

FREEMarket

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WHAT IS THE FREE MARKET?

Murray N. Rothbard

Murray N. Rothbard (1926–1995) was dean of the Austrian School of economics and vice president for academic affairs of the Mises Institute.

The free market is a summary term for an array of exchanges that take place in society. Each exchange is undertaken as a voluntary agreement between two people or between groups of people represented by agents. These two individuals (or agents) exchange two economic goods, either tangible commodities or non-tangible services.

Thus, when I buy a newspaper from a news dealer for fifty cents, the news dealer and I exchange two commodities: I give up fifty cents, and the news dealer gives up the newspaper. Or if I work for a corporation, I exchange my labor services, in a mutually agreed way, for a monetary salary; here the corporation is represented by a manager (an agent) with the authority to hire.

Both parties undertake the exchange because each expects to gain from it. Also, each will repeat the exchange next time (or refuse to) because his expectation has proved correct (or incorrect) in the recent past. Trade, or exchange, is engaged in precisely because both parties benefit; if they did not expect to gain, they would not agree to the exchange.

This simple reasoning refutes the argument against free trade typical of the “mercantilist” period of sixteenth- to eighteenth-century Europe, and classically expounded by the famed sixteenth-century French essayist Montaigne. The mercantilists argued that in any trade, one party can benefit only at the expense of the other, that in every transaction there is a winner and a loser, an “exploiter” and an “exploited.”

We can immediately see the fallacy in this still-popular viewpoint: the willingness and even eagerness to trade means that both parties benefit. In modern game-theory jargon, trade is a win-win situation, a “positive-sum” rather than a “zero-sum” or “negative-sum” game.

How can both parties benefit from an exchange? Each one values the two goods or services differently, and these differences set the scene for an exchange. I, for example, am walking along with money in my pocket but no newspaper; the news dealer, on the other hand, has plenty of newspapers but is anxious to acquire money. And so, finding each other, we strike a deal.

Two factors determine the terms of any agreement: how much each participant values each good in question, and each participant’s bargaining skills. How many ➡



cents will exchange for one newspaper, or how many Mickey Mantle baseball cards will swap for a Babe Ruth, depends on all the participants in the newspaper market or the baseball card market—on how much each one values the cards as compared to the other goods he could buy.

These terms of exchange, called “prices” (of newspapers in terms of money, or of Babe Ruth cards in terms of Mickey Mantles), are ultimately determined by how many newspapers, or baseball cards, are available on the market in relation to how favorably buyers evaluate these goods. In shorthand, by the interaction of their supply with the demand for them.

Given the supply of a good, an increase in its value in the minds of the buyers will raise the demand for the good, more money will be bid for it, and its price will rise. The reverse occurs if the value, and therefore the demand, for the good falls. On the other hand, given the buyers’ evaluation, or demand, for a good, if the supply increases, each unit of supply—each baseball card or loaf of bread—will fall in value, and therefore, the price of the good will fall. The reverse occurs if the supply of the good decreases.

The market, then, is not simply an array, but a highly complex, interacting latticework of exchanges. In primitive societies, exchanges are all barter or direct exchange. Two people trade two directly useful goods, such as horses for cows or Mickey Mantles for Babe Ruths.

But as a society develops, a step-by-step process of mutual benefit creates a situation in which one or two broadly useful and valuable commodities are

chosen on the market as a medium of indirect exchange. This money-commodity, generally but not always gold or silver, is then demanded not only for its own sake, but even more to facilitate a re-exchange for another desired commodity.

It is much easier to pay steelworkers not in steel bars, but in money, with which the workers can then buy whatever they desire. They are willing to accept money because they know from experience and insight that everyone else in the society will also accept that money in payment.

The modern, almost infinite latticework of exchanges, the market, is made possible by the use of money. Each person engages in specialization, or a division of labor, producing what he or she is best at. Production begins with natural resources, and then various forms of machines and capital goods, until finally, goods are sold to the consumer.

At each stage of production from natural resource to consumer good, money is voluntarily exchanged for capital goods, labor services, and land resources. At each step of the way, terms of exchanges, or prices, are determined by the voluntary interactions of suppliers and demanders. This market is “free” because choices, at each step, are made freely and voluntarily.

The free market and the free price system make goods from around the world available to consumers. The free market also gives the largest possible scope to entrepreneurs, who risk capital to allocate resources so as to satisfy the future desires of the mass of consumers as efficiently as possible. Saving and investment can then develop capital

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goods and increase the productivity and wages of workers, thereby increasing their standard of living. The free competitive market also rewards and stimulates technological innovation that allows the innovator to get a head start in satisfying consumer wants in new and creative ways.

Not only is investment encouraged, but perhaps more important, the price system, and the profit-and-loss incentives of the market, guide capital investment and production into the proper paths. The intricate latticework can mesh and “clear” all markets so that there are no sudden, unforeseen, and inexplicable shortages and surpluses anywhere in the production system.

