract which entitled another agent to compel anyone within a given territory to come to it exclusively for protection and judicial decision-making, barring any other agent from offering protection and judicial services?
 - ▶ “Such monopoly-contract would imply that every private property owner had surrendered his right to ultimate decisionmaking and the protection of his person and property permanently to someone else. In effect, in transferring this right onto some else, a person would submit himself into permanent slavery.”
—Hoppe (2001), *Democracy. The God That Failed*, p. 227.

- Such a submission-contract is from the outset impermissible (hence null and void), because it contradicts a praxeological category of human action: namely individual self-ownership (private property of one’s own body), which is an inalienable right.
 - ▶ No one would voluntarily agree to render his person and property permanently defenseless against the action of someone else. And no one would submit voluntarily to a monopolist protector which can determine unilaterally, without the consent of the protected, the price (tax) the protected must pay for his protection.

- “Liberalism’s erroneous acceptance of the institution of government as consistent with the basic liberal principles of self-ownership, original appropriation, property, and contract, consequently led to its own destruction.
 - ▶ “Contrary to the original liberal intent of safeguarding liberty and property, every minimal government has the inherent tendency to become a maximum government. Once the principle of government – judicial monopoly and the power to tax – is incorrectly accepted as just, any notion of restraining government power and safeguarding individual liberty and property is illusory.”
—Hoppe (2001), p. 229.

- The chain of reasoning seems to tell us that the state will become, sooner or later, *totalitarian*. Before we jump to any conclusion, however, we have to develop the argument in some more detail.

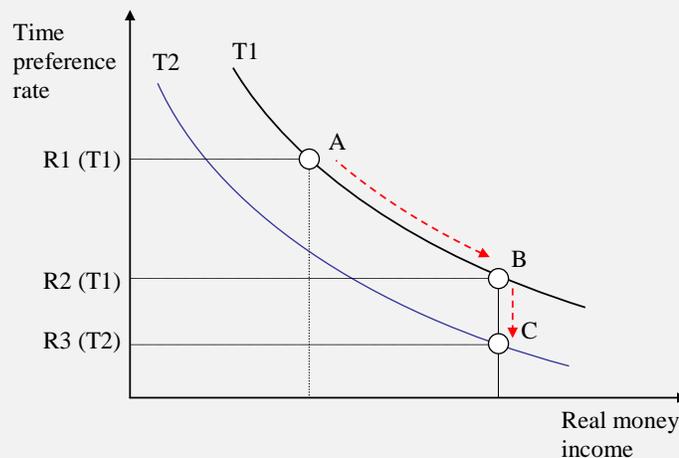
ON THE OWNERSHIP OF STATE POWER

- Under the assumption of *self-interested actors*, every form of government (state) will use its monopoly to its own advantage (to maximize its income and wealth) and will exhibit an inherent tendency towards expansion.
- We can distinguish two basic types of governments:
 - (1) Private ownership of the governmental apparatus of compulsion (*monarchy*),
 - (2) public ownership of the governmental apparatus of compulsion (*democracy*).
- *Private ownership of government* implies a (distinct) moderation with respect to the ruler’s effort to use his monopoly of expropriation. The private owner of state will want to maximize the *capital value* of his personal property.

Some brief remarks on time preference

- The movement from point A (where the time preference rate is $R_1(T_1)$) to point C (where the time preference is lower, namely $R_3(T_2)$) represents the process of civilization. It can be explained by two factors:

