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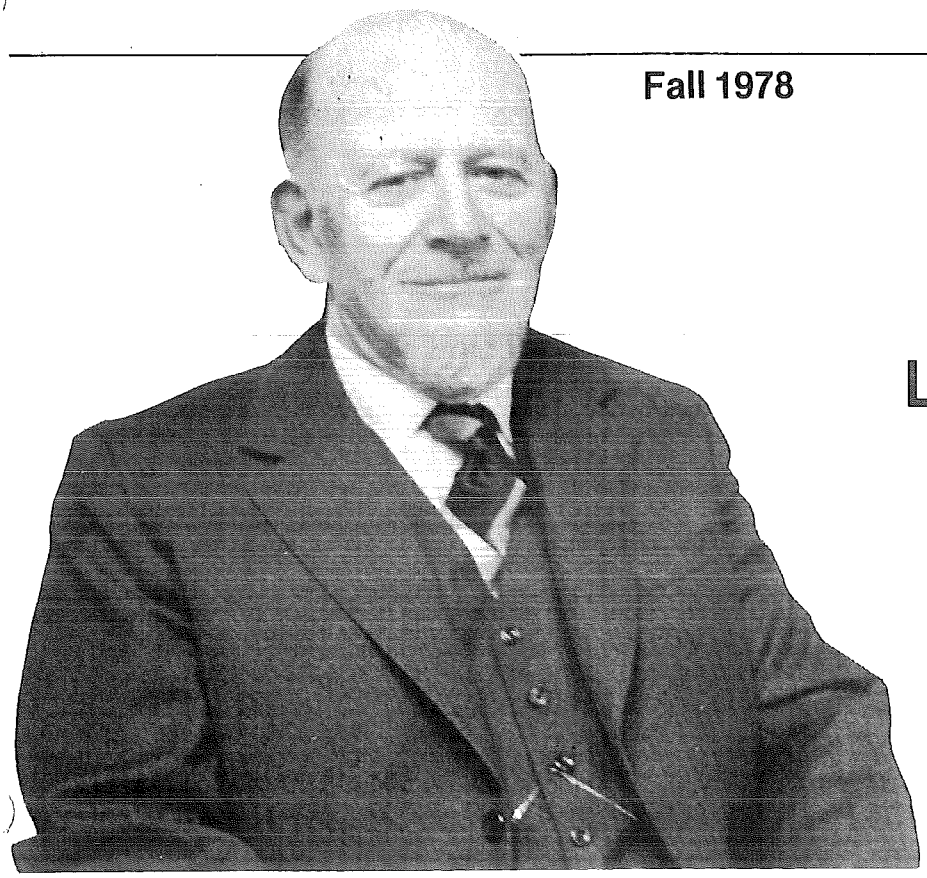

An Interview with Ludwig Lachmann

Professor Ludwig M. Lachmann, one of the most prominent members of the Austrian school, has centered his long and productive career around the importance of subjectivism in economics. From his early work on the role of expectations to his more recent endeavors in capital theory and the market process, Lachmann has been a tireless advocate of subjectivism and methodological individualism. A collection of his essays, *Capital, Expectations, and the Market Process,* was recently published, and his *Capital and Its Structure* will soon be reprinted. Notable among his other contributions are the discussions of methodology and the significance of institutions in *The Legacy of Max Weber* and his trenchant attack on modern macroeconomics in his "Macroeconomic Thinking and the Market Economy." Professor Lachmann was interviewed on November 18th, 1977, shortly before his return to South Africa and near the end of his three year appointment as Visiting Professor of Economics at NYU. This interview was conducted by Richard M. Ebeling and Gary G. Short.

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Austrian Economics Newsletter: Professor Lachmann, you have been one of the main contributors to the Austrian tradition for forty years. How did you get interested in the Austrian school?

Lachmann: Well, I grew up in the Berlin of the Weimar Republic where the official creed was a kind of revolutionary socialism. I didn't like it. So, naturally, I was looking around for something different. I had read Schumpeter and had been quite impressed. One day, I really don't know by what accident, I came across an article by Mises, who, you'll remember, started publishing methodological essays in the German journals in the late 1920's. I don't remember the first occasion on which I came across one of these articles, but I read it, and found it most interesting. In particular the Austrian economics Mises espoused seemed to be something rather different from what I knew from the textbooks. I got interested and read more Mises and that is how I became an Austrian.

A: Did you meet Mises while you were living in Germany?

L: Yes, once in June, 1932, the year before Hitler came to power, there was a conference in Berlin, a "world economic conference," as it was called, that had been arranged by one of the big liberal newspapers in Berlin. Mises had been invited to it and I prevailed on someone in the financial editor's staff of that paper to introduce me to Mises. The meeting of course didn't last longer than two minutes, but I did meet Mises that way.

A. After you moved to England in 1933 you became a research assistant to Hayek. What type of topics were usually of interest in the famous Hayek-Robbins seminar?

L: In general, problems of the business cycle and of capital theory. I actually worked on secondary depressions. That is to say, what Hayek first used to call the process of secondary deflation, a word that had been coined by a German economist to denote that part of the process of depression which goes beyond any kind of primary maladjustment. That is to say, that kind of depression that would not be an adjustment process in the Hayekian sense. It was by then (1933) admitted that a depression of this kind could develop and I think everybody admitted that by 1933 the world was in a process of secondary depression.

A: You have talked a number of times about the importance of expectations in business cycle theory. What first drew your interest to expectations as far as the business cycle question was concerned?

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The *Austrian Economics Newsletter* is designed as a research and communications device for work in Austrian economics. As such, it is essential that we have the active support and cooperation of our readers. We need any information which would be of value to other Austrians and we welcome any suggestions for improving the *Newsletter*. The success of the *Newsletter* fundamentally depends on our ability to encourage the participation and involvement of our readers.

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L: Talking to Paul Rosenstein-Rodan, who was then a lecturer at University College, London—not technically in the London School of Economics—but he gave a course on the history of economic thought to which all of us who were research students then went. It was Rosenstein-Rodan who in discussing Austrian trade cycle theory with me said, "Ah yes, but whatever happens in the business cycle is in the first place determined by expectations." And then he told me of the work that had been done in Sweden.

A: When you arrived in England you obviously must have seen the great concern that a lot of English economists were giving to the problem of the Great Depression. How did you perceive the English interpretation of the Great Depression?

L: Well, there was no English interpretation of it as such. There was the London School of Economics interpretation which of course was Hayek's interpretation and which you also find reflected in Lionel Robbins' book, *The Great Depression,* published in 1934. That was the London interpretation. I then realized that there was, in Cambridge, a different kind of interpretation. But at first it was something rather difficult to get hold of. I then realized that to some extent it was something I was already familiar with. I had first come to England for the summer term in 1931 and I had been in Cambridge for a few days, and thanks to an introduction that Schumpeter had given me I had met R. F. Kahn, who had told me about the multiplier that was then just being discovered. In fact, it was shortly before I met him that Kahn's famous article appeared in *Economic Journal.* So, in a way I knew about the multiplier, but I didn't know much more.

A: Were you involved a great deal with the debates between Cambridge and London? Was there constant contact between the parties, or were they isolated and not talking to each other?

L: No. There was no question of isolation. We did talk to each other. I may remind you that the *Review of Economic Studies* was started in the fall of 1933 as a joint venture by London, Cambridge and Oxford students. So there was contact. And the contact became even more intimate when in 1935 Abba Lerner, a product of the London School, went to Cambridge. After that there was for a few years a joint London, Cambridge and Oxford seminar, that is to say a joint seminar of the research students in economics at these three universities. Anyone from another university who was interested could join, of course, and it would meet one Sunday a month in one of the three towns, and discuss more or less Keynesian economics.

A: What type of reception did you notice was taken by economists when the *General Theory* appeared?

L: It was a big success, and immediately so; that I think I can say. Naturally, there was some discussion, not everybody understood the whole thing at once. I had some advantage—or, we in London had some advantage—because we had Lerner explaining what it all meant. And this was very good teaching indeed.

A: In 1938 you had written an article called "Investment and the Cost of Production" in which you raised the issue of "capital complementarity" in understanding expansionary monetary policies: that, in fact, expansionary policies may not bring forth greater output if some complementary factors are scarce. What first brought the importance of complementarity and substitutability in capital to your mind?

L: My attention was drawn to it by Hayek's paper, "Investment that Raise the Demand for Capital" which was published in 1937, in the *Review of Economic Statistics.* It had impressed me and it intrigued me to hear from Hayek that Keynes had said to him, "You know this is really quite an interesting idea, it had never occurred to me."

A: In the early '30's there had been great interest among the profession in the "Austrian" or Hayekian theory of the trade cycle. Yet as the 1930's progressed even those who had been adherents seemed to have given up their belief in its correctness. What reasons do you think were behind this?

L: Well, you presumably know about the two different letters to the *London Times* that appeared in October, 1932. This, of course, was before I came London. In one of them, Keynes and some Cambridge economists who were not, in general, his friends, like Pigou and Dennis Robertson, demanded that the government should take steps against unemployment. And three days later, Hayek, Robbins and Arnold Plant sent another letter saying that anything the government did by way of public works or similar methods would only make things worse and would not have the effect that Keynes claimed it would have. That is to say, the "Austrians" seemed to be committed to a policy of continuous deflation whatever happened. Yes, I'm

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Subjectivism Conference Held in Birmingham, England

A conference on "Subjectivism and Industrial Organization" was recently held in Birmingham, England. Sponsored by Liberty Fund and administered by the Institute for Humane Studies in cooperation with the Industrial Economics Study Group of the Social Research Council, the conference took place on June 1st and 2nd, and was directed by S.C. Littlechild and J.R. Slater.

Thursday's session began with a paper by Stephen Littlechild (Professor of Commerce, University of Birmingham), "Subjectivism and Austrian Economics: Some Implications for Industrial Policy." His talk was a summary of his recent IEA paper (reviewed in this *AEN*), and was highly critical of the neo-classical treatment of industrial organization. Littlechild particularly questioned the usefulness of the neo-classical focus on perfect competition, and offered the Austrian emphasis on the market as a process as an alternative approach. In his comment, A.K. Maynard (Reader in Economics, University of York) discussed Marshall as a "quasi-Austrian." It was Maynard's contention that Marshall shared several characteristics with the Austrians in that he was primarily concerned with issues of economic growth and development, and hence did not stress the concept of equilibrium.

In "The Co-ordination of Economic Activities," Gerald O'Driscoll (Assistant Professor of Economics, NYU) maintained that Robbins' definition of economics as a science of choice, articulated within a microeconomic context, had been illegitimately extended to macro or social choice—a context within which it makes no sense. He further argued that Hayek's extension of Robbins' analysis to the problem of the coordination of the separate individual decisions is obscured in contemporary economics. Professor D.W. Reekie (University of Edinburgh) commented on O'Driscoll's paper. He expressed his wide agreement with the paper and proceeded to relate Hayek's work on competition and monopoly to that of Adam Smith.