But exchanges are not necessarily free. Many are coerced. If a robber threatens you with “Your money or your life,” your payment to him is coerced and not voluntary, and he benefits at your expense. It is robbery, not free markets, that actually follows the mercantilist model: the robber benefits at the expense of the coerced. Exploitation occurs not in the free market, but where the coercer exploits his victim. In the long run, coercion is a negative-sum game that leads to reduced production, saving, and investment, a depleted stock of capital, and reduced productivity and living standards for all, perhaps even for the coercers themselves.

Government, in every society, is the only lawful system of coercion. Taxation is a coerced exchange, and the heavier the burden of taxation on production, the more likely it is that economic growth will falter and decline. Other forms of government coercion (e.g., price controls or restrictions that prevent new competitors from entering a market) hamper and cripple market exchanges, while others (prohibitions on deceptive practices, enforcement of contracts) can facilitate voluntary exchanges.

The ultimate in government coercion is socialism. Under socialist central planning the socialist planning board lacks a price system for land or capital

goods. As even socialists like Robert Heilbroner now admit, the socialist planning board therefore has no way to calculate prices or costs or to invest capital so that the latticework of production meshes and clears.

The Soviet experience, where a bumper wheat harvest somehow cannot find its way to retail stores, is an instructive example of the impossibility of operating a complex, modern economy in the absence of a free market. There was neither incentive nor means of calculating prices and costs for hopper cars to get to the wheat, for the flour mills to receive and process it, and so on down through the large number of stages needed to reach the ultimate consumer in Moscow or Sverdlovsk. The investment in wheat is almost totally wasted.

Market socialism is, in fact, a contradiction in terms. The fashionable discussion of market socialism often overlooks one crucial aspect of the market. When two goods are indeed exchanged, what is really exchanged is the property titles in those goods. When I buy a newspaper for fifty cents, the seller and I are exchanging property titles: I yield the ownership of the fifty cents and grant it to the news dealer, and he yields the ownership of the newspaper to me. The exact same process occurs as in buying a house, except that in the case of the newspaper, matters are much more informal, and we can all avoid the intricate process of deeds, notarized contracts, agents, attorneys, mortgage brokers, and so on. But the economic nature of the two transactions remains the same.

This means that the key to the existence and flourishing of the free market is a society in which the rights and titles of private property are respected, defended, and kept secure. The key to socialism, on the other hand, is government ownership of the means of production, land, and capital goods. Thus, there can be no market in land or capital goods worthy of the name.

Some critics of the free market argue that property rights are in conflict with “human” rights. But the critics fail to realize that in a free-market system, every person has a property right over his own person and his own labor, and that he can make free contracts for those services. Slavery violates the basic property right of the slave over his own body and person, a right that is the groundwork for any person’s property rights over nonhuman material objects. What’s more, all rights are human rights, whether it is everyone’s right to free speech or one individual’s property rights in his own home.

A common charge against the free-market society is that it institutes “the law of the jungle,” of “dog eat dog,” that it spurns human cooperation for competition, and that it exalts material success as opposed to spiritual values, philosophy, or leisure activities. On the

contrary, the jungle is precisely a society of coercion, theft, and parasitism, a society that demolishes lives and living standards.

The peaceful market competition of producers and suppliers is a profoundly cooperative process in which everyone benefits, and where everyone’s living standard flourishes (compared to what it would be in an unfree society). And the undoubted material success of free societies provides the general affluence that permits us to enjoy an enormous amount of leisure as compared to other societies, and to pursue matters of the spirit. It is the coercive countries with little or no market activity, notably under communism, where the grind of daily existence not only impoverishes people materially, but deadens their spirit. ■

This article was written for the Concise Encyclopedia of Economics.

WHAT ECONOMICS IS NOT

Llewellyn H. Rockwell, Jr.

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The most common misunderstanding about economics is that it is only about money and commerce. The next step is easy: I care about more than money, and so should everyone, so let’s leave economics to stock jobbers and money managers and otherwise dispense with its teachings. This is a fateful error, because, as Mises says, economics concerns everyone and everything. It is the very pith of civilization.

There is a confusion sown by economists themselves, who postulate something called “economic man” who

possesses a psychological propensity to always behave in ways that maximize wealth. Their mathematical models, predictions, and analysis of policy are based on this idea.

In the real world, however, we know this not to be the case. The world, as we know, also involves profit seeking but also extraordinary acts of charity, sacrifice, nonpecuniary giving, and voluntarism (though I dislike that term since

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News from the Institute

The Rothbard Histories are Back!

After many years of waiting, the Mises Institute secured the printing rights to Murray Rothbard's last great treatise: *An Austrian Perspective on the History of Economic Thought*. Many students, professionals, and faculty have waited years for them to become available. They were initially published at a forbidding price, but thanks to generous donations to the cause, the Mises Institute will make them affordable at a price of \$50 for two large volumes.

