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Austrian Economics and the Political Economy of Freedom

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Abstract: The revival of the modern Austrian School of economics may be said to have begun 30 years ago. In 1974 the Austrian School had been on hiatus for almost a quarter of a century. For more than 60 years before the 1940s, the Austrian economists had been considered some of the most original contributors to economic theory and policy. They were among the leading developers of the theories of marginal utility, opportunity cost, value and price, capital and interest, markets and competition, money and the business cycle, and comparative economic systems – capitalism versus socialism versus the interventionist welfare state. But the rise and triumph of the Keynesian explanation of and prescription for the Great Depression eclipsed all competing approaches to the problems of economic depression and high unemployment. Despite all that, however, fundamental Austrian insights about man and the market exposed in this article are still corner-stones of a unique Austrian approach which is incompatible with the positivist, historicist, and neoclassical economic views of the world.

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1 Introduction

The revival of the modern Austrian School of economics may be said to have begun 30 years ago, during the week of June 15–22, 1974, when the Institute for Humane Studies sponsored a conference on Austrian economics for about 40 participants in the small town of South Royalton, Vermont.

In 1974 the Austrian School had been in hiatus for almost a quarter of a century. For more than 60 years before the 1940s, the Austrian economists had been considered some of the most original contributors to economic theory and policy. They were among the leading developers of the theories of marginal utility, opportunity cost, value and price, capital and interest, markets and competition, money and the business cycle, and comparative economic systems – capitalism versus socialism versus the interventionist welfare state.

But the rise and triumph, in the late 1930s and 1940s, of the Keynesian explanation of and prescription for the Great Depression eclipsed all competing approaches to the problems of economic depression and high unemployment. This included the Austrian theory of the business cycle, which in the early 1930s had been a leading alternative to the emerging Keynesian macroeconomics.²

At the same time, there developed what came to be called the neoclassical approach in microeconomics. The study of the logic of individual decision-making, the allocation of scarce resources among competing uses, and the distribution of income among the factors of production – land, labor, and capital – became increasingly an exercise in mathematical optimization under conditions of various quantitative constraints. The focus of attention was on the specification and determination of the narrow and often highly artificial conditions under which a market economy would be in general equilibrium.

² For an exposition and contrast of the Austrian and Keynesian explanations of and policy prescriptions for the Great Depression of the 1930s, see Richard M. Ebeling, “The Austrian Economists and the Keynesian Revolution: The Great Depression and the Economics of the Short-Run” in Richard M. Ebeling, ed., *Human Action: A 50-Year Tribute* (Hillsdale, Mich.: Hillsdale College Press, 2000), pp. 15–110.

This, too, was in stark contrast to the approach of almost all Austrian economists, who attempted to explain the logic and processes of market competition in a world of constant change. The Austrians, unlike their neoclassical rivals, emphasized imperfect knowledge, the pervasive role of time in all market decision-making, and the nature of market coordination through continual adaptation to changing circumstances.³

Eight months before that conference in South Royalton, in October 1973, the most important contributor to Austrian economics in the twentieth century, Ludwig von Mises, had died at the age of 92.⁴ The second most prominent member of the Austrian School at that time, Friedrich A. Hayek, had been invited to attend the conference, but had declined due to health problems that made it impossible for him to travel to America from Europe. No one at the conference anticipated that only four months later, in October 1974, Hayek would be awarded the Nobel Prize in economics.⁵

The speakers at the conference were three other leading figures in Austrian economics: Ludwig M. Lachmann, who had studied with Hayek at the London School of Economics in the 1930s; Israel M. Kirzner, who had studied with and written his

³ For an overview of many of the theoretical and policy themes in the writings of the Austrian Economists, see Richard M. Ebeling, "The Significance of Austrian Economics in 20th Century Economic Thought," *Austrian Economics and the Political Economy of Freedom* (Northhampton, Mass.: Edward Elgar, 2003), pp. 34–60; also, Ludwig M. Lachmann, "The Significance of the Austrian School of Economics in the History of Ideas" [1966] reprinted in Richard M. Ebeling, ed., *Austrian Economics: A Reader* (Hillsdale, Mich.: Hillsdale College Press, 1991), pp. 17–39.

⁴ For expositions of Mises's many contributions to economic theory and policy, see Richard M. Ebeling, "A Rational Economist in an Irrational Age: Ludwig von Mises," *Austrian Economics and the Political Economy of Freedom*, pp. 61–100; Richard M. Ebeling, "Planning for Freedom: Ludwig von Mises as Political Economist and Policy Analyst," in Richard M. Ebeling, ed., *Competition or Compulsion? The Market Economy versus the New Social Engineering* (Hillsdale, Mich.: Hillsdale College Press, 2001), pp. 1–85; and Richard M. Ebeling, "The Economist as the Historian of Decline: Ludwig von Mises and Austria Between the Two World Wars," in Richard M. Ebeling, ed., *Globalization: Will Freedom or World Government Dominate the International Marketplace?* (Hillsdale, Mich.: Hillsdale College Press, 2002), pp. 1–68; Richard M. Ebeling, "Ludwig von Mises: The Political Economist of Liberty" Parts I & II, *The Freeman: Ideas on Liberty* (May & June 2006) pp. 16–19 & 34–40; and Richard M. Ebeling, "Ludwig von Mises and the Vienna of His Time," Parts I & II, *The Freeman: Ideas on Liberty* (March & April 2005) pp. 24–53 & 19–25. Also, Murray N. Rothbard, *Ludwig von Mises: Scholar, Creator, Hero* (Auburn, Ala.: Ludwig von Mises Institute, 1988); and Israel M. Kirzner, *Ludwig von Mises* (Wilmington, Del.: ISI Books, 2001).