Israel Kirzner (Professor of Economics, NYU) gave Thursday's final talk, "The Role of Knowledge in Business Organization: A Subjectivist Approach." Kirzner argued that the assumption of perfect knowledge (or of perfect knowledge of a probability distribution) ignores the vital role of spontaneous knowledge. He also stressed the importance of the entrepreneurial role in coordinating the plans of the various market participants. G.L.S. Shackle (Professor Emeritus, University of Liverpool) responded favorably to Kirzner's paper. He began by rhetorically asking how economics has come to be viewed as a kind of calculus, when it is actually concerned with men acting and choosing under uncertainty. He went on to elaborate the creative nature of choice and the role of imagination in entrepreneurship.

C.K. Rowley (David Dale Professor of Economics, University of Newcastle-upon-Tyne) and A.R. Appleyard (Lecturer in Accounting, University of Newcastle-upon-Tyne) began Friday's session with a paper defending the architect's association in England. They argued that the association is a voluntary organization to foster architectural quality and to maintain the income of architects over the business cycle. In his comment, Professor David Myddleton (Cranfield School of Management) was highly critical of the paper. He insisted that the association is not really voluntary, but rather is a government-backed cartel which serves as a barrier to entry into the profession. The paper and comment generated a sharp discussion with the audience on the appropriate way of viewing the association.

The final paper of the conference was presented by Jack Wiseman (Professor of Economics, University of York). In "Subjectivism and Group Decision-Making," Wiseman attempted to set forth a general theory of group behavior from a strict subjectivist viewpoint. In several respects his arguments were similar to those of Buchanan, Alchian, and Demsetz. Professor David O'Mahoney (University College, Cork, Ireland), in commenting on the paper, insisted that since different groups have different purposes, no general theory of group decision-making is possible.

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While they were in England, several of the participants in the Birmingham conference were involved with other events relating to Austrian economics. Prior to the conference, Jerry O'Driscoll and Walter Grinder informally met with the staff of the London School of Economics. During this luncheon, hosted by David Demeza (Lecturer at LSE), they were joined by Tibor Scitovsky and Itla Myint. On May 30th, Israel Kirzner gave a lecture to about 25 graduate students and faculty at University College in Cork, Ireland. His talk, chaired by David O'Mahoney, centered around a theme to which much of his recent work has been devoted: the subjective nature of knowledge and the role of the entrepreneur in discovering and making use of such knowledge.

Following the conference, Professor Kirzner and O'Driscoll spent several days meeting with various groups. On Sunday, they spoke to a group of businessmen in London, with S.H. Frankel offering comments on their talks. Tuesday they gave informal presentations in conjunction with a luncheon at City Polytechnic University at which lively and productive discussion ensued. That evening they spoke before the Economic Research Council, an exclusive club of prominent individuals in financial and political affairs. They spoke on inflation, and again, a lively discussion followed their talks.

Austrian Economics Program at New York University

The Austrian economics program at New York University will benefit this fall from the addition of Dr. Gerald P. O'Driscoll, Jr. (formerly of Iowa State) whose UCLA doctoral dissertation was recently published as *Economics as a Coordination Problem: The Contributions of Friedrich A. Hayek.* He is currently editing a volume of essays on Adam Smith's *Wealth of Nations.*

In addition, Dr. Mario Rizzo (Ph.D., University of Chicago), formerly a postdoctoral fellow at NYU, is being hired as an assistant professor. The organizer of the very successful January, 1978, NYU conference on Austrian economics, he is now editing the papers for publication.

Professor Ludwig Lachmann, whose seminar and participation in the Austrian Colloquium have been greatly missed, will be returning for the spring semester. Students interested in pursuing graduate work in Austrian economics are urged to write to Dr. Israel Kirzner (Dept. of Economics, NYU, 500 Tisch Hall, 40 West Fourth St., New York, NY 10003). Full scholarships are available for highly qualified students.

Studies in Economic Theory

Sheed Andrews and McMeel has recently released the following books in its *Studies in Economic Theory* series:

Ludwig von Mises. *The Ultimate Foundation of Economic Science: An Essay on Method.* Introduction by Israel M. Kirzner. 168 pp. $15 cloth, $4.95 paper.

Louis M. Spadaro, ed. *New Directions in Austrian Economics.* 256 pp. $15 cloth, $4.95 paper.

Scheduled for fall release is:

Ludwig M. Lachmann. *Capital and Its Structure.* 156 pp. $15 cloth, $4.95 paper.

Lange's Theory of Socialism After Forty Years

By David Ramsay Steele

Forty years after publication, Oskar Lange's *On the Economic Theory of Socialism* is more or less permanently in print, in paperback, and recommended to thousands of students every year as the decisive answer to Mises and Hayek.[1] The numerous vigorous criticisms it has received are less well known.[2]

In 1920, Mises had contended that socialism, as the term was then widely understood, was an impossibility. Socialism was conceived as a social order in which factors of production were no longer allocated through the market, but by central direction. Yet socialism was expected not only to equal, but to greatly outstrip the level of production, and hence material living standards, achieved within the market. Mises argued that if there were no market prices for factors of production, it would be impossible to adjust production to the satisfaction of human wants. Precise, meaningful cost-accounting would be unavailable to the socialist planners, therefore central planning would entail general impoverishment.[3]

To appreciate the response to Mises' challenge, it is particularly important to grasp the fact that for many years both avowed socialists and critics of socialism took for granted that socialism excluded a market for factors of production. Today this is no longer the case. Socialism is a much broader, more elusive idea than it used to be.

Two years after its publication, Mises' 1920 article was incorporated into a full-length study of socialism.[4] It was widely read, and socialists were thrown on the defensive, especially because of contemporary political developments. In Russia, the bolsheviks' attempt to introduce a socialist order (1918-21) was an ignominious fiasco resulting in starvation for millions.[5] And in Germany it was becoming clear that the Marxists had no clear idea of how to introduce the "socialization" they had confidently preached for so long.[6]

These were the days when authoritative socialist theoreticians dreamed of the *Naturalwirtschaft,* a society without markets or money, where the planners would run the whole of industry as though it were Crusoe's island, using only technological calculations "in kind."[7] A variant of this idea, which showed only a very faint inkling of the problem, was that the planners would use "labour-hours" to measure costs of production, a proposal open to two immediately obvious objections pointed out by Mises: the heterogeneity of "labour," and the fact that unproduced factors also need to be economized.[8]

When Mises' argument compelled more serious attention to the problem of allocation, one response was the suggestion that millions of simultaneous equations could be drawn up and solved by the planners. Given full knowledge of the consumers' wants, of society's resources and of production recipes, the optimum allocation could be derived by mathematical calculation. Confusion arose because some socialist writers erroneously attributed this scheme to earlier economists: Wieser, Pareto and Barone. Actually, these economists had not been in the least concerned to advocate any such system. They had argued that a socialist society, assuming hypothetically such could exist, would not be able to avoid conforming to certain patterns of allocation found within the market. Socialism would therefore have to use categories corresponding to rent, interest and profit. It would have to proceed by trial and error, sometimes abruptly closing down factories that were found to be loss-making, just as occurred within the market.

Barone, in particular, was scathing in his anti-socialism, and very probably thought socialism totally impracticable. He did not (as is so often stated) try to propose a method of allocation by solving equations, but quite flatly asserted that this was "impossible," as his teacher Pareto had already pointed out.[9] It was not Barone's intention to offer any method for administering socialism, but to show that, however socialism was administered, certain principles of allocation found in market economies would have to be followed, which was denied by most socialists at the time. Mises raised an altogether different question: whether they *could* in practice be followed.

The suggestion that socialism could operate by solving millions of simultaneous equations was soon abandoned. Such equations depict an imaginary equilibrium, and cannot describe any realistic disposition of factors, or the most efficient route towards an equilibrium position. In his original article, Mises had pointed out that socialism could easily be imagined under equilibrium conditions, and that it was precisely the incessant changes abstractly eliminated in the equilibrium construct which made socialism impossible. Furthermore, the equations would be so many that they could not be solved within any reasonable time-period.[10]

Most fundamentally, however, the proposal simply ignores the core of the Misesian objection, what Mises called the "intellectual division of labour," and Hayek later elaborated under the name "division of knowledge." This is the fact that the market makes use of knowledge dispersed among the members of society. To write out the equations, the planners would have to collect together all the knowledge which millions of people individually and separately possessed, and which determined their responses within the market. This would have to include not merely codified knowledge, but knowledge of particular circumstances (e.g. the idiosyncracies of a particular piece of equipment), hunches based on experience, and the propensity to examine problems in a particular way.

Lange's scheme was one of several kindred proposals, all published within a few years of each other,[11] but it was Lange's which most caught the attention of economists and the general public. What *was* the Lange proposal? His work is short, readable and one would have guessed, not easily misinterpreted. Yet there is a startling paradox. Lange's work is now commonly seen as a pioneer of 'market socialism.' But he very clearly presented it as a way of avoiding the necessity for a market of factors in production.[12]

Lange states: "There is no market for capital goods and productive resources outside of labour."[13] (The need for a consumers' goods market had already been conceded by many socialists, and was not at issue.) Lange persistently refers to the fact that, in his proposed system, central planning has replaced factor markets; indeed, he takes this for granted as an essential feature of socialism. He repeatedly counterposes and contrasts his socialist economy to a "competitive market." All the more remarkable then, that *Lange himself,* thirty years later, looked back on his system as one which had demonstrated how socialism could employ a market.[14]

Lange's proposal is a re-arrangement of the features of perfectly competitive equilibrium. There is what he calls a "genuine market"[15] for consumers' goods and labour, though there is only one seller of consumers' goods (the state), one buyer of labour (the state) and the state is assumed to be able to distribute incomes in any way it likes. Prices

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Austrian Economics Seminar: Part II: 1976-77

by Don C. Lavoie

In Part I of this report on the Austrian Economics Seminar at New York University the diversity of thought within the Austrian school was analyzed by reference to two contrasting tendences among Austrians: "nihilism" and "Ricardianism." Each "side" is suspicious about the dangerous implications of statements made by the other, even though each would unhesitatingly denounce both nihilism and Ricardianism. The "anti-Ricardians" accuse Rothbard, Kirzner and others of failing to extend subjectivism far enough, while the "anti-nihilists" accuse Lachmann, Shackle and others of, in a sense, extending subjectivism too far.

