Mises and His Understanding of the Capitalist System

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To someone not familiar with Ludwig von Mises' understanding of the market, there would, on the surface of Mises' exposition, appear to be a puzzling tension in that exposition—a tension having to do with some very basic elements of Mises' position. We shall find that the resolution of this tension is, once it has been explained, fairly obvious, but we shall also find that a careful consideration of this resolution can help us more fully appreciate the uniqueness (and the intellectual integrity) of Mises' understanding of the capitalist system.

A Tension within Mises' Economics?

The apparent tension in Mises to which we refer relates to the nature and significance of the market prices for inputs and outputs that emerge at each moment in the real world. These actual market prices are described by Mises as reflecting an "equilibrium of demand and supply"; they actually equalize "the size of the demand" with "the size of supply"; in the "unhampered market," any "deviation of a market price from the height at which supply and demand are equal is"—apparently instantaneously—"self-liquidating" (Mises 1966: 762). It is on this basis that Mises pronounces any government interference with market prices of commodities or resource services (including wage rates)—that is, any requirement that a price at a given date be different from the value which the unhampered market would have generated for that date—as disturbing the "equilibrium of demand and supply," and, therefore, in general, as producing results that are (from the perspective of the government) worse, not better, than the conditions the government wished to improve.

Joseph Salerno (1993: 121) has interpreted this Misesian position to mean that all market prices are "market-clearing prices." "The

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constellation of resource prices that emerges on a market unhampered by legal restrictions *always* reflects the circumstance that existing resources are devoted to their most valuable uses as determined by entrepreneurial appraisements of future output prices." The impression conveyed here is that actual market prices are, in the relevant sense, the "correct" prices, the prices that ensure that resources are channelled to their most valuable uses. Interference with those prices necessarily obstructs the efficiency with which the market allocates resources.

And yet, on the other hand, Mises is clearly entirely aware that the market prices at any given date are almost certainly *not* the "correct" prices. In Salerno's words, market prices are, as a consequence of the unavoidable errors of entrepreneurial judgment under uncertainty, "also disequilibrium prices" (Salerno 1993: 121). In Mises' own words, the market prices at any given date are, in contrast to the imaginary prices that would characterize the imaginary "final state of rest," seen as "*false* prices" (Mises 1966: 245, 338). It is the market process, driven by the competition of profit-seeking entrepreneurs, that modifies those false prices and tends to ensure that they are replaced by prices more closely and "truthfully" reflecting the underlying preferences of the consumers. What stimulates that process is the realization by entrepreneurs that the existing market-generated pattern of resource allocation is not the ideal one. There is, in fact, "a discrepancy between what is done and what could be done" (Mises 1966: 336).

One can surely sympathize with the beginner-reader of Mises who finds himself puzzled by these statements, which seem, when taken together, to claim that actual market prices are the correct (equilibrium) prices, but that they are also false (disequilibrium) prices—that the pattern of resource allocation actually achieved at any given date is optimal, but is, at the same time, not at all as efficient as it might be.

Tension Resolved

A more mature student of the Misesian system is able to reassure such a puzzled beginner. There is no internal tension in Mises' exposition. What needs to be understood is the distinction between what Mises (1966: 244–45) calls "the plain state of rest" (or simply "the state of rest"), on the one hand, and what he calls the "final state of rest" (a state not identical with, but closely related to Mises' concept of the "evenly rotating economy"—the Misesian concept that is the closest to standard Walrasian general equilibrium [see Mises 1966: 246–47]), on the other. It is not our purpose here to elaborate on

Mises' "final state of rest" or on his "evenly rotating economy." What we wish to do is to clarify key aspects of Mises' "plain state of rest."