TIME PREFERENCE, TIME PREFERENCE RATE AND CIVILIZATION



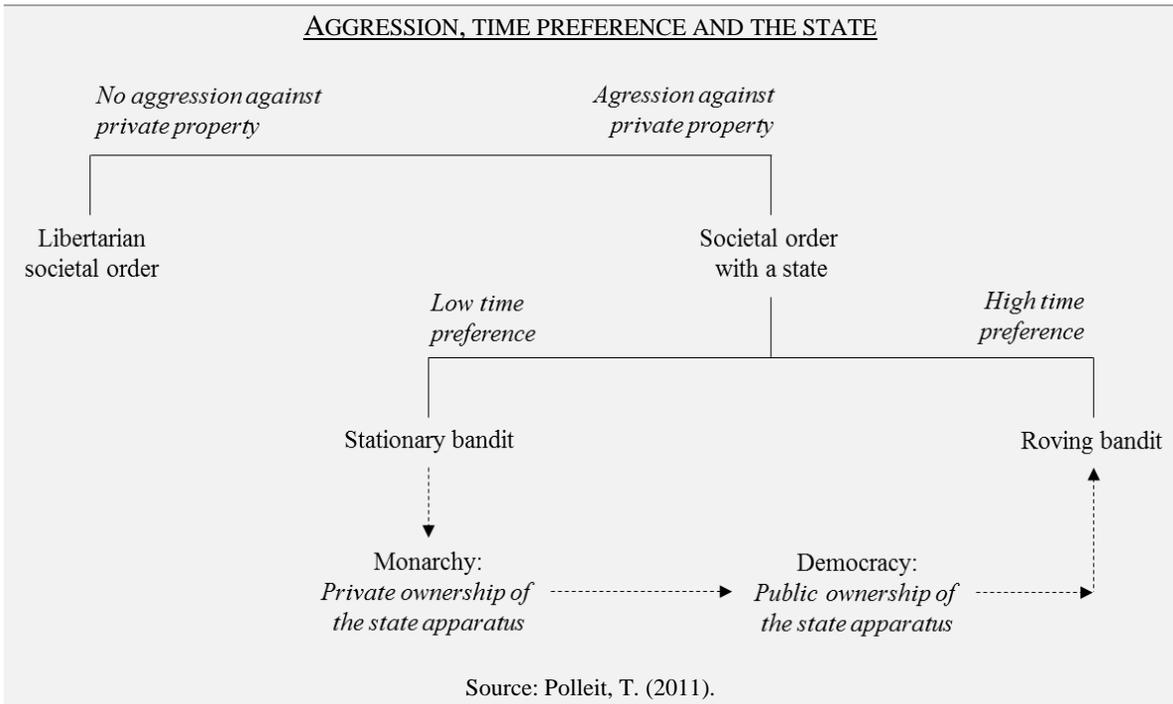
— The movement along T1 from A to B is due a higher supply of present goods, *reducing the marginal utility of present goods vis-à-vis future goods*, lowering time preference.

- The movement from *B* to *C* implies the move from a higher to a lower time preference schedule (as a result of, for instance, a transition from childhood (*present orientation*) to adulthood (*future orientation*)).
- The movement from *A* to *C* can also be characterized as the *process of civilization*. Likewise, the movement from *C* to *A* would represent the *process of decivilization*.

Crime (violation) of property rights reduces the supply of present goods of the victimised appropriator-producer, raising his time preference.

It also leads to a reallocation of resources (building fences, alarm systems etc.), leading to expenditures which were wasteful without the existence of crime.

- The *time preference* of a private owner of government coercive power is lower than the time preference of a temporary caretaker of government coercive power.
- ▶ Aggression against private property will typically be less pronounced under private ownership of government compared to public ownership of government.



- *Public ownership of government* means that *temporary caretakers* will wield the power of coercion. The latter's objective is to maximize *current income*, as a higher capital value of the government estate (due to a decrease in exploitation) – *cannot* be reaped by him (privately).

- What is more, the time preference of the ruled will be *lower* under private ownership of government, and it will be *higher* under public ownership of government.
- The appropriator-producer is actually defenseless against the *state's aggression*:
 - ▶ He must expect that his supply of future goods will be lower (compared with a situation in which law and order is provided by the free market).
 - ▶ His return on investment declines. As a result, consumption is encouraged at the expense of investment. The society becomes more present- and less future-oriented.