In this Part we will stress that there is, however, no rigid line-up of the two poles and that the controversial nature of the often pioneering insights emerges on an *individual* level, issue by issue, and moment to moment. Each individual participant of the AES employs his own critical judgment to challenge the arguments of his fellows, thus it is not surprising that these individuals do not consistently divide into identifiable camps. On any particular point any imaginable combination of protagonists and antagonists will emerge, only to be redivided along new lines for the next controversy as their convictions are variously swayed.

Thus while the modern Austrian school can be usefully analyzed with the theoretical tool of this "nihilist-Ricardian" spectrum, it is also true that this framework, like any such theoretical tool, must to some extent simplify its subject-matter. There are many other internal divisions over particular issues which do not conveniently line up according to these poles. It is out of this continual flux of critical confrontations and not from one rigid split that genuine, if gradual, intellectual progress can be forged.

The October, 1976, meeting of the AES was the occasion for a most fascinating internal debate which cannot easily be subsumed under the "nihilist-Ricardian" framework. The two major American followers of Ludwig von Mises—Murray Rothbard and Israel Kirzner—locked horns over the problem of empirically defining the money supply.

Austrians generally agree that *theoretically* money is simply the generally recognized and subjectively perceived medium of exchange, and that the *empirical* designation of components of the money supply ought to proceed from this theoretical starting place. The controversy here emerges with the specific application of the Austrian theoretical framework to the contemporary American economy. Some things are clearly part of the money supply, such as the actually circulating currency and demand deposits, both of which are commonly accepted as direct payment in exchange for goods and services. Other things, such as savings deposits, are less obvious.

In his important paper, "Austrian Definitions of the Supply of Money," Rothbard argues for including savings deposits and some other items as part of the money supply, while excluding genuine time deposits and other credit instruments. "The operative difference" between money and other assets, Rothbard argues, is "whether the asset is redeemable at a fixed rate, at par, in money." (pp. 10-11) When, as with the case of small CD's, the assets "are redeemable before the date of redemption at fixed rates, but at penalty discounts rather than at par," he is less certain but is tentatively inclined to include these at the penalty level.

Rothbard rejects "liquidity" as the criterion for making the distinction between money and other assets. There is a range of liquidity of money from cash in a wallet, to cash in a drawer at home, to cash in a safe at the bank, to cash under the floorboards; and there is a range of liquidity of nonmonetary assets, from those more easily salable, such as stocks and bonds, to those more difficult to cash in, such as land or a collection of antiques. We cannot simply say that the most liquid of a person's assets are his money assets, since it may be the case that some of the least liquid forms of monetary assets, such as buried cash, may be *less* liquid than some of the most liquid forms of credit instruments such as bonds. Thus Rothbard's criterion includes all currency actually held by the individual, plus that which he can retrieve on demand by turning in his warehouse receipts or by digging up his floorboards. It does *not* include assets which can only be *sold* for cash, no matter how easy such an exchange may be to carry out. The total money supply is the sum of all individuals' money holdings. An individual's cash balances are considered to be that cash over which he has title, either through direct possession or through warehouse receipts for some fixed amount of cash retrievable on demand. Cash which the individual loans to another is that other person's money holdings. Valuable liquid assets are considered nonmonetary because they can be turned into money only when someone else depletes *his* money holdings in order to purchase the assets. Thus Rothbard's framework seems to avoid double-counting or undercounting the money supply, and, as he demonstrated in *Amerca's Great Depression,* is also readily applicable to the real world.

In his written comments Kirzner raised a few significant objections to this framework. According to Mises, he argued, a claim for cash is to be treated as money only if that claim *itself* circulates as a medium of exchange, and by this criterion savings deposits do not qualify as money. Kirzner also argued against adding together different components of money as if they were homogeneous into an aggregate money supply and suggested that *if* such aggregation is required we would have to recognize "many degrees of moneyness" weighted according to their liquidities. While much fruitful work is yet to be done in this whole area (for example, what about credit cards or overdraft facilities?) these two papers are an indispensable starting place for any economist intent upon applying Austrian monetary theory to historical analysis.

One of the main topics discussed in the first AES session, operationalism, became the central issue in the second session. Kirzner had discussed Rothbard's contribution in terms of recent literature on defining money, distinguishing between the operationalists (Friedman and Schwartz, Laidler) and the "a priorists." Both, Kirzner explained, are empirical, but "the former define money based on the empirical correlations, while the latter define money based directly on empirical identification of the a priori postulated criterion." (p. 5) The a priori group can be further divided into those who use the "medium of exchange" (Pesek and Saving, Yeager, Mises, Rothbard) and those who use the "liquidity" (Gurley and Shaw, Sayers), criterion. All of these "a priori" approaches which first derive a principle from economic theory and then apply it to history must be sharply contrasted with the operationalist approach which selects a definition of money on the basis of econometric observations of history. In this latter approach money is not a preconceived notion but a "tentative scientific construct to be invented"; that definition which yields the best results is what this group calls money.

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This operationalist approach stems from its underlying positivist methodology, elaborated in Milton Friedman's well-known essay "The Methodology of Positive Economics." This methodology was the primary object of attack in the November session featuring Dr. Mario Rizzo's paper "Praxeology and Econometrics: A Critique of Positive Economics." Rizzo, a recent Ph.D. graduate from the University of Chicago, went to the heart of the positivist method with a number of powerful criticisms, few of which were controversial among the Austrian economists present. For example, Rizzo subjected the positivist claim that prediction is the goal of economics to the positivists' own categorization of all meaningful statements as either "synthetic" or "analytic." What then is the epistemological status of this claim that prediction is the goal? Is it a synthetic statement, a mere record of the fact that prediction has been the goal of scientists (in which case it surely could be otherwise) or is it analytic, a mere linguistic convention? Rizzo further criticized the use of falsifiability as the criterion of meaning and econometric attempts to test economic statements that can only hold ceteris paribus. While some of these arguments have already undermined positivism in philosophy, in economics this is a bold challenge to prevailing methods.

Indeed the Austrian school is most clearly contrasted with other contemporary schools in its methods. Contemporary economics has split into, on the one hand, abstract equilibrium formalizations with little or no connection to the real world, and, on the other, econometric studies with little connection to any theoretical apparatus. The methodological realism of Austrian economics, however, enables it to build a theoretical apparatus that is directly applicable to historical work, to elaborate concepts which are abstract but not unrealistic, to formulate general theoretical statements which are, as Rizzo puts it, "no less about 'reality' than any generally recognized empirical statement." (p. 14)

Professor Ludwig Lachmann attempted to further clarify the unique attributes of the Austrian school in his December AES paper, "An Austrian Stock-Taking: Unsettled Questions and Tentative Answers." He cites three fundamental distinguishing characteristics of "Austrianism": (1) its radical subjectivism, (2) its awareness of many facets of time, and (3) its overriding goal of tracing the source of economic phenomena to the minds of individual economic actors. From (1) arises the Austrians' interest in the subjectivity of expectations, which, like tastes, are in general divergent. "[A]ll economic action is, in the first place, shaped by plans dependent on expectations," (p. 3) but expectations, while relevant to all action, are more important in asset markets than in markets for products. From (2) Lachmann emphasizes the difference between future time and past time. In the discussion Lachmann's rather strong thesis that "[a]ll our knowledge belongs to the past" was challenged by the "anti-nihilists," but it was generally agreed that the *ex ante—ex post* distinction and the importance of time in analyzing capital theory and the growth of knowledge are fundamental to the Austrian approach. From (3) arises the Austrian critique of macroeconomic aggregates that are left unconnected to their roots in individual actions. Lachmann suggested that Austrians try to disaggregate macro variables in order to relate the subclassifications to purposive choice, and gave the development of monetary theory as an illustration of fruitful disaggregation. Many discussants found his specific illustration, which seems to see Keynesian and Hicksian monetary contributions as unambiguous advances over Misesian monetary theory, to be somewhat dubious, but Lachmann's general point that macro aggregates are useless unless tied to individual choice found a more favorable response.

Many of Lachmann's points reflected his persistent advocacy of what we've been calling the "anti-Ricardian" position; however other types of controversies were generated as well. For example, Lachmann's suggestion that Austrians disaggregate macro concepts in order to relate them to individual choices, led to a debate over the most advisable strategy for infusing Austrian ideas into contemporary economics. Some argued that we should expend our scarce intellectual resources building, refining, and applying our own economic theory rather than revising a fundamentally flawed macroeconomics. As a distinct paradigm seeking both recognition and acceptance within an often hostile economic establishment, should Austrians devote more attention and resources to nudging mainstream economics in our direction or to developing our own theoretical system? The two sides of the strategy question, as in the nihilist-Ricardian debate, reflect more a difference of emphasis than of fundamental principle.

This and related strategic questions were the main topics in the January, 1977, strategy session which dealt with a number of papers relevant to the Austrians' attempt to foment an intellectual revolution in academia. Harry Johnson's "Revolution and Counter Revolution in Economics" discussed the factors contributing to the Keynesian wave in the 1930's, whose tide washed the Austrian school into over thirty years of relative obscurity, and the more recent Chicago counter-revolution. (This was the only paper covered without the author's presence.) Louis Spadaro's "Toward A Program of Research and Development for Austrian Economics" made a number of intriguing suggestions for possibly fruitful avenues of scholarship, and made a more contentious case for Austrians devoting less time to refutations of existing fallacies and more to developing Austrian theory itself.

Walter Block contributed two papers, the first, a letter to Professor Armentano that made a cogent case for the division of labor applied to conferences, and the second, a more general case for an activist strategy. The latter, drawing on the examples of other intellectual revolutions from the Fabians to the Chicago school, argued that we sould act as self-conscious professionals in frankly radical opposition to the establishment, from its fundamental methodology to most of its policy implications, and should boldly offer our own journal articles, sympathetic graduate schools and carefully planned conferences. Block's letter was a critique of the Austrian Conference at Hartford arguing that it suffered from trying to combine three kinds of conferences into one: (1) an introductory conference for those as yet unfamiliar with Austrian economics, (2) an advanced seminar for those with a solid understanding of major Austrian economists, and (3) a confrontation conference for debate with non-Austrians.

In his comment on Spadaro's paper Rothbard defended the importance of Austrian critiques of mainstream economics, criticized some of Spadaro's specific suggestions, argued for developing strategy on the basis of a self-consciously Austrian approach, and stressed the need to interact with political and legal philosophy and to apply Austrian theory to history. Finally, he em-

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phasized that the Austrians' greatest needs are institutional: we require a journal, a Society of Austrian Economists, and a favorable graduate department.

Against Spadaro's contention that we should place more emphasis on positive contributions than on repeating critiques of mainstream economics, it was pointed out that in the case of the criticism of central planning the debate has developed, the questions have shifted and thus little needless repetition has taken place.