For students coming to Mises from a background in standard microeconomic theory, it is easy to view Mises' "plain state of rest" as corresponding to the mainstream short-run equilibrium state. That error might lead students to interpret Mises' statements concerning the "equilibrium of demand and supply" in a particular market as corresponding to the conditions prevailing at the intersection of the Marshallian demand and supply curves. But such an understanding would be quite mistaken. The Marshallian intersection refers to a state of affairs in which all participants (and all potential participants) in a specific market have somehow become aware of that price which is capable of clearing the market, and have correctly anticipated that that price would indeed prevail in this market. A price that "clears the market" means, in this mainstream sense of the term, one that ensures that all those who might—were they to be informed as to this prevailing price—be prepared to sell (buy) are, in fact, so informed and are able to find buyers (sellers) willing to accept their offers to sell (buy) at this prevailing price. Mises' "plain state of rest" does not entail any such assumptions concerning the state of information. His plain state of rest "comes to pass," in the real world, "again and again": "At any instant all those transactions take place which the parties are ready to enter into at the realizable price." "When the stock market closes, the brokers have carried out all orders which could be executed at the market price" (Mises 1966: 244). Clearly, such a state of rest (which, as Mises emphasizes, "is not an imaginary construction" but a state achieved repeatedly in the real world) refers to the completion of transactions between only those who are aware of the existing situation. The "supply and demand" that are continually in equilibrium in Mises' world do not refer to the supply and demand schedules so basic to mainstream microeconomic theory. They refer simply to the circumstance that, in any situation, those potential transactors who have been aware of available mutually beneficial trade possibilities will have moved to take advantage of those opportunities. Of course, once those opportunities have been grasped, market activity ceases, and the "plain state of rest" has been attained.

To describe the price emerging from those exchange transactions as a "market-clearing price" (Salerno 1993: 121) is therefore misleading. Certainly the price permits all those who stand to gain by exchanging at that price—and who are aware of it—to exchange to the point where no known remaining mutually gainful opportunities exist. But the term "market-clearing price" (a term not used by Mises) is used in standard economics to refer to the exhaustion of all mutually gainful exchange opportunities *under the hypothetical conditions of (relevant) omniscience.* Standard economics indeed notoriously proceeds, in applying supply and demand theory to the real world, to operate *as if* conditions of relevant omniscience can be taken as given. Mises is certainly not making any such assumption of omniscience. His market prices are certainly *not* "market-clearing prices" (in the usual sense of that term). There is, one is able to reassure the puzzled reader, therefore no contradiction in his exposition. Real-world market prices are *not* the equilibrium prices of standard economic theory. (Real-world prices relate to equilibrium only in a very narrow sense, a sense to which no attention at all is given in standard theory.)

Real-world prices are indeed likely to be "false" prices, setting off entrepreneurial-competitive activity modifying the pattern of resource allocation. The real-world pattern of resource allocation at any given moment can be described as optimal only relative to existing *information in fact possessed by entrepreneurial market participants.* The tension in Mises is quite imaginary; it is perceived—quite understandably and reasonably perceived—only as a result of reading Mises through the spectacles acquired in studying mainstream economics.

But this resolution of the puzzle should itself surely raise a different puzzle of its own. It would appear, if one accepts the above interpretation of Mises, that Mises' references to what is achieved every day in the market must, while certainly true, strike any economist as being merely *trivially* true. The optimality achieved every day in the market is optimality only within the extremely narrow framework relevant to real-world conditions. All those aware of the opportunities for mutually gainful exchange, which are, in fact, available, take advantage of these perceived opportunities. To recognize this truth may be an achievement for someone who had not previously understood the significance (and mutual gainfulness) of interpersonal exchange. But this has little to do with the central insight that all economists share concerning the effectiveness of markets in tending to stimulate the exhaustion of *all possible* opportunities for mutually gainful exchange. Here we must of course proceed, with Mises, to recognize that the market prices at any date are surely "false" prices, prices that generate entrepreneurial activity likely to cause those false prices to change. Certainly Mises clearly understood and expounded the competitive entrepreneurial process that continually tends to replace "false" prices by more "truthful" prices. But, then, one can only ask, what is the point of emphasizing the apparently trivial Misesian insights concerning what is *actually* achieved every day in the "plain state of rest"?

