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Finance behind the Veil of Money: Response to Dr. Braun's Comment

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What is the relationship between opportunity cost, choice and action? In my review of Eduard Braun's *Finance behind the Veil of Money* (2014), I took exception with his view that opportunity costs are not only unnecessary, but even detrimental to understanding decision making.

The most substantial difference between our views comes from Braun's treatment of the relationship between opportunity cost and choice. Consider his example of an unprepared hiker being given the choice of either of his friend´s apples, and choosing one over the other (Braun, 2014, p. 32). (Braun assumes that the hiker is indifferent between the two options, or in his own words, "that the two apples are alike"). In choosing one apple over the other, the hiker realizes no net benefit since he also incurs the opportunity cost of the foregone alternative, the unchosen identical apple. Braun begs the question to the extent that it is trivial to

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state that one will receive no net benefit if the associated cost is an equally preferred alternative.[1]

As with other apparent paradoxes of choice similar to Buridan's ass, the solution requires identifying a hidden option. In Braun's case (as with the ass), the other option is not eating at all, and starving. The foregone alternative cannot be something perceived to be identical to what one is choosing since a preference of one option to another is a requisite of choice (Rothbard, [1956] 1997, pp. 225–226). Both the hiker and the ass make their choice based on the foregone alternative of starving, resulting in the more obvious (and conventional) gain from trade. In other words, the hiker's benefit came at the point when he avoided death by being offered one of two apples. The choice of what specific apple to consume is a subsidiary issue to the realization of this benefit.

Braun could have relaxed his assumptions, e.g., make the apples imperfect substitutes, yet still not achieve his desired end. In choosing the more highly valued red apple and foregoing the other yellow one, the hiker will indeed forego the lesser value of the yellow apple. As a result, his gain from this trade will be less than that of the previous example with identically satisfying apples. This outcome accords with reason and is an alternative way to illustrate the effect of scarcity on value.

These results can be summarized as in table 1. Braun's example is represented as example A, with indifference between the two apples. Choosing one of the apples will not result in the foregone alternative of the other apple, as the next best alternative is the third ranked preference of death. In example B, the hiker is not indifferent and prefers the red to the yellow apple. Choosing the red apple implies foregoing the yellow one, and the utility associated with it. Clearly one will benefit more when faced with indifference between the alternatives. While this indifference does not pose a theoretical problem, it cannot be demonstrated by choice (Rothbard, [1956] 1997, p. 226). As a consequence, example

[1] This is analogous to a movement along an indifference curve in mainstream price theory, though I know of no framework used by Austrian School economists to illustrate this phenomenon (I provide a suggestion in Table 1). This example represents another point of departure of Braun´s analysis from more conventional Austrian School approaches (e.g., Rothbard, [1956] 1997).

A is not a valid illustration of the point Braun wishes to make. Note that Braun is far from the only economist overlooking this point: 78 percent of economists polled at the 2005 annual meeting of the American Economic Association were unable to answer a similar question concerning value and opportunity cost (Ferraro and Taylor, 2005, p. 7).

Table 1: Preference Ranks With and Without Indifference

Preference Rank	Example A	Example B
1st	glass of water	glass of water
2nd	red apple ~ yellow apple	red apple
3rd	death	yellow apple
4th	can of Mountain Dew	death
.	.	.
.	.	.
.	.	.

Braun thinks that the opportunity-cost doctrine leads to seemingly perverse outcomes because it gives no heed to the role of ownership (p. 33). Since one can only forego what he owns, Braun reasons that a cost can only be created by foregoing something owned. From this he concludes that since the action undertaken (the embodiment of the choice) can only be made at the expense of something one owns, the cost can only be realized at the point the action is undertaken. In Braun's words, opportunity-cost analysis "creates costs where they do not exist—in decisions—and neglects costs when they actually arise—in action" (p. 33). In my review, I addressed the latter part of his objection (Howden, 2016, p. 579), though some comment on the former part is also necessary.

Braun believes that there is a distinction to be made between choice and action. Maybe so, but the distinction is neither helpful nor important for the task at hand. Braun's theory heavy book assumes implicitly an unhampered market.[2] As a consequence, there is no reason to believe that choice does not translate to action. There is no distinction in saying that "a choice gives rise

[2] The only exception is his unrelated discussion of BFH monetary systems (pp. 170–177).

to a cost" instead of "an action gives rise to a cost," since choice implies action.

Despite these differences, Braun and I both *partially* agree on one of his central conclusions though by different means. In Braun's analysis, a cost "*can only arise* … [*if*] *one has to abstain from consumption in order to attain one´s end*" (p. 34). I agree that all costs must ultimately be valued according to the theory of imputed value (Menger, [1976] 2007, ch. 3), but this is different than saying that a consumption good must be sacrificed in order for a cost to be realized. After all, an automotive company must choose (and produce based upon that choice) whether to use steel or aluminum to cast the engine´s block. Neither the steel nor the aluminum are consumers' goods for the company. Does that mean that no cost will be incurred from the choice? No, and the magnitude of the cost will be determined by the discounted value the alternatives have according to their utility in producing a consumers' good. Thus consumers' goods are necessary to determine the magnitude of the cost, but it is incorrect to claim that costs may only arise when a consumption good is foregone. This insight is useful in demonstrating that only the prices of consumers' goods are relevant to the purchasing power of money, thus substantiating the popular notion that Marget ([1938] 1966, p. 487) lamented had no existing rigorous proof.

Braun also points out that I have incorrectly attributed to him the erroneous view of others, namely that all acts of production are also acts of consumption. I retract this claim.

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