As another example of criticisms yielding positive theory, a concise exposition of Austrian monetary theory was contained in Richard Ebeling's critique of Hicks' "The Hayek Story," the topic for February. Among the important foci of both Ebeling's paper and the ensuing discussion was the impossibility for the businessman of distinguishing real relative price changes from inflationary monetary effects. Lachmann pointed out the distortionary effects on profits when inflation leads the producer to believe his revenues are higher and his future costs lower than are actually the case. Kirzner argued that Hicks' contention that Austrian business cycle theorists have to take explicit account of lags was mistaken. To the extent that the temporary period in which credit expansion takes place (the period, that is, when the interest rate is artificially lowered) is sufficiently long to allow irreversible capital investment decisions to be made, these production plans cannot be sustained and recession will occur.

Another important issue discussed was the question of anticipating business cycles. Even if a businessman knows Austrian business cycle theory; the credit expansion, by its distortion of relative prices between stages in the structure of production, subsidizes businessmen into lengthening their production processes. Even if he knows that the interest rate is being manipulated he cannot know when the boom will peak and become a recession.

At the March, 1977, AES this last issue was the central point of "The Cluster of Errors," the first of two more contributions from the energetic pen of Walter Block. Austrians emphasize that entrepreneurs invariably err but at the moment of recession there is revealed a *cluster* of errors, a consequence of the reassertion of consumer time preferences as against the distorted interest rate that misled producers into embarking upon overly roundabout production processes. No businessman can foresee when the continual injections of credit cease to depress the interest rate enough to postpone the inevitable recession.

Discussion on the first paper developed into another "nihilist-Ricardian" confrontation, however Block's other paper, "Austrian Monopoly Theory—Once Again" stimulated a classic debate between Israel Kirzner and Murray Rothbard. Kirzner developed the monopoly price theory advanced by their mutual mentor Mises, while Rothbard contended that the only praxeologically meaningful distinction between the 'competitive' and the 'monopolistic' is between freedom of entry and monopolistic privileges granted by the state. Block, in his characteristically entertaining style, defended Rothbard's position, although many discussants felt that he misstated Kirzner's position in many important respects.

While for more familiar controversies like the above there are a variety of different alignments in debate besides the "nihilist-Ricardian" issues, for pathbreaking Austrian innovations there is usually an even greater diversity of opinion. New ideas have to be digested for the first time by each participant, their implications pondered, different possible criticisms raised and these in turn assessed as shifting combinations of protagonists and antagonists engage in a groping process to gradually discover and clarify their own views. Typically the more original the ideas under discussion, the more fluid are the adversary sides in the debate.

At the April session a clear step toward furthering the frontiers of Austrian theory was taken in the highly original paper by Jack High, arising out of some of his preparatory work for his dissertation on market process at UCLA. Austrian economics can be sharply contrasted with the mainstream by its emphasis on the market equilibrating process in a disequilibrium world rather than focusing on the equilibrium state itself. High pursued in some detail the nature of the equilibrating process, distinguishing among three kinds of opportunities that arise when, outside of equilibrium, information is necessarily incomplete: *correct estimation, arbitrage,* and *speculation.* Employing Wicksteedian demand curve analysis (itself a point of controversy in the ensuing discussion), High developed three hypothetical cases to illustrate the differences among these kinds of opportunities for entrepreneurial gain. For case 1, assuming uniform though not necessarily correct price expectations, there is still the opportunity for gain by more *correct estimation* of the proper price. For case 2, assuming divergent expectations of the future price but only one current market price, there arises the possibility for gain by *speculation* but not yet by arbitrage. Then for case 3, he drops the implicit assumption of case 2 that everyone knows what offers everyone else is making, and thus here introduces the possibility for gain by *arbitrage.* The importance of High's contribution lies in its explicit treatment of the complex problems of "false trading," that is, exchanging at disequilibrium prices due to the inherent uncertainty of all actors. As with any pioneering work, many unanswered questions and difficult problems persist, but if this paper is any indication, we can anticipate an important dissertation from Jack High's studies in this area.

On May 10th, the AES wrapped up a second productive year with a meeting honored by the participation of one of the greatest economists and social philosophers of this century, F. A. Hayek. The discussion focused on his most recent, innovative contribution to economics, *The Denationalization of Money,* where Hayek argues that competing private currencies indexed to bundles of commodities would retain stable value through time. Richard Ebeling argued that according to Hayek's own brilliant contributions to monetary theory, the feasibility of indexing a currency, whether public or private, should be highly suspect. No indexing scheme can fully reflect the changes of relative prices that accompany monetary phenomena. Another important issue in the discussion was whether, as Hayek suggested, his scheme could really replace the more traditional precious metals as the widely recognized private media of exchange. Many participants argued that while Hayek's scheme would be preferable to government fiat money, it would be unlikely to beat gold in free competition.

On different issues in these advanced intellectual discussions any proposal is likely to find different adherents and different critics. While "nihilist-Ricardian" controversies recur in a number of different contexts there are not only two

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On the Manipulation of Money and Credit, Ludwig von Mises.

Free Market Press, Dobbs Ferry, NY, 1978, liv, 296 pp., $14.00.

Reviewed by Richard M. Ebeling

In a 1937 *festschrift* in honor of Irving Fisher, John Maynard Keynes insisted that "orthodox theory... is concerned with a simplified world where there is always full employment and where doubt and fluctuations of confidence are ruled out." In addition, he claimed that "the orthodox theory... involves a strict interpretation of the quantity theory of money, namely that P changes in the same proportion as M."

Anyone, however, who is familiar with the 18th century monetary contributions of Richard Cantillon and David Hume and the 19th century contributions of Henry Thornton and John E. Cairnes realizes how far this interpretation of "orthodox theory" is from the truth.

In their studies, many of the classical economists explicitly included an analysis of the short-run effects that monetary expansions and contractions could exert upon employment, output and expectations, as well as prices. Their attempt to follow the short-run steps that would culminate in the long-run consequences led them to doubt the stability of the economic situation created by the initial monetary stimulus. It is true, however, that most of the classical economists focused their attention on the dynamic effects of money upon aggregates—overall output and employment and the general price level. Relative price relationships were usually submerged and regarded as of secondary importance.

The subjectivist revolution, with its emphasis on methodological individualism, opened new vistas for developing a sound microfoundation for the early attempts of Cantillon and Cairnes to explain changes in relative prices that followed in the wake of monetary disturbances.

A valuable contribution towards this goal was made by Ludwig von Mises. The focal point in Mises' theory is the transmission mechanism and the necessarily non-neutral manner in which expansions and contractions influence not merely the *general scale* but also the *relative structure* of prices. In the first and second editions of his *Theory of Money and Credit* (1912;1924), Mises developed what he called the step-by-step approach: the theorist analyzes the microeconomic sequence of events that follows from an increase (decrease) in the quantity of money, given an initial assumption concerning the manner in which the money is injected (withdrawn) and the choices the actors would make about increasing (decreasing) their money demand for the alternative goods.

In the 1920's and early 1930's, Mises published several essays elaborating and refining his theory of money and credit. The most important have recently been translated and published under the title, *On the Manipulation of Money and Credit.* The most valuable work in the volume is his 1928 monograph, "Monetary Stabilization and Cyclical Policy." Following many of the classical economists, Mises defined purchasing power in terms of money's value as it exchanged against the entire array of goods rather than in terms of a statistical "price level." Hence, he focused on the possible variations in the exchange ratios between money and each of the respective market products and how the sequential variations in these individual exchange ratios cumulatively bring about a change in general purchasing power during monetary expansion or contraction.

Thus Mises was critical of Irving Fisher's proposal for stabilizing the "price level" with the use of index numbers. Estimating the purchasing power of money by computing the value of a "basket" of goods tends to totally submerge the monetary influence upon relative prices. It, therefore, could create the impression of stability when, in fact, significant disturbances were occurring.

The non-simultaneous and non-proportional manner in which prices would be affected also implied that every monetary-induced change in prices necessarily brings about distributional effects. Mises argued that under the existing (1928) institutional setting, these distributional effects were not random. Since, almost all increases (decreases) in the quantity of money were funneled through the banking system in the form of investment stimulus (retardation), monetary forces had a tendency to distort the allocation of resources among consumption and production activities. To demonstrate this process, he presents an extended exposition of the Austrian theory of the trade cycle.

Anticipating some aspects of the "rational expectations" literature, Mises pointed out, in a 1933 essay, that a lowering of the money rate of interest will stimulate investment activity only if the new rate of interest is expected to prevail for some time into the future. If, on the other hand, entrepreneurs perceive the interest rate change as the result of policy manipulations on the part of the government, investors will be hesitant to be guided by it and the governmental policy goal will be frustrated.

Five years before the publication of Keynes' *The General Theory,* in a 1931 lecture on "The Causes of the Economic Crises," Mises analyzed a "new idea" that was gaining popularity: the concept of "money illusion." He criticized the belief that trade unions would passively accept a fall in real wages by allowing money wages to remain constant in the face of rising prices. "Labor unions," Mises said, "no longer contend over the height of *money* wages, but over the height of *real* wages."

The availability of these essays and their extreme readability is due to the much to be appreciated work of the translator, Bettina Bien Greaves. Unfortunately, the extended introduction by

Ludwig von Mises in the 1930's

the volume's editor, Percy L. Greaves, cannot be given quite the same high marks. In a section on "Some Misconceptions of the Mises Cycle Theory," Mr. Greaves misinterprets not only some of the critics of the Austrian trade cycle theory, but some of its expositors, as well. Pinpointing these errors is made somewhat difficult due to the editor's cavalier way of referring to authors who "have missed some of the fine, very important points that are part of the Misesian theory" without naming these authors or footnoting any of the works in which these supposed omissions occur.

Two examples can be given where Mr. Greaves is obviously referring to the

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On the Manipulation of Money and Credit (concluded)

writings of F.A. Hayek. In a subsection analyzing the concept of a statistical "price level," Mr. Greaves criticizes an analogy Hayek has sometimes made that monetary expansion is similar to honey flowing into a vessel. Greaves comments that those who have used this metaphor "seem to think that money poured into an economy acts more like honey. It is sticky, and slow to level, but given time, they maintain the 'price level' will rise evenly." Contrary to the impression Greaves creates in this passage, Hayek has always used this analogy to explain exactly why money *will not* affect all prices proportionally, but will have a non-neutral effect upon the relative price structure; though the honey eventually spreads over the entire surface in a ripple-like fashion, as long as the honey is poured in at a particular point a small mound is produced that remains higher than the surrounding area.

In another subsection, Mr. Greaves discusses the "Ricardo Effect" and the erroneous belief that by a union-induced raising of wages in relation to the price of capital, one can stimulate capital formation, while at the same time increasing the relative income share of workers in general. But Hayek's use of the Ricardo Effect was in a totally different context; he was interested in analyzing the changes in the use of input combinations during the phases of monetary-induced trade cycles and *not* the influence of unions on the economy.