The purpose of this paper is to argue that, in emphasizing these apparently trivial insights, Mises revealed his unique understanding of what is achieved in the capitalist system. To appreciate this, it will be helpful to refer to the pioneering vision of the founder of the Austrian tradition, to Carl Menger. It is perhaps worthwhile recalling that Mises, referring to his first reading, in 1903, of Menger's *Grundsätze*, remarked that "it was the reading of this book that made an 'economist' of me" (Mises 1978: 33).

The Vision of Carl Menger

Menger is usually recognized as one of the three pioneers of marginal utility economics, offering economists a theory of subjective value.[1] But, in regard to a subjective theory of value, the claims made on behalf of Menger's originality are somewhat clouded. As Erich Streissler (1990) has shown, there were German economists of the early 19th century, with whose works Menger was unquestionably familiar, whose value theory had incorporated subjective insights long before Menger. Yet Menger certainly believed that his *Grundsätze* was breaking entirely new ground. Friedrich Hayek (1934: 16) has told us that Menger "is said to have once remarked that he wrote the *Grundsätze* in a state of morbid excitement."

What appears to have happened was that Menger glimpsed, at least, a grand perspective on the functioning of the entire market system that contrasted radically with the still dominant Ricardian way of seeing that system. For the Ricardian vision, the size and rate of growth of aggregate output, and the pattern of its distribution among the factor classes that produce it, are inexorably determined, at least in the long run, by objective, physical realities. In the explanation of such determination there is no place for any roles for human resourcefulness, human valuation, human expectations, human discoveries.

Menger, on the other hand, glimpsed a way to understand economic history in diametrically opposite terms. For this view, the physical and biological realities recede into the background; it is the impact of the actions of human beings that *alone* actively determines the course of human events. It was this revolutionary new vision that, I suggest, was responsible for the "morbid excitement" with which Menger wrote his book. And this was a vision that had certainly not been shared by the early 19th century German pioneers in the subjective theory of value, to whom Streissler has referred.

It was Menger, rather than any forerunners, who (already in his 1871 book) recognized that it is the consumer valuation of output

[1]The ideas briefly presented in this section have been developed more fully by the writer in his editorial Introduction to volume one of Kirzner (1994).

that tends to be reflected in the market prices of the relevant inputs—which Menger identified as "higher order goods"—making Menger a pathbreaker in the development of neoclassical marginal productivity theory. It was this insight that drew the attention of the profession to the truth that the importance of the means needed to achieve specific ends is governed entirely by the importance attached to those ends. This is not merely an insight demolishing cost theories of value; it is an insight that introduces a new understanding of economic causality throughout the economic system. Every act of production, every market transaction, is set in motion and wholly governed by consumer preferences. Armed with this radical—and quintessentially "Austrian"—vision of Menger, we may return to Mises and his understanding of the capitalist process.

Mises and the Doctrine of Consumer Sovereignty

The concept of "consumer sovereignty" entered into economic terminology, it appears, largely as a result of the work of the late William H. Hutt (see Hutt 1936: chap. 16, and 1940).[2] This concept became central to Mises' understanding of the market economy. I shall argue that, in emphasizing this centrality, Mises was simply pursuing the Mengerian vision discussed in the preceding section.

In *Human Action*, one section of chapter 15 ("The Market") is entitled "The Sovereignty of the Consumers." In that section (a mere two pages, in a 900-page treatise) Mises presented his own vision of the capitalist process. He explains that while entrepreneur-producers directly control production and "are at the helm and steer the ship," they are not supreme; the "captain is the consumer." "Neither the entrepreneurs nor the farmers nor the capitalists determine what has to be produced. The consumers do that" (Mises 1966: 270). "A wealthy man can preserve his wealth only by continuing to serve the consumers in the most efficient way." So that "the owners of the material factors of production and the entrepreneurs are virtually mandatories or trustees of the consumers" (Mises 1966: 271). (Mises finds only one instance—the case of monopoly—where the wishes of the consumers can be flouted. We shall, later in this paper, pay a good deal of attention to this exception to the general rule of consumer sovereignty.)