THE LIBERTARIAN CONCLUSION

- Referring to Rothbard, Hoppe concludes that “the institution of the state cannot be reformed but must be abolished in order to achieve justice and protection.”
 - ▶ What about law and order, then? How to organize protection and security?



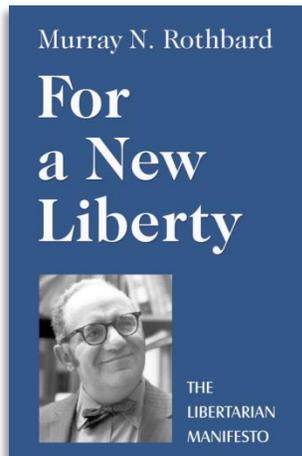
13. On Hoppe’s private property society

THE PURPOSE OF THIS SESSION:

(1) Learning about the workings of a free market in protection/security, (2) discussing some of its theoretical and practical issues, and (3) highlighting a key aspect of the “libertarian strategy”.

READINGS:

Rothbard, M. N. (2006), *For a New Liberty*, Ludwig von Mises Institute, Auburn, US Alabama, Chapter 12;
Hoppe, H.-H. (2001), *On Government and the Private Production of Defense*, in: *Democracy – The God That Failed*, Translation Publishers, New Brunswick, New Jersey, pp. 239 – 266.



- Gustave de Molinari (1819 – 1912), the nineteenth-century Belgian free-market economist, was the first person in history to contemplate and advocate a *free market for police protection*.

“Under a regime of liberty, the natural organization of the security industry would not be different from that of other industries.”

—Molinari (1977 [1849]), *The Production of Security*, p. 59.

- “Defense in the free society (including such defense services to person and property as police protection and judicial findings) would ... have to be supplied by people or firms who (a) gained their revenue voluntarily rather than by coercion and (b) did not—as the State does—arrogate to themselves a compulsory monopoly of police or judicial protection. ... [D]efense firms would have to be as freely competitive and as noncoercive against noninvaders as are all other suppliers of goods and services on the free market. Defense services, like all other services, would be marketable and marketable only.
—Rothbard (2006), *Power and Markets*, p. 2.

► How much shall the state spend for police services? How much shall it invest in electronic equipment, fingerprinting equipment, detectives as against uniformed police, patrol cars as against foot police, etc.? The state has no rational way to make these decisions.

- Libertarians hold that defense/security is a form of *insurance*, and that defense expenditures represent a sort of insurance premium (price). The (most likely) candidates to offer protection and defense services are insurance agencies/companies.
 - ▶ *Uninsurable risks*: Someone has partial or full control over the likelihood of the outcome (such as, for instance, suffering entrepreneurial losses, myself committing suicide, me not feeling like getting up in the morning).
 - ▶ *Insurable risks*: Someone runs the risk of being aggressed against (provided the aggression is unsolicited). He who wants insurance against such an aggression will have to submit to specified norms of nonaggressive, civilized conduct.
 - ▶ Mutual insurance *versus* individual insurance.
- One important implication of a free market for protection/security is that *any known aggressor* would be unable to find an insurer – and thus be economically isolated. Economic pressure on uninsured aggressors would rise to adopt the standards of nonaggressive social conduct.
- Aggressors would want to limit their targets, preferably to uninsured property, and avoid collateral damage, as they have to expect the reaction of economically powerful professional protection/security agencies.
- Likewise, all defensive violence would be highly selective and targeted, trying to avoid collateral damage – as the insurance agency would otherwise become entangled with and liable to other insurers.
- Competitive insurers would have a great incentive to prevent crime and to be efficient in detecting, apprehending and punishing criminal offenders.
- The better the protection of insured property is, the lower are the damage claims and hence an insurer's costs. Providing effective protection is therefore in every insurer's own interest. Victims will be compensated (whereas under statist conditions, the state forces victims to pay as taxpayers for the apprehension, imprisonment and rehabilitation of aggressors).
- Rather than imposing *a uniform set of standards* onto everyone (as the state does), insurance agencies would compete against each other not just via *price* but also through *product differentiation*. There would exist, side by side, say, Catholic insurers applying Canon law, Jewish insurers applying Mosaic law, or Muslim insurers applying Muslim law. That is, no one would be forced under "foreign" law, thereby eliminating a *source of conflict*.
- Competition among insurers in terms of offering certain law codes would promote a tendency towards the *unification* of property and contract law and a *harmonization* of the rules of procedure, reducing the sources of conflict.