But what is most troublesome in Mr. Greaves' contribution to the volume is its general attitude and tone. At times he seems overly concerned with assuring the reader of the almost divine nature of Professor Mises' work. For instance, he refers to "Mises' revelation" and the dust-jacket informs the reader that Mises' *"Human Action* is truly the economics bible for all peoples." Furthermore, deeming it appropriate to include some of his own "popular" essays in the volume (including a rejected letter to the *Wall Street Journal*) Greaves freely talks about the close relationship between "sound economics" and good "Christian morality."

That Mises' contributions have been extremely underrated and that he incisively dealt with many of the theoretical problems that are only now being taken up by the economics profession can hardly be denied. But it is highly questionable whether such a dogmatic tone as Greaves presents is the one most likely to interest economists in the Austrian tradition and Mises' works in particular. It is almost certain that the attitude exemplified by Greaves will tend to discourage interest in the very theories he values so highly.

Calm analysis and willingness to admit that truth may occasionally reside in the other fellow's point of view is more likely to open discussion and gain a fair hearing than terse insistence upon "revelation" and apodictic faith.

Notes and Recollections, Ludwig von Mises.
South Holland, IL: Libertarian Press, 1977, $9.95.

Critique of Interventionism, Ludwig von Mises.
New Rochelle, N.Y.; Arlington House, 1977, $8.95.

Reviewed by Richard M. Ebeling

In the history of economic thought, the zenith of the Austrian school is usually considered to be the 1890's. By this time Menger's original work had been taken over and refined by Wieser and Böhm-Bawerk and had achieved recognition among the world community of economists.

The inter-war period of the 1920's and 1930's, however, was equally important for development of the Austrian tradition. It was the period in which what is usually called the third and fourth generations of the Austrian school made the greater part of their contributions; the time when it was common practice for economists of every nationality to visit Vienna to take part in the university and private seminars of the Austrian economists; and the time when, because of Robbins and Hayek, the London School of Economics had become (in Sir Arnold Plant's words) "a suburb of Vienna."

The most prominent of the inter-war generation of Austrians was certainly Ludwig von Mises. Indeed, almost every important development of the Austrian tradition in the twentieth century seems to have had its impetus from his seminal works. This is what makes Ludwig von Mises' *Notes and Recollections* both a fascinating and valuable work. It is not merely the history of some of the events in a man's life; rather, it is an autobiography of a mind.

Those who are familiar with Professor Mises' style of writing will not be surprised by the tone in which he has penned these notes and recollections. He speaks frankly about the personalities and ideologies of Austria and Germany in the period between the World Wars. Written in 1940, the volume carries in it the despair of the forced exile recently arrived in America. Indeed, throughout the book the air hangs heavy with the intellectual isolation and political pessimism of one who cared deeply about the pursuit of knowledge and the preservation and advancement of human liberty.

Mises found the intellectual caliber of both historians and economists in Germany and Austria far below that of other European nations. Though the members of the German Historical School were supposed to be concerned with history, he considered most of them ignorant of the necessary tools for serious historical research. He also recounts how the University of Vienna economics professors spent most of their time with intrigues among themselves, while the scholastic ability of the students was allowed to languish.

In great despair over these circumstances, Mises writes (in one of the chapters devoted to his monetary theory) that he owed "a great deal to the stimulation of the works of B.M. Anderson, T.E. Gregory, D.H. Robertson, Albert Hahn, Friedrich von Hayek and Fritz Machlup . . . they gave me comfort that I was not alone as an economist and did not work just for the libraries."

But his pessimism over the future of political and economic liberty was just as great as his concern over the future of economic and historical research in central Europe.

Mises tells us that when he "entered the university I saw no possibility of an economic science . . . there was no more consistent follower of historicism than I." Mises also tells us that at the time, "I, too, was a thorough statist." However, his study of history lead to a deep dissatisfaction with the Historical School and their apologism for Prussian State power.

He threw himself into the study of economics and social policy. However, it wasn't until he did research for his university professors on housing conditions and laws pertaining to domestic servants that his political-economic views began to change. "It then dawned on me," says Mises, "that all real improvements in the conditions of the working classes were the result of capitalism; and that social laws frequently brought about the very opposite of what the legislation was intended to achieve." A series of other projects analyzing reform programs finally brought Mises to the classical liberal point of view for which he became known.

In his position in the Austrian Chamber of Commerce from 1909 to 1938 Mises attempted to influence the direc-

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tion of Austrian policy. In *Notes and Recollections* he discusses his writings on various social topics, his role in halting the Austrian inflation of 1923, and his attempts to shore-up the financial and banking disasters of the Austrian government. He concludes in despair, however, that, "I set out to be a reformer, but only became the historian of decline." In fact, he finally came to "regret that I spent my literary efforts on one more refutation of fallacies that had been exploded a hundred times before. I regret that I spent too much of my limited strength on the fight against pseudo-economics ... But time and again my temper led me to get involved."

Though distracted by the politico-economic debates, it was during the period around World War I and the 1920's that Professor Mises was most prolific in producing theoretical works. Three chapters in *Notes and Recollections* are devoted to an explanation of the development of his thoughts on monetary theory over a thirty year period; he also includes an account of the discussions of his *Theory of Money and Credit* in Böhm-Bawerk's seminar and why Böhm-Bawerk disagreed with his arguments on the non-neutrality of money. In another chapter, Mises explains his reluctant decision to enter the discussions over methodology in the social sciences and how he came to his views about the *a priori* character of economic theory.

In the 1920's, Professor Mises also wrote his series of works on "Systems of Social Cooperation," i.e., liberalism, socialism and interventionism. His study on *Socialism* has been in English since the mid-1930's and his exposition of classical liberalism has been available to the English-speaking reader since the early 1960's under the title *The Free and Prosperous Commonwealth.* But the third of these studies, his *Critique of Interventionism,* has only recently been translated and published.

Critique of Interventionism was written in an environment antagonistic toward theoretical economics. Mises often noticed a disdain for both theory and economic laws in advocates of the "mixed-economy." Thus, in the essay, "Social-Liberalism"—an analysis of the ideological and practical arguments for interventionism—Mises quotes one member of the Historical School who admitted, "Schmoller did not care to see his road to scientific justification of social policy blocked by the concept of an external economic regularity independent of man."

Thus, the argument for economic interventionism was somewhat different than the one offered today. Since the 1930's, it has centered around the role and importance of "demand-management" for stabilizing aggregate quantities—output, employment and the "price level"—in the economy.

At a fundamental level, however, Professor Mises' criticisms remain as relevant as when they were first penned. When he defended theoretical analysis against the German Historicists, Mises was, in fact, defending the edifice of microeconomics—the economics of interrelationships between individuals and sectors of the economy. The classical and subjectivist economists had "recognized that laws of the market draw entrepreneurs and owners of the means of production into the service of consumers, and that their economic actions do not result from arbitrariness, but from necessary adjustment to given conditions."

The Historicists, in not analyzing these interrelationships, did not notice the secondary effects of market intervention. Macroeconomists, operating without a sound microeconomic foundation, have not only misunderstood secondary consequences, but have also failed to comprehend the process by which "demand-management" techniques distort relative prices and resource allocation.

In the essays "Interventionism," "The Hampered Market Economy," and the "Theory of Price Control," Mises explains the microeconomic-subjectivist principles that led him to conclude that "in a private property order isolated intervention fails to achieve what its sponsors hoped to achieve."

In perhaps the most fascinating essay in the volume, Mises discusses the phenomena of "Anti-Marxism," which later became German National Socialism. Writing in 1925, he prophetically argues that an attempt to unify the "Aryan race" under a nationalist-militarist banner would have disastrous consequences: "If Germany, a nation surrounded by other nations in the heart of Europe, were to assault in accordance with this principle, it would invite a coalition of all its neighbors into a world-political constellation: enemies all around. In such a situation Germany could find only one ally: Russia .... German Anti-Marxism and Russian Super-Marxism are not too far apart."

It was the correct anticipation of future events in *Critique of Interventionism* that brought Ludwig von Mises to America and the writing of *Notes and Recollections.*

B.R. SHENOY
1905-1978

On February 20, 1978, Professor Bellikath Raghunath Shenoy passed away from a heart attack at his home in New Delhi, India. A leading proponent of Austrian economics in Asia, Professor Shenoy was born in 1905. After receiving his MA from Benares Hindu University and an MSc (Economics) from the London School of Economics, he joined the University of Ceylon in 1936 as a lecturer. From 1942-1946 he was on the faculty at the University of Ahmedabad. During 1948 through 1951, Professor Shenoy was the Far East representative of the International Monetary Fund stationed in Bombay. After 1954 he served as Director and Professor of Economics, University School of Social Sciences, Gujarat University. And until his death he served as director of the Economics Research Center located in New Delhi.

Professor Shenoy's interest in the Austrian tradition dates from 1931 when he attended the lectures of Professor Hayek at the London School, which were published as *Prices and Production.* In 1932, Professor Shenoy wrote a number of articles in the *Quarterly Journal of Economics* criticizing J.M. Keynes' *Treatise on Money* from an Austrian perspective. After returning to India, he specialized in the problems inherent in national planning and currency manipulation. Among his works are *Ceylon, Currency and Banking, Problems of Indian Economic Development, Indian Planning and Economic Development* and *Indian Economic Policy.*

An Interview with Ludwig Lachmann
(continued)

quite sure that the apparent insistence of the "Austrians" that the depression must run its course in the sense that both prices and wages in general must fall seemed to make it increasingly difficult for most other economists to support it, because it was by then obvious that wages didn't fall, not in the Britain of the 1930's anyway. That is to say, there was an obvious difference between the point of view expressed by Hayek, Robbins and their letter of October, 1932, and their willingness to admit the following year that a secondary depression was possible.

A: Besides your work in capital theory, you've also written a book on Max Weber. What got you interested in doing a work on him?

L: Well, anyone who is interested in the methodology of the social sciences must take an interest in Max Weber. I had heard about Weber first at the University of Berlin from my teacher Werner Sombert, who had still known Weber personally, of course. It struck me that what Weber thought and what the Austrians said was more or less the same thing. As you know, Mises admitted that an impetus for his own Neo-Kantian interpretation of the logical part of economics came from Max Weber. In the early years in Johannesburg I read a good deal about Max Weber. And it struck me that his methodology was obviously the Austrian methodology.

A: You've been at New York University for about three years. In that period there has tended to be a revival of the Austrian school and there are now more graduate students who are interested in the Austrian tradition. What prospects do you see for Austrians now?