In *Human Action* not much further attention is paid to the idea of consumer sovereignty, but there can be no doubt as to its centrality for Mises' understanding of the market economy. I vividly recall Mises'

[2]Hutt used the term "consumer sovereignty" fairly frequently in his papers of the mid-1930s, (see e.g., Hutt 1935; reprinted as chapter 12 of Pejovich and Klingaman 1975).

continually repeating, in his lectures and seminar presentations, that consumers control the pattern of production by their decisions to buy or to refrain from buying. A glance at the index to a volume of Mises' more popular and shorter pieces (Mises 1990) reveals how frequently the idea of "consumer sovereignty" shaped his thinking, especially in his later years.

There is no doubt that, in emphasizing the supremacy of consumers in the market economy, Mises was often seen as going beyond the role of positive scientist and appealing to widely shared judgments of value. But, in fact, for Mises the doctrine of consumer sovereignty was much more fundamental and significant than its being a normative application of positive economics. The doctrine of consumer sovereignty was, in its own right, an important part of positive economics; it was a scientific theorem marking the completion of Menger's vision. What happens in markets is that consumers shape the pattern of resource use and the assignment of resource rewards according to their preferences. The outputs being produced at any date, the methods of production being employed, and the rewards being given to the various owners of productively used resources are those dictated by consumers. The consumer is indeed "the captain." This *may* be seen as a desirable feature of the market economy, but for Mises the significant scientific point is simply that consumer sovereignty does in fact prevail. In free markets it is the consumers whose preferences govern every act of production and every transaction involving the purchase and sale of a unit of resource service.[3]

Consumer Sovereignty and the Mutual Benefits Derived from Exchange

In order better to appreciate the meaning and significance of consumer sovereignty, it may be helpful to contrast the doctrine of consumer sovereignty with the doctrine of mutual benefit derived from exchange. The market is often hailed as the arena in which all parties to freely made exchanges benefit (in their own ex ante best judgment)—that is, the market is the social framework permitting and stimulating all possible positive-sum (exchange) games. The recogni-

[3]The late Murray N. Rothbard (1962: 560–66) has sharply attacked Hutt's notion of consumer sovereignty. (Rothbard does not refer to Mises' very frequent references to the doctrine of consumer sovereignty.) However, Rothbard concedes that in a "formal" sense (in which the ultimate goals of producers are recognized as consumption goals) "consumer sovereignty, by definition, always obtains" (Rothbard 1962: 561). There is reason to believe that Rothbard's position is not inconsistent with the interpretation of Mises being presented in this and subsequent sections of this paper.

tion of this achievement of the market is certainly an important economic insight. It is indeed possible to interpret the entire market process—involving resource markets, processes of production, and product markets—as being simply an elaboration of the central circumstance that all parties to voluntary exchanges are beneficiaries of those exchanges. (There is a solid basis for the conjecture that Walras's more mature expositions of general equilibrium theory, including production, emerged simply as the logical extension of his earlier version of general equilibrium in the pure exchange economy.) But the doctrine of consumer sovereignty, taken in conjunction with what we have described as Menger's vision, permits us to see the overall character of the market process from an entirely different angle. What happens in the market economy is not merely that the owners of resource services and those eager to consume the products (able to be produced with those resource services) are, through the intermediation of entrepreneurial producers, led to mutually beneficial exchanges. What happens in the market economy is that the owners of resource services are led to sell those services to those producers whose production plans are best calculated to cater to consumer preferences. The preferences of consumers determine the uses to which resources are assigned. The market may validly be seen as the arena in which the potential benefits from voluntary exchanges are extracted. But the free market is more fundamentally the arena in which the value scales of consumers come to govern the disposition of potential factors of production.