- ▶ Let's assume a Catholic, a subscriber to Catholic law, comes into conflict with someone subscribing to Muslim law.
 - No difficult would arise if both law codes reach the same conclusion.
 - If the law codes arrive at different conclusion, a problem arises. As a result, the insured would want to get *protection against the contingency of intergroup conflict*.
- The Catholic and Muslim law insurers would develop/offer a *problem solution*. In their contracts, they would agree (to their mutual benefit as well as to the benefit of their respective clients) to take recourse to an *independent arbitrator* to settle any disagreements that may arise.
 - ▶ Is it likely that an arbitrator will adopt a *hit-and-run strategy*?
- Protection/security *contracts* come into existence as the result of insurers competing for a voluntarily paying clientele.
 - ▶ The contracts have well-specified clauses, outlining the scope of protection and delineating duties and obligations.
 - ▶ Parties to a contract would be bound by the term of the contract. Any changes to the contract would require the unanimous and voluntary consent of all parties concerned.
- Under competition (unlike under statist conditions), *no legislation* would or could exist: There would be *constant law* instead of changing legislation.
- What about poor people? Could they afford protection/security services?
 - ▶ Well, this is a problem that applies to any commodity that is necessary – such as, for instance, food, clothing and shelter. Yet almost nobody says that therefore the government must nationalize food, clothing, shelter, etc., and supply these free as a compulsory monopoly.
 - ▶ Poor people would be supplied, in general, by private charity; perhaps by the police companies themselves for goodwill (as hospitals and doctors do now).
 - ▶ One may very well be paying more in taxes for police now than one would in fees to private, and far more efficient, police companies.
- Wouldn't the agencies always be clashing? Wouldn't "anarchy" break out, with perpetual conflicts between police forces as one person calls in "his" police while a rival calls in "his"?
 - ▶ Since there would be no overall state, we would at least be spared the horror of inter-state wars, with their plethora of massive, super-destructive, and now nuclear, weapons. It is painfully clear

that the number of people killed in isolated neighborhood “rumbles” or conflicts is as nothing to the total mass devastation of inter-state wars.

- ▶ If both *Ruritania* and *Walldavia* were dissolved into a libertarian society, with no state and innumerable private individuals, firms, and police agencies, the only clashes that could break out would be local, and the weaponry would necessarily be strictly limited in scope and devastation.
- ▶ If every person is a subject of a state, in the eyes of every other state he becomes irretrievably identified with “his” government. The citizen of France is identified with “his” state, and therefore if another state attacks France, it will attack the citizenry as well as the state of France. But if company *A* battles with company *B*, the most that can happen is that the respective customers of each company may be dragged into the battle—but no one else.
- A key aspect of the ‘libertarian strategy’

▶ Well, I am afraid we have to conclude here. Let us end with the following quote:

“There is no gainsaying the fact that this suggested program will strike most people as impossibly “radical” and “unrealistic”; any suggestion for changing the status quo, no matter how slight, can always be considered by someone as too radical, so that the only thoroughgoing escape from the charge of impracticality is never to advocate any change whatever in existing conditions. But to take this approach is to abandon human reason, and to drift in animal- or plant-like manner with the tide of events.”

—Rothbard (2005), *The Case for a 100 Percent Gold Dollar*, p. 185-6.

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*Can be downloaded for free on: www.mises.org.

Recommended websites:

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www.mises.org

Ludwig von Mises Institut Deutschland

www.misesde.org

Ron Paul Institute for Peace and Prosperity

www.ronpaulinstitute.org