L: Well, the first steps in the Austrian revival have been taken. How quickly we get on now depends on the Austrians themselves. I think we have broken through the barrier of ignorance, that is to say that state of affairs in which very few economists had ever heard of Austrian economics. I think we are much better known than we were three years ago. From now on everything will depend on how good Austrian economists are, i.e., how readily or how well the Austrians tackle the problems they deal with.

A: What type of problems do you think Austrians will have to tackle and what are the important issues that could enable the Austrians to gain the initiative in the field of ideas?

L: I would agree with a view Hicks has expressed in his paper, "Some Questions of Time in Economics" in the Georgescu-Roegen essays. The most important problems are problems of market structure and certain problems of the effect of technical progress on the capital structure and on the economic structure as a whole. I suppose it doesn't need any great emphasis that if Austrians stress the market process as the central economic process they should take some interest in the way in which the market functions in various parts of the system and in particular in the way in which different markets function. We have learned for instance that there is a difference between asset and commodity markets and that in some markets expectations are more important than in others. All this I think should be developed further, including, of course, the problem of the forward markets, which as it were, has been thrown at us by certain prominent neoclassical figures.

The other is the problem Hicks has been trying to deal with, questions of technical progress in an economy in which most capital goods are durable and where the effects of technical progress only begin to show themselves gradually and only at first in some sectors of the system but not in others. Now this might lead to some revision of the Austrian trade cycle theory, the subject on which I have become somewhat skeptical. It still seems to me that Wicksell's insistence that the trade cycle has something to do with the uneven rate of technical progress in different parts of the system was fundamentally a sound one. And I hope that Austrian economists somehow will find a way to incorporate such views in the Austrian trade cycle theory. As it stands, of course, there is no reference whatever to technical progress. But it is surely clear that in the real world it does matter.

Another problem Austrians should tackle is a critical examination of certain concepts that are used by other economists. The other day listening to Professor Tobin one learned that he thought that there was a good deal of excess capacity at the moment in the American economy. Now, how exactly would one go about measuring that? It seems to me that economists taking some interest in capital problems should take an interest in such matters as excess capacity.

A: Professor Lachmann, how do you think the Austrians should relate to the recent work at Chicago?

L: In the first place we should distinguish between practical matters, theoretical matters and philosophical matters. Now, in practical matters, I take it we can agree. Personally, I am willing to go along with a good deal of the practical recommendations of Milton Friedman—how to combat inflation, for example. And it seems to me that on what he calls the "natural rate of unemployment," he has said a good deal that makes perfectly good sense. But this doesn't mean that we must necessarily agree on the theoretical level. For instance, is the natural rate of unemployment a minimum, which we could all accept, or is it, as it seems to me, both a minimum and a maximum? And there are certain other questions. But I think on the philosophical level a real abyss yawns between at least some of the Chicago thinkers and us.

My impression from reading certain recent Chicago publications such as the famous article, "De Gustibus Non Est Disputandum" (*AER*, March, 1977), is that these economists don't understand the difference between action and reaction.

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sides in these battles. The dozen or so participants in the AES discussions, as befitting those who so often emphasize individual diversity, can be properly divided into no fewer than a dozen or so sides.

Nozick on Methodology

Several years ago, well-respected Harvard philosopher Robert Nozick wrote a critical examination of the methodology of Austrian economics. This careful study "On Austrian Methodology," which was discussed at the April, 1976, meeting of the Austrian Economics Seminar (see the Spring, 1978, *AEN*) has now been published in *Synthese,* a journal of methodology (36 (1977) pp. 353-392). The paper consists of four parts: first, a general analysis of methodological individualism; second, a highly critical treatment of the claim that some fundamental axioms of economics may be known to be true *a priori;* third, a study of Austrian preference and choice theory; and fourth, an examination of time preference theory.

of consumers' goods are determined in this "genuine market," but the "prices" of factors are purely notional "accounting prices" drawn up by a "Central Planning Board" and revised from time to time. Managers of enterprises are instructed to follow two rules: (a) combine factors so as to minimize costs, and (b) choose the scale of output where the price of the product equals its marginal cost. In carrying out these rules, the managers must operate solely on the basis of the "accounting prices," which are revised according to the rule: wherever a surplus of any factor emerges, reduce the price, and wherever a shortage arises, increase the price.

As Hayek pointed out, the system seems to assume that factors of production are grouped into a few classes, with every member of each class being absolutely identical in every respect which ought to affect prices. Yet this cannot be. Many factors are 'one of a kind'—either because they started out that way, or because they have become that way with use. There are machines produced only once, to special order, and there are those which were produced in a large batch of similar pieces, but which are now in varying states of repair. Just what would it mean in such cases to adjust prices by reference to "a physical shortage or surplus"?

Many other insuperable difficulties could be cited,[16] but perhaps the most serious error in the scheme is that it takes "costs" to be objective and publicly inspectable. It assumes that someone can look and see whether the managers are obeying the rules. Ultimately, just like the millions-of-equations notion, the Lange system is based on the premise that there is no real uncertainty, and no need for experimental trial and error.

Profits are made by out-guessing the market, but there is no room for outguessing in a system where salaried officials dutifully follow strict rules. We cannot expect a system where the managers strictly follow unambiguous rules in order to please their superiors, to duplicate the results of a system which relies upon the seizing of opportunities glimpsed only by the seizers. Since the relevant costs are foregone alternatives, it is not possible to establish whether the managers are obeying the rules. As Roberts points out,

> A manager cannot undertake simultaneously all his alternative courses of action. The alternative chosen depends on his judgement of the outcomes of the possible lines of action. A marginal rule directive could only check the ability of a manager to forecast the outcome of the alternative he chooses (in the sense of it being profitable or not) and control the rate of output; it cannot check its relative profitability against the alternatives that were not followed. Therefore a marginal rule directive does not set a manager's task because it does not determine whether he should have chosen the course of action that he chose.[17]

The subjectivity of costs, and therefore the indeterminacy and inapplicability of Lange's rules, was touched upon by Hayek in his 1940 reply to Lange.[18] It was elaborated, with great clarity and force, by Thirlby in 1946 and Wiseman in 1953.[19] These arguments were incorporated in the writings of Roberts and Buchanan—the former addressed mainly to students of Marxism and the Soviet system, the latter to economic theorists.[20] Yet textbook accounts of the economic calculation debate still ignore this whole line of attack.

Apart from the unfeasibility of Lange's system, there is the question of its relation to the traditional aspirations of socialism. Here, it would seem that its ambiguity has been its greatest asset. Seen at the time as a defense of socialism, by definition non-market, it is now seen as a model of "market socialism." It is the meaning of the word "socialism" which has undergone a change. But there are, of course, still many socialists who cling to socialism in the old sense—centrally planned and non-market. It is not many years since the Cuban government attempted to forcibly abolish the market, in much the same way as the Lenin-Trotsky government did up to 1921.[21] The Lange system is all things to all men: to the orthodox Marxists it brings the gratifying news that "socialism" has been shown to be a practical proposition; to the trendy reformers in Eastern Europe, who are abandoning everything their fathers and mothers understood by "socialism," it is also seen as theoretical justification.

In fact, Lange's system is neither a market nor central planning. It is best classified as a *simulated market.* The managers are rule-following automata. The allocation of resources is not decided centrally at all. As Roberts points out, the "Central Planning Board" is not a planning body, since it must fix prices in the way indicated by the managers' actions.

What Lange did was to present two ideas simultaneously, without distinguishing them. This becomes clear if we ask why his managers are not simply ordered to maximize profits—purely notional "accounting profits," naturally. That would be a pretend market. Everyone would pretend that there was a market and act as if there were a market, but there would be no market in actuality. Such a proposal would have immediately prompted the thought that if the pretence were to achieve the same results as the real things, it might have to become the real thing. This notion of a pretend market was obscured by Lange's simultaneous advocacy of the marginal rule. It is only because no one really makes losses that Lange's managers can ignore the pursuit of profits. Discussion of the marginal rule often went on without clearly establishing whether its setting was the real market or a pretend market. By the time the marginal rule was generally seen to be inapplicable, the question of real versus pretend market had lost its urgency: "Market socialism" had arrived.

Lange's scheme was first presented as above all a practical suggestion.[22] Yet it has never been tried and very likely never will be. No one will go to the barricades to replace capitalism with a textbook illustration of capitalism. Today the two most commonly cited refutations of Mises are Lange and the Soviet Union. But the Soviet Union is not practicing the Lange system. We therefore have a "socialist" society without any satisfactory theoretical explanation, and an allegedly practical theory with no real-world application.

(1) Oskar Lange, "On the Economic Theory of Socialism," in B.E. Lippincott (ed.), *On The Economic Theory of Socialism,* McGraw-Hill, New York, 1964.

(2) It would be a great service if someone could publish an 'anti-Lange' volume, bringing together, along with other writings, Hayek, "The Competitive 'Solution'," *Economica,* May, 1940 (Reprinted in Hayek, *Individualism and Economic Order,* University of Chicago Press, Chicago, 1948); G.F. Thirlby, "The Ruler," *South African Journal of Economics,* December, 1946 (Reprinted in J.M. Buchanan and G.F. Thirlvy (eds.) *LES Essays on Cost,* London, 1970) J. Wiseman, "Uncertainty, Costs and Collectivist Economic Planning," *Economica,* May, 1953 (Reprinted in Buchanan and Thirlby, op. cit.); Paul Craig Roberts, "Oskar Lange's Theory of Socialist Planning: An Obscurant of Socialist Aspirations," in *Alienation and the Soviet Economy,* University of New Mexico Press, Albuquerque, 1971;

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CLS Summer Fellows

Left to right: Joe Salerno and Barry Brownstein.

This summer the Center for Libertarian Studies, with the financial support of the Schultz Foundation, has provided fellowships for six young economists. Under the direction of Mario Rizzo, the program has also offered lectures by Murray Rothbard, Leland Yeager, Gerald O'Driscoll and James Buchanan. We are pleased to provide summaries of the work being done by the fellows.

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Frank Arnold, now a second year graduate student at Harvard, has recently researched several areas. As an undergraduate he wrote a senior thesis surveying monopoly theory. Last summer, as a fellow at the Institute for Humane Studies, he read in the areas of methodology, and capital and interest theory. The latter led to a paper, "Some Discussion of Selected Aspects of the Pure Time Preference Theory of Interest," presented at the Austrian Economics Seminar in March.

He is currently studying reswitching and capital reversal with reference to Böhm-Bawerk, and plans to write a critique of recent work in these areas for presentation at the Atlantic Economics Association meetings.