The Significance of Private Property

For Mises, the doctrine of consumer sovereignty offers an insight into the social role fulfilled by the institution of private property. There is, as a matter of scientific fact, no conflict of interest between the owners of productive resources (whether land or labor power), on the one hand, and the consuming public on the other. *The owner of a productive resource can derive economic benefit from his resource only to the extent that he places it at the service of the consuming public.* As we have already cited from Mises, a "wealthy man can preserve his wealth only by continuing to serve consumers in the most efficient way." The doctrine of consumer sovereignty demonstrates the harmony of interests existing in a market economy between owners of resources and consumers. Recognizing this harmony of interests is merely another way of sharing Menger's vision. It is the circumstance that consumers dictate the allocation of resources that in fact creates this harmony of interests. And, of course, it is the institution of private property that permits and stimulates this harmony of interests.

Because entrepreneurs compete in resource markets, inspired by the hope of winning pure profit by redirecting the deployment of resources in ways more satisfying to consumers, we are able to understand how consumers control—and ultimately direct—the pattern of production, the organization of industry, and the allocation of resources among competing industries. But Mises pointed out one situation—the case that he called the "monopoly price" case—in which the doctrine of consumer sovereignty does *not* apply. "Monopoly prices are an infringement of the sway of the consumers" (Mises 1966: 272). For this monopoly price situation, the institution of private property does *not* spell a harmony of interests between the resource owners and the consuming public. For that situation—and *only* for that situation—it might indeed be rational for consumers to invoke political power to modify the outcomes forthcoming from the unhampered market. It was Mises' merit (and a reflection of his intellectual integrity) to identify this case and accord it the scientific attention it deserves. Unfortunately, not all Mises' followers have properly appreciated the place that his theory of monopoly price plays in his overall understanding of the capitalist system.

Mises and the Theory of Monopoly Price

The nature and place of monopoly theory in Mises' system differ radically from the part monopoly theory plays in standard microeconomics.[4] For standard economics, a monopolistic market for a commodity differs from a perfectly competitive market primarily in that the monopolist faces a downward-sloping demand curve, so that the profit-maximizing decision by the monopolist permits him to charge a price that exceeds marginal cost. Standard monopoly theory is thus a theory exploring the peculiarities of decisionmaking by a *producer*. The consequences of monopoly decisionmaking are assessed primarily in terms of the way such decisionmaking may be held responsible for resource misallocation, in regard to the economy as a whole. For the Misesian theory of monopoly price, matters are quite different.

Unlike conventional economists, Mises identified monopoly *at the level of resource ownership*—not, except as a derivative, at the level of the decisions made by producers. For Mises, the possible case of resource monopoly (where the entire supply of a scarce resource is

[4]For further discussion of the Misesian theory of monopoly price (and a critique of some work by followers of Mises who have, in this writer's opinion, not adequately appreciated the Misesian theory), see Kirzner (1991).

controlled by a single resource owner) is of scientific and normative interest, not in terms of possible "misallocation of resources" (a concept that is not clearly identified in the Misesian system), but, rather, insofar as it may affect incentives in a manner *at variance with the doctrine of consumer sovereignty.* Depending on the degree of elasticity of demand for the monopolized resource, it may be the case that its owner could extract greater revenue from the market by *withholding* (or even destroying) part of the resource stock that he owns than by placing all of it at the service of consumers. He might then charge a "monopoly price" that would enable him to gain by withholding part of his resource stock. If this is indeed the case, then we have an exception to the general rule of consumer sovereignty. We have an exception to the general rule that private ownership of resources results in a harmony of owners' interests with those of the consuming public. We have a case where it is in the interest of a property owner, in effect, to deny consumers the productive capacity of the resources he controls. For Mises the austere, *wertfrei* scientist, such a case is not, by itself, "bad" or "inefficient." It is simply a case that, unlike any other possible situation, pits the interests of consumers against those of a property owner. It would not be irrational, in such a case, for consumers to explore political avenues through which to modify the outcomes that would emerge from the unhampered market.