Many scholars believe this was his most important work. The irony is that it is not the work it was supposed to be, and thank goodness. He was asked to do a short overview of the modern era. He ended up writing more than 1,000 pages of original ideas that remade the whole of intellectual history up through the late 19th century.

In the course of this, Rothbard heralds the contributions of economists who are little known today, such as Juan de Mariana, A.R.J. Turgot, and Richard Cantillon. His demolition of Karl Marx is more complete and in-depth than any ever published.

The number of insights in these volumes are countless. Rothbard seems to have read everything. His originality is overwhelming. His passion for liberty and integrity in science is evident. His disdain toward those who sell out to the state is manifest as well.

You will find these volumes to be among the most intellectually edifying that you have ever encountered. We thought this day would never arrive, but we are so pleased that they will be available in the spring. ■

Short Takes

Of the many thousands of possible winners in the world, the Mises.org blog was chosen by the Weblog Awards as one of the top 15 best. In the voting process that followed, the blog came in a very high 4th place, beating many of the more establishment blogs. Thank you to all our readers!

Other books to look for this spring and summer are: *Money, Bank Credit, and Economic Cycles* by Jesús Huerta de Soto, *For a New Liberty* by Rothbard, *The Complete Libertarian Forum*, *The Economics and Ethics of Private Property* by Hans-Hermann Hoppe, *A Study Guide to Man, Economy, and State* by Robert Murphy, *Making Economic Sense* by Rothbard, *The Essential Rothbard* by David Gordon, and—we are very pleased to say—Guido Hülsmann's intellectual biography of Mises (about which much more later).

This winter the top selling items in our catalog were the full set of Austrian t-shirts, *What Has Government Done to Our Money?* by Murray Rothbard, *Speaking of Liberty* by Lew Rockwell, *Economics for Real People* by Gene Callahan, and *The Quotable Mises*, edited by Mark Thornton. And here's an interesting item: you can buy the entire Mises Institute book catalog contents for \$2,000!

The Mises Institute needs to acquire a piece of software to make our website even faster and more robust. It is MS-SQL 2005, a piece of database software that will cost \$6,000. If you are interested in assisting with this named giving opportunity, or any other particular projects that the Institute is currently undertaking, write our development office at giving@mises.org. ■

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all commercial exchanges are voluntary too!).

How to account for these? The Austrian approach to economics dispenses with the idea of “economic man,” or rather broadens the meaning of economics to include all action, which takes place in a framework of scarcity. Scarcity requires that we economize on something in all that we do, even when wealth is not the motivation. For this reason, Austrians analyze acting individuals, not maximizing prototypes.

Why is this important? A common complaint against the free market is that it needs to be supplemented by laws that restrict the power of materialism unleashed. The market does “greed” well, people admit, but we need government to provide charity, order, law, and restraint of all sorts, as if these areas lie outside the domain of economics.

The truth is that a theoretical structure that explains stock markets but not charity auctions, chain stores but not church attendance, savings rates but not child rearing, has no claim to be a universal theory at all.

This is why the Rothbard article in this issue is so important. He defines the free market as integral to an entire theory of a free society that is ordered and developed through cooperative action of all its membership. That action is not conditioned on profit seeking only but on the institutions of ownership, contract, and free association.

Economics, then, is a science that is rooted in a larger understanding of what used to be called the liberal order. The central claim of this understanding is that society—just like the smaller subset often called “the economy”—needs no central manager to thrive.

And just as economic structures are best managed by property owners and traders, the entire society contains within itself the capacity for self management. Any attempt to thwart its workings

through the coercion of the state can only create distortions and reduce the wealth of all.

Anyone familiar with current economics texts and journals knows that this is not the view that they promote. They are still stuck in an era where bureaucrats imagined themselves as smarter than the rest of us, where central bankers believed that they could end business cycles and inflate just enough to cause growth but not ignite inflation, where antitrust experts knew just how big businesses should be.

But can government managers know better how to manage daily decisions on production and allocation better than property owners? Can they improve on the agreements, innovations, and rules created by acting individuals? They have neither the intellectual equipment nor the incentive to do so. They are blind to the realities of our lives and incapable of doing more for us than we can do for ourselves, even if they had the incentive to do more than rob and coerce us.

How is it that the economics profession has come to overlook these points? Murray Rothbard believed it was partially due to the decline of the general treatise on economic theory, systematic books that begin with fundamentals and trace cause and effect through the whole range of human action.

These books were common in the 19th century (we distributed books like J.B. Say's *Principles*, and a similar book by Frank Fetter!). Thank goodness that Mises wrote his amazing work *Human Action*, and Rothbard wrote his elaboration on Misesian economics in the form of *Man, Economy, and State*. The Mises Institute publishes both.

You know what? They are still being read, teaching each new generation of economists through the work of the Mises Institute. And not just in the United States: we receive regular progress reports from study groups in China, Latin America, Eastern Europe, and Africa. A universal theory is once again having a universal impact. ■

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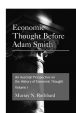
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