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As noted in the last issue, **Robert Bradley, Jr.,** (graduate student, University of Houston) wrote a paper "Positivism and Praxeology: An Essay on the Philosophy of Economics," which was discussed at the Methodology conference last November. He has since written several more papers. The first, "Market Socialism: A Subjectivist Evaluation," strongly criticized the Taylor-Lerner-Lange revisions of socialist theory and in particular dissected the "trial and error" proposal in light of Misesian entrepreneurship.

Another paper, "Ludwig von Mises: His Life and Contributions," summarized Mises' contributions to economic theory, including some implicit themes that Hayek later developed. Finally in "Say's Law and the Business Cycle: Keynes and his Critics," Bradley explored the complementary relationship of business cycle theory and Say's law, Keynes' rejection of this integration, and Hayek's microeconomic alternative to Keynes' macroeconomics.

Bradley is presently examining the Mises-Hayek business cycle integration of money and price theory with particular emphasis on the difference between these two "mal-investment" theorists. He will then consider recent objections to this theory which some Austrians have raised. Finally, he plans to critically examine orthodox literature on inflation and stagflation which attempts to explain recent empirical developments.

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Barry Brownstein (Economics Department, Fairleigh Dickinson University) is writing a paper critical of the mainstream economic arguments that government subsidy or provision of goods or services should be furnished if the good generates external benefits or has public goods properties. The orthodox approach, if true, would have far-reaching consequences since nearly all goods have external effects. In his criticism, Brownstein is incorporating Austrian insights including the subjective nature of costs. He further hopes to demonstrate that the role of transaction costs in the market is misinterpreted in mainstream literature.

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Don Lavoie is studying socialist economics both in preparation for a field exam at New York University and as background for a dissertation. He is concentrating on the contrast between Marxian socialism (the complete abolition of commodity relations), and modern "market socialist" theories which try to combine the market with elements of central planning. The Austrian school and Marx agree that markets, and the price system in particular, are incompatible with central planning and would both argue that market socialism is a misguided attempt to combine irreconcilable socioeconomic systems. Lavoie is also studying the Marxian economics of the Japanese scholar Kozo Uno and is especially interested in the "Austro-Marxists" (e.g., Otto Bauer and Rudolf Hilferding) who, along with the Russian revolutionary Nicolai Bukharin, were significantly influenced by Böhm-Bawerk and the Austrian school.

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Joe Salerno is completing his doctoral dissertation (Rutgers University, New Brunswick). Entitled "The Doctrinal Antecedents of the Monetary Approach to Balance of Payments: From Isaac Gervaise to Ludwig von Mises," it covers the period 1720 to 1925. He stresses economists who either emphasized the microeconomic foundations of balance of payments theory or studied market process as opposed to comparative statics.

His study of eighteenth century writers focuses on six individuals who originated and developed the monetary approach: Isaac Gervaise, Cantillon, Vanderlint, Hume, Joseph Harris and Adam Smith. Salerno's treatment of the nineteenth century is a study of four controversies revolving around, first, the Bullionists, Ricardo and Thornton; second, the Currency and Banking Schools; third, Mill, Senior and Cairnes; and finally Taussig, Wicksell and Jacob Hollander. He concludes with a study of Ludwig von Mises' *Theory of Money and Credit* which he sees as the capstone of the tradition.

Salerno will join the faculty of the Economics Department of Rutgers, Newark in the fall.

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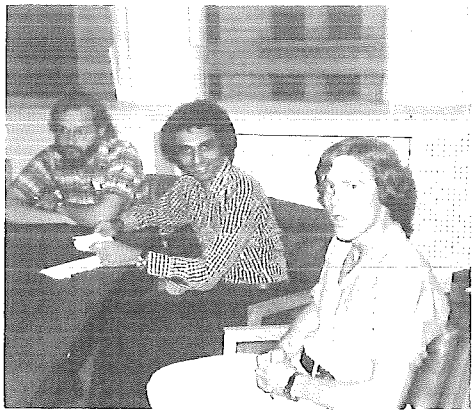

Left to right: Don Lavoie, Mario Rizzo and Frank Arnold.

Lawrence H. White, a second year graduate student (UCLA) has recently revised for possible publication a paper relating the decision-theoretic ideas of Shackle to certain questions in moral philosophy. He is presently writing a

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Two Meetings Stress Entrepreneurship

The recent **American Economic Association's** meetings included a session on entrepreneurship. The session, held on August 31, was presided over by J. Fred Weston (UCLA). The papers presented were: "Rational Expectations and Entrepreneurship," Gerald O'Driscoll (NYU); "Knight's Theory of Uncertainty: A Reconstruction," Mario Rizzo (NYU); "Alertness, Luck, and Entrepreneurship," Israel Kirzner (NYU). T.W. Schultz (Chicago) and J. Huston McCulloch (Boston College) were the discussants.

The **Southern Economic Association's** forthcoming meetings will also include a session of interest to Austrians. Entitled "Entrepreneurship and Economic Activity," the session will begin at 8:30 AM in the Edison Room of the Washington Hilton Hotel (Washington, D.C.) on Thursday, November 9th. The panel will be chaired by John Formby (UNC-Greensboro). The included papers are: Lawrence White (UCLA), "Entrepreneurship and Market Adjustment"; Israel Kirzner (NYU), "Entrepreneurship, Choice, and Freedom"; J.R.T. Hughes (Northwestern), "The Entrepreneur in American History." Commenting on the papers will be Gerald O'Driscoll (NYU), Charles Meyer (Iowa State), and M. Bruce Johnson (UC-Santa Barbara).

CLS Summer Fellows
(Continued)

summary and commentary on Hayek's *Pure Theory of Capital* from notes compiled from his participation in the UCLA study group.

White is preparing a paper on entrepreneurship which will critique mechanistic models of price adjustment. The paper will be delivered at the November meetings of the Southern Economics Association.

He also has two tentative projects in mind: first, a paper on the capital theoretic basis of the economics of Keynes, and, second, an econometric implementation of Ronald Findlay's "An Austrian Model of International Trade and Interest Rate Equilibrium" (forthcoming in *JPE*). For the latter he needs help locating data on investment periods (the temporal length of production processes) and capital-labor ratios in the production of internationally-traded intermediate and final goods.

Austrian Economics at Rutgers University

This fall Rutgers University at Newark, New Jersey, has initiated a very promising undergraduate program in Austrian economics. Developed through the tireless efforts of Richard Fink, it will become an integral part of the Economics Department, thus complementing the already diverse faculty. New Austrians on the faculty are Richard Fink and Joseph Salerno. And Walter Block has returned to Rutgers after a year on sabbatical. In addition lectures by prominent economists will be offered on a regular basis and a major Austrian conference will be held in April. Of great importance to the program is the funding provided by the Fred C. Koch Foundation which will make possible scholarships for promising students.

Richard Fink, who taught part time last year at Rutgers, is himself a graduate of Rutgers. Holding a Masters degree from UCLA he is now pursuing a PhD at NYU and will soon begin a dissertation involving an empirical study of the Hayekian business cycle theory. Joe Salerno is now completing his PhD from Rutgers at New Brunswick where he specialized in international trade theory. (A summary of his dissertation appears on page 13.) Dr. Walter Block's Columbia dissertation was a study on rent control. Though he has been teaching at Rutgers for several years, he spent last year on sabbatical studying privatization of roads. Classes expected to be offered include Social Control of Business, Law and Economics and a seminar in Austrian economics.

Rutgers, Newark, already has a well-developed economics program which provides a strong grounding in neoclassical theory and quantitative methods. Exposure to a variety of viewpoints is assured by the faculty which includes professors in the Keynesian, Chicago and Marxist traditions. The economics program is part of a department which also includes respected programs in business administration and accounting. Strong ties have been developed to the business community.

The editors feel that this program is the most promising of its kind for students with an interest in Austrian economics. There are a few other undergraduate schools which encourage study in Austrian economics, but they often fail to prepare students for graduate work. In contrast, the program at Rutgers was established to equip Austrian students for graduate work. Thus students will be expected to become proficient in contemporary economic theory and mathematical methods.

While Rutgers has a nicely developed campus, it is in inner city Newark. Nevertheless there are quite pleasant nearby suburban areas where many students live. The campus is also only a few minutes from New York City, the location of many Austrian activities.

Lange's Theory of Socialism
(continued)

G. Warren Nutter, "Markets Without Property: A Grand Illusion," in N. Beadles and L. Drewry Jr. (eds.), *Money, the Market and the State,* University of Georgia Press, Athens, 1968.

(3) Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth," in Hayek (ed.) *Collectivist Economic Planning,* Routledge, London, 1935.

(4) Mises, *Socialism, An Economic and Sociological Analysis,* Cape, London, 1969.

(5) On this see Roberts, *Alienation and the Soviet Economy.*

(6) See Mises, *Omnipotent Government,* 204-05.

(7) In 1919 two outstanding socialist theoreticians published works advocating a marketless, moneyless society. Otto Neurath, *Durch die Kriegswirtschaft zur Naturalwirtschaft,* Munich (Through the war economy to the natural economy) and Otto Bauer, *Der Weg zum Sozialismus,* Vienna (The Road to Socialism).

(8) Mises, "Economic Calculation," 112-16.

(9) Enrico Barone, "The Ministry of Production in the Collectivist State," in Hayek, *Collectivist Economic Planning,* 286-88.

(10) David Masters of the University of Hull Computer Centre informs me that with present techniques the solution of one million simultaneous linear equations would take about 300 years.

(11) H.D. Dickinson, *The Economics of Socialism,* Oxford, 1939. Abba Lerner, *The Economics of Control.*

(12) On this point, see especially Roberts, op. cit.

(13) Lange, op. cit., 73.

(14) Lange, "The Computer and the Market," in C. Feinsten (ed.) *Capitalism, Socialism and Economic Growth,* Cambridge University Press, 1967, 158.

(15) Lange, "On the Economic Theory of Socialism, "73.

(16) Hayek, "The Competitive 'Solution'," passim.

(17) Roberts, *Alienation,* 98.

(18) Hayek, op. cit., 196.

(19) Thirlby, "The Ruler." Wiseman, "Uncertainty, Costs and Collectivist Economic Planning."

(20) Roberts, *Alienation and the Soviet Economy.* Buchanan, *Cost and Choice,* Markham, Chicago, 1969.

(21) See Robert M. Bernardo, *The Theory of Moral Incentives in Cuba,* University of Alabama Press, 1971.

(22) Lange, op. cit., 64.

An Interview with Ludwig Lachmann
(concluded)

They seem unwilling to admit that there is such a thing as spontaneous action in the world. For if there is such a thing as spontaneous action, then it will also take place in the economic field. And if it does take place in the economic field, then it evidently cannot be predicted. Chicago economists seem wedded to the notion that prediction will make everything come true, it is by means of prediction and predictive tests that we are able to distinguish that which is true in the end from that which is not true. But in a world in which spontaneous action exists, such action evidently cannot be predicted. So, I do feel it is very difficult to see how we can possibly agree with them on such matters.