Because substitute resources are normally available—so that the demand curve for the resource may be sufficiently elastic to make it impossible to gain by withholding part of the resource supply from production—and because entrepreneurs have an incentive to innovate (which would reduce the uniqueness of any particular monopolized resource), Mises did not believe that the case of monopoly price is an empirically important case.[5] But it remains an intriguing theoretical possibility, primarily in its unique property of permitting production to be conducted in a pattern that no longer faithfully reflects the preferences of consumers. It represents the theoretical possibility that, as a result of an accident of the pattern of resource ownership, Menger's vision may be partly inaccurate. Economic phenomena may, in an unhampered market, *not* be shaped exclusively and entirely by consumer demand; sovereignty over production may not reside

[5]Nor, it should be emphasized, is the case of monopoly price one that can be empirically identified and observed. Failure to use all the available supply of the monopolized resource may simply reflect the monopolist's entrepreneurial judgment that future consumer demand may be strong enough to justify postponing its use to the future. Even physical destruction of part of the supply *might* (admittedly far-fetchedly!) be the manner in which the monopolist is expressing his *own* consumer preferences.

entirely in the preferences of the consuming public but in the ownership rights of one or more resource owners.

As with many theoretical exceptions to generally prevailing patterns, the case of monopoly price seems of importance, for the Misesian system, not so much in the intriguing possibility that it itself represents as in the light it throws on the more general pattern—that to which Menger's vision and the doctrine of consumer sovereignty do apply. Indeed, now that we understand the sweeping generality of the doctrine of consumer sovereignty, we can perhaps better understand certain aspects of Mises' system which, at the outset of this paper, we found mystifying.

Mises, Market Prices, and Consumer Sovereignty

It will be recalled that Mises made certain assertions concerning the prices that prevail in real-world markets, which we found puzzling. Those assertions attributed apparent optimality properties to these prices, and to the transactions to which they give rise. We were able to establish that Mises understood that the market prices of any given date are likely to be *false* prices, generating corrective entrepreneurial-competitive production activity. But we were left mystified regarding the sense in which the everyday market prices (and the transactions to which they give rise) can be pronounced the "correct" prices, prices consistent with an "equilibrium of demand and supply." Surely, we asked, the simple insight that, in any market, exchanges benefit all parties to them (in their own best estimation)—and the related insight that, to the extent that potential beneficiaries are aware of the possible opportunities arising from exchange, they can surely be relied upon to take advantage of them—is too simple, almost too trivial, and too limited to permit Mises to denounce any governmental interference as counterproductive. Perhaps the insights we have gained in the preceding sections of this paper can help demystify Mises' position.

Once we have understood the central position of the doctrine of consumer sovereignty in Mises' overall system, we can surely sense and appreciate the deep respect Mises felt for the actual market prices of productive resources. Certainly these prices are likely to be "false" prices, in that they necessarily imperfectly anticipate the true future valuations of consumers for the various possible potential products (at the times when these products might conceivably be made available to consumers). Nonetheless, these prices, and the transactions in which they emerge, are wholly governed—of course, ignoring now the special exception of the monopoly price case—by the preferences of consumers. These prices and these transactions fulfil Menger's vision: they express consumer sovereignty. Mises would of course not deny that, in the absence of omniscience, actual prices and actual plans for production may only imperfectly reflect the patterns of intensity of consumers' preferences. But "sovereignty" need not imply that the wishes of the sovereign are instantaneously and successfully carried out. It may surely mean that each act of those directly or indirectly acknowledging that sovereignty is motivated by the incentive of fulfilling those wishes as far as human effort and human will can succeed in doing. Even the mistakes that may occur under pressure of this incentive must be attributed to the supremacy of the sovereign.