It seems to me to follow from the Austrian rejection of prediction as a test of theories that, again, contrary to the Chicagoans, we have to be very careful about what assumptions we are making because if we have made assumptions which are unrealistic, we will get results which are unrealistic. In Chicago they don't seem to be interested in what assumptions they make as long as they have the possibility of prediction. It seems to me that we must be very careful of the realism of our assumptions and Austrians should in general insist on precisely this.

A: How do you see the relationship of the Keynesians to the Austrians?

L: Now, this is a bit more difficult because the question arises, "Who now are the Keynesians?" I did notice that a certain economist whom I always thought was a Keynesian has described himself as a nonmonetarist. So, it seems to me, that Austrians and Keynesians have certain things in common. They have a common methodology, which in the case of the Austrians is laid down of course in Mises' *Human Action.* And which I would say so far as Keynes was concerned is expressed as you know succinctly in the famous letter to Roy Harrod of July 16, 1938, that I have quoted several times: "Economics is not a natural science. It has to deal with human purposes." That as it were unites us with the Keynesians as against certain other economists, this kind of subjectivism. What also I take it we have in common is a general interest in the facts. After all, we are living in the same world, and it is assumed we accept that facts matter; a proposition which in Chicago doesn't seem to be so readily accepted. But if we admit that facts matter, then we should be able to establish those facts.

A: You mentioned the comment by Keynes in which he made a methodological statement. In fact most Keynesians, at least in the United States, follow a methodology that limits itself to a study of averages and aggregates. Is it possible to see this relationship when, in fact, they for the most part operate with a methodological holism?

L: I don't know what you have in mind, and then of course the question again arises who is a Keynesian? I would point out, for instance, that in a book like Paul Davidson's *Money and the Real World,* subjectivism is after all present. I wouldn't know any good examples of what you call methodological holism. The mere fact that someone deals with macroaggregates does not necessarily mean that he is not methodologically an individualist. This was, I think, brought out quite well by Frank Hahn, in his famous critique of Friedman. I would say the mere fact that some economists are interested in macroaggregates does not necessarily impair their methodological subjectivism. It still leaves the avenue open for explaining the phenomena pertaining to macroaggregates ultimately in terms of human motives, as, for instance, Keynes did himself when he tried to split up the demand for money (money as a macro-aggregate) into the famous motives. That was an attempt at subjectivism, at least.

A: One theorist who has said that he comes out of a Keynesian tradition is Shackle, and he says that he is trying to develop the subjectivism that he sees in Keynes, in particular Keynes' thoughts on expectations. What relationship do you see between Shackle's work and that of the Austrians?

L: I can think of no one more distinguished or important to the fundamental Austrian ideas than Shackle. Whether he wishes to identify himself with Austrian economics or not, or whether he prefers to rather not be associated with any particular kind of school, is an attitude one certainly can appreciate. I regard Shackle as, in fact, an Austrian.

A: Did you have the opportunity to get to know Shackle well in your London School days?

L: Reasonably well, I would say. We were both research students under Hayek for two years between 1935 and 1937. We certainly talked very often. Also, these years include the crucial year 1936, in which *The General Theory* was published.

A: Professor Lachmann, the Austrians have always emphasized the importance of the price mechanism in disseminating information and as an allocative tool for efficient resource utilization in an economy. The western world is now facing the situation in which an important price is more and more inflexible downwards; i.e., wages, particularly in England. What types of policy recommendations or what types of theoretical insights can an Austrian give in a world in which wages are rigid downwards?

L: All one can say of course is that it would be better if wages were not as rigid as they are, and I think Austrian economists should tell everybody who is willing to listen to them that wages that are inflexible downwards are not in the interests of society and not in the interests of the workers concerned; that in a market economy it is not the path of wisdom never to reduce the price of what one has to sell.

A: A collection of your essays has recently been published. Perhaps you would like to say a word or two about it.

L: The collection of essays, *Capital, Expectations and the Market Process,* is of course a selection of articles I have written, the earliest from 1940, "A Reconsideration of the Austrian Theory of Industrial Fluctuations." I think that in general these articles reflect both my reaction to the Keynesian economics as well as my growing disenchantment with what was called orthodox or mainstream economics. I do take some pride in an article which will be included that originally came out in February, 1943, "The Role of Expectations in Economics as a Social Science." Before 1942 when I wrote the article it had not become clear to me that the introduction of expectations into economics would mean a major revision of economic theory. And this has been one of the themes on which I have written since 1943. That is to say, fundamentally, the incompatibility of a world in which spontaneous action exists and expectations are as subjective as preferences are.

A: What plans do you have for the near future? Do you have any books in particular that you are working on or will you just continue to write in this vein?

L. No, I just intend to write in this vein as long as I am permitted to.

A: Well, I can assure you, Professor Lachmann, that we all hope that you come back to New York frequently after your stay in South Africa and enable us to further learn from you and enjoy your company. Thank you very much.

S.C. Littlechild, *The Fallacy of the Mixed Economy: An Austrian Critique of Conventional Mainstream Economics and of British Economic Policy*

Institute of Economic Affairs, London, 1978, 86 pp., $4.95

Reviewed by Gary G. Short

In discussions with other economists, Austrians are often able to generate interest in their unique insights into economic problems. In such situations it is often helpful to suggest a concise body of literature which clarifies the Austrian approach to economics and explains the underlying similarities and differences between Austrian economics and neo-classical economics. Unfortunately, it is often difficult to convince other economists to thoroughly examine such comprehensive works as *Human Action* or *Man, Economy and State.* Moreover, because the transition between Austrian and neo-classical economics is not easily made for someone not familiar with both approaches, neo-classical economists often seem to have difficulty understanding Austrian concepts and a corresponding tendency to underestimate the insights provided by the Austrian framework. It might also be added that Austrians have not always presented their views in a manner which would catch the interest of other economists.

Steve Littlechild's recent work, *The Fallacy of the Mixed Economy,* is a noteworthy attempt to eliminate this communication gap. He carefully lays out the major tenets of the Austrian framework and examines their significance in light of contemporary neo-classical thought. And, he does so in a manner which is conducive to opening discussion between the two points of view. His well-measured, non-polemical work provides an excellent introduction to Austrian economics.

Littlechild (Professor of Commerce, University of Birmingham) is one of a growing number of British economists who have begun to seriously explore the Austrian tradition. He has participated in several Austrian conferences in the last few years and recently spent a month at NYU, taking part in various Austrian functions and profiting from discussions with Professors Lachmann and Kirzner.

In *The Fallacy of the Mixed Economy,* Littlechild examines two principal questions: "What is Austrian economics?" and "What does it have to say about the current policies of the British government toward industry?" He devotes equal weight to each and, while the latter is directed primarily to a British audience, his remarks are certainly relevant for any discussion of the role of government in the economy. In addressing the first question, he briefly discusses the history of the Austrian school and then explains the distinguishing characteristics of Austrian economics which he contrasts with neo-classical economics.

Littlechild identifies the twin pillars of Austrian economics as thoroughgoing subjectivism (not just subjective tastes, but also expectations, alertness, knowledge of opportunities, and interpretations of events and actions) and methodological individualism. He also finds the emphasis on the market as a process to be the heart of Austrian economics, and he contrasts this with the neo-classical focus on competitive equilibrium at a point in time, characterized by perfect knowledge. Littlechild notes that while neo-classical economics pays lip-service to the principles of methodological individualism and subjectivism, their emphasis on perfect information actually allows very little role for a market process. In a world of perfect knowledge there is no room for the entrepreneur and thus questions concerning *how* prices become known and hence *how* a competitive equilibrium is brought about do not arise. In contrast, the Austrians focus on the market as a device for transmitting information and facilitating the coordination of plans—stressing the role of the entrepreneur.

The second half of *The Fallacy of the Mixed Economy* deals with the role of government in the economy. As mentioned, the discussion centers around British policies, but most of the argument is couched in terms which are applicable to any country. Further, much of Littlechild's analysis is a critique more of welfare economics than of particular governmental policies. He also offers a critical examination of James Meade's *The Intelligent Radical's Guide to Economic Policy: The Mixed Economy.* (Meade shared the most recent Nobel Prize in Economics.)

Littlechild notes that allegations of market failure are often based on the lack of information possessed by market participants. However, he argues that it is illegitimate to assume that government policy makers will have the requisite information to correct cases of market failure. Further, citing the public choice literature, he questions whether policy makers would have the appropriate incentives to eliminate market failure even if they had the necessary information. Littlechild also observes that the rules which are offered as ways of inducing the government to act efficiently are often fraught with difficulties, many of which become clear when one emphasizes subjectivism. In particular, he singles out the idea that nationalized industries should set price equal to marginal cost as an inappropriate rule which assumes that "the relevant products, demands, resources, resource prices, and techniques are 'given'," thus essentially making costs objective. (p. 53)

The failure of Britain's national economic planning is also considered. Littlechild argues that mainstream economics is not well equipped to examine why indicative planning has failed to live up to its expectations: "A framework of general equilibrium which assumes perfect knowledge cannot hope to explain a situation whose very essence is *lack* of knowledge." (p. 68) In contrast, the Austrians have long stressed the importance of uncertainty and the wide dispersion of knowledge within an economy. Indeed, one of Hayek's most important contributions to economics was his work in the 1930's and 1940's on the role of knowledge in society—a theme to which he has often returned.

In a work which concisely covers as much ground as *The Fallacy of the Mixed Economy,* there are naturally certain aspects which one might wish to see handled differently. Littlechild is a little too inclined to lump the property rights work of Coase, Demsetz and Alchian in with the Austrians. While there is certainly much to be admired in their writings (and much that is consistent with an Austrian approach) it is questionable whether Alchian and Allen's *University Economics* should be categorized as an "Austrian textbook." (p. 11) And, after offering a very clear explanation of the relationship and difference between economic theory and value judgments (see expecially pp. 42-43 and p. 71), Littlechild seems far too comfortable discussing "Austrian policy." While the value judgments necessary to get from Austrian theory to Austrian policy may be few in number and command wide assent, no policy conclusions follow directly from Austrian economics. It is certainly possible for Austrians to agree about the analytical aspects of an economic problem yet disagree about policy recommendations because they possess different value systems.

In spite of these problems, *The Fallacy of the Mixed Economy* is an extremely valuable additon to the Austrian literature. While it is certainly true that many of the points made by Professor Littlechild have been made by others, his concise treatment of such a wide body of literature is admirable. Further, the fact that this work is written in a manner which is readily understandable by non-Austrian economists makes it particularly welcome. Littlechild's arguments are cogent and well-measured—an ideal introduction to Austrian economics.