Surely, Mises' profound insight into the character of the capitalist market process was that, at every moment, the decisions made by entrepreneur-producers and resource owners are directly or indirectly made under the powerful incentive to cater to the true pattern of consumer preferences. Each market price for a resource directly reflects the judgments of competing entrepreneurs as to the most valuable use—valuable as judged by anticipated consumer willingness to pay—to which that resource can be assigned. Each production plan that is initiated at any given moment expresses the judgments of competing entrepreneurs (acting in the light of the resource market prices of the moment and in the light of their anticipations of the market prices for future products) as to the most effective ways of deploying productive resources in the service of satisfying consumer preferences.

The near certainty that hindsight will reveal the "falsity" of present prices and the "inefficiency" of present production plans does not in the slightest degree cast a shadow on the validity of Menger's vision or the reality of consumer supremacy. The truth remains that, at any given time, the market is effectively deploying the best current information commanded by market participants and the most accurate and shrewdest entrepreneurial judgments concerning future market conditions. What drives and motivates such deployment is the incentive to win pure profit, through improving the faithfulness with which consumer preferences are respected in the patterns of production.

Thus, when Mises declares any intervention by government that might alter market prices (or other decisions that might have been made in an unhampered market) to be harmful, he does not imply that the prices (or other decisions) that would have emerged in an unhampered market on any given date are optimal in the sense that they accurately reflect all the considerations an omniscient observer would wish to have taken into account. What he means is that the existing conditions in an unhampered market express the most strenuous efforts on the part of the shrewdest entrepreneurial minds to identify and correct existing discrepancies between what *might* be done to best satisfy consumer preferences and what *is* being done. Not only are these strenuous efforts being made at all times, these efforts have been made in the past and current market prices have been modified (from those of the past) to the extent that the *past* shrewd judgments of entrepreneurs revealed those earlier plans to have been "false."

When Mises emphasizes the virtues of real-world market prices and transactions, which continually generate his "plain states of rest," he was not simply emphasizing the obvious notion that voluntary exchange leads to mutual gain. Rather, he was emphasizing the role played by real-world prices and transactions in the exercise of consumer sovereignty. For Mises, the supremacy of the consumer is not simply a tendency manifested in the ongoing entrepreneurial-competitive market process; it is a reality fulfilled at every moment. Certainly such supremacy is not to be confused with any hypothetically "perfect" allocation of resources to correspond to the pattern of consumer preferences. Where neoclassical welfare economics focused exclusively on such possible correspondence, Mises' more "dynamic," "process-oriented" mindset focused on a quite different aspect of markets. In seeing the market as *continually striving*, as it were, to better satisfy consumer preferences, Mises articulated an understanding and appreciation of free markets that, most unfortunately, relatively few of his readers have themselves understood and appreciated.

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Mises and the Dialog of Science

Gordon Tullock

My first encounter with Ludwig von Mises was at a time when he was practically unknown to the American economics profession. There was a small but distinguished group of economists who admired and understood Mises, but most economists had not read any of his work. Unfortunately, he attracted a number of mainly younger economists who almost formed a church in his honor. They tended to misunderstand his main message and greatly exaggerated those minor parts of his work that were wrong.

Mises like most economists did make mistakes. Even where his work was fully up to the standards of his day, like his contemporaries, to some extent he has become obsolete. All these things may be said about any economist. Mises much more than made up for these flaws by his great positive contribution. Unfortunately, most economists never even knew of those contributions because they did not read him. Thus, the bulk of the profession remained in ignorance of his great positive contribution. Economics was much handicapped as a result. The existence of a small group of eccentric students who practically deified him made the situation even worse. The only bright spot was the existence of a collection of very good economists, of whom Israel Kirzner was a leader, who understood his work and not only taught it but made significant improvements.

Economics tends to have warring schools. In the long run we hope the best will triumph. The current revival of Mises is an example, but not necessarily the final word. Even today only a minority of economists have read his work. Still the situation is much better that it was. Once again, Kirzner has played a major role in this revival, and his paper is a further step in the process of spreading the Mises message.

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Contesting the Dominant Opinion

The problem to which Kirzner mainly directs his attention is more than verbal but nevertheless has verbal aspects. Mises, like many economists of his day (including me), used language that implied the system was more accurate than it actually was. Speaking from my own memory, economics came close to a real war between interventionists of various sorts and advocates of the market economy.

I can recall a fellow student who thought that a planned economy would double our national product. He was an intelligent man and more or less reflected what, if not the dominant opinion, was certainly one strongly held. Many others, of course, thought various specific reforms were necessary. No doubt improvements were possible but most of the suggested reforms would have made the situation worse.

Under the circumstances there was a tendency to accept things as they were as a defense against this kind of more or less dominant opinion. Mises, of course, was particularly strong in his position on the planned economy. He had after all produced the first strong disproof of its feasibility. That his language was somewhat unformed is not surprising. In particular, the specific faults emphasized by Kirzner no doubt looked insignificant in view of the major problems of convincing people that the market works.

The Market Process School

Once again, according to my memory, I did the same thing, although of course I was a very minor student at the time. Not only I but many important economists of the day said the same sort of thing. It has been one of the major contributions of the market process school and Kirzner in particular to indicate that equilibrium either does not exist or is imperfect. What is important is a social structure in which people are continuously pressed to improve. Kirzner mainly talks of entrepreneurs continuously seeking new profit opportunities. The same phenomenon is found, however, when a housewife decides to look in one more shop before finalizing her purchases. All of us, and for that matter many nonhuman species, seek improved outcomes (see Tullock 1971). No doubt the entrepreneur is more important, but the phenomenon is widespread.

Of course, that is not all that market process is. It involves a significant improvement in the field. Mises, like many other economists of his day (including me), tended to take what from the present day appears to be too static a view of the economic system. The view that it was always in equilibrium is, of course, true only with a very special definition of equilibrium. If we define equilibrium as the current situation, then we are always in equilibrium. A definition rather like this has been used occasionally by members of the Chicago school. They will point out that any situation that is not changed is not changed because the change would be too expensive.

As an illustration of this type of meaning for equilibrium, during the recent San Diego meeting of the Western Economic Association, I saw a dime on the floor and picked it up. A friend, a good Chicagoan, laughingly said that it must have been an optical illusion. In essence, he was saying that the coin on the floor was a nonequilibrium phenomenon. An Austrian might not have even seen this as an opportunity for minor humor. My picking it up was an example of a corrective process although not necessarily a market process.

The genius of the market system is that people are motivated to seek out changes that will benefit society. But while they are seeking them the existing situation is a very short-run equilibrium. Between the time that Henry Ford decided he could make cars cheaper with the assembly line and the time that the new cheap cars came out, there was a period in which no change would be made simply because it took time. In one sense that was in equilibrium. Normally, however, that is not what we mean. Further, the fact we do not mean that causes no confusion.

Much of Kirzner's article is devoted to this particular problem and pointing out that Mises use of equilibrium does not confuse. Mises did not directly correct the static model, but the best argument for capitalism has been an argument for a process and the argument that the market process is the best process. This argument is to a considerable extent the work of Kirzner. In this article he deals with the apparent contradiction between Mises' use of equilibrium and market process procedure. No doubt verbally there is a difference, but I doubt that many were positively misled by it. It is worthwhile clearing up possible confusion like this and clearly pointing to the process and not to the potential goal. Nevertheless, Mises made a great contribution here even if his language followed the custom of his day and hence was a little imprecise.

Conclusion

We all make mistakes. Correcting them is part of the dialog of science. Mises pushed economics a great distance ahead. Kirzner in this article has pushed it even further. Let us all try to implement the scientific process and make still further gains.

References

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