⁵ For a summary of Hayek's life and contributions to economics, see Richard M. Ebeling, "Friedrich A. Hayek: A Centenary Appreciation," *The Freeman* (May 1999), pp. 28–32; also, Bruce Caldwell, *Hayek's Challenge: An Intellectual Biography of F. A. Hayek* (Chicago: University of Chicago Press, 2004).

dissertation under Mises at New York University in the late 1950s;⁶ and Murray N. Rothbard, who had attended Mises's NYU seminar for many years beginning in the late 1940s and had received his doctoral degree in economics from Columbia University.

One evening during the conference, Milton Friedman came from his summer home in Vermont to join us for dinner and make a few remarks after the meal. Friedman commented that he was delighted to be with us and recalled he had long known both Mises and Hayek, having been a founding member of the Mont Pelerin Society and present at its first meeting in Switzerland in April 1947.⁷ But what stood out in his remarks for many of us there was his statement that there are no different schools of thought in economics; there is only good economics and bad economics. Clearly, therefore, in Friedman's mind, we were on a fool's errand attending a conference on something called "Austrian" economics.

2 Acting Man as the Core of Austrian Economics

Yet most of us attending that conference did not consider ourselves on a fool's errand. We just considered Austrian economics to be "good economics."⁸ At its most fundamental level, Austrians see the individual as "acting man." This was already clearly stated by Ludwig von Mises in 1933:

In our view the concept of man is, above all else, also the concept of the being who acts. Our consciousness is that of an ego which is capable of acting and does act. The fact that our deeds are intentional makes them actions. Our thinking about men and their conduct, and our conduct toward men and toward our surroundings in general presuppose the category of action.⁹

⁶ For a summary of Kirzner's contributions to Austrian economics, see Richard M. Ebeling, "Israel M. Kirzner and the Austrian Theory of Competition and Entrepreneurship," *Freedom Daily*, August 2001, pp. 8–14.

⁷ See R. M. Hartwell, *A History of the Mont Pelerin Society* (Indianapolis: Liberty Fund, 1995).

⁸ For a summary of the conference's events, see Richard M. Ebeling, "Austrian Economics on the Rise," *Libertarian Forum*, October 1974, pp. 3–6; the lectures delivered by Lachmann, Kirzner, and Rothbard at South Royalton were later published in Edwin G. Dolan, ed., *The Foundations of Modern Austrian Economics* (Kansas City, Kan.: Sheed & Ward, 1976).

⁹ Ludwig von Mises, *Epistemological Problems of Economics* (New York: New York University Press, 1981 [1933]), p. 14.

The Austrian view of man refutes the positivist, historicist, and neoclassical conceptions of man as a mere physical, quantitative object, or as a passive subject controlled by the dark forces of history, or as a “dependent variable” in a system of mathematical equations. Positivism tried to reduce man and his mind to mere magnitudes to be studied and manipulated like the inanimate matter experimented on in the natural sciences. Historicism claimed that man is determined and molded by external laws of history that shape his thoughts, actions, and destiny, with little latitude for the individual to design and guide his own future.¹⁰ Neoclassical economics treats man like a mathematical function possessing given tastes and preferences, which are themselves induced by his surroundings and on the basis of which he responds in predictable ways when confronted with various constraining and objective tradeoffs in the form of market prices.¹¹

For Austrians, on the other hand, man is a purposeful being. He thinks, plans, and acts. Man may be made up of matter, but he possesses consciousness. He has the capacity to imagine, create, and initiate. His mind is not simply reducible to lifeless matter. He has spirit and will. Man reflects on the circumstances in which he finds himself. He judges aspects of his physical and social surroundings less than satisfactory. He imagines states of affairs that would be more to his liking. He creates in his mind plans of action that would bring those preferred states of affairs into existence. He discovers that the things he can use as means to achieve *some* of his ends are insufficient to achieve *all* of his ends. He has to weigh the alternatives and decide which he prefers more, since some of them, in the face of scarcity, will have to be forgone today or forever. He, therefore, has to decide the tradeoffs he is willing to make, and as a result he determines the costs of his own choices in the form of goals he is willing to give up in order to pursue others that he considers more important.

¹⁰ One of Mises's most insightful but unfortunately highly neglected works was devoted to undermining the assumptions and absurdities in both positivism and historicism; see Ludwig von Mises, *Theory and History: An Interpretation of Social and Economic Evolution* (Auburn, Ala.: Ludwig von Mises Institute, 1985 [1957]); also F. A. Hayek, *The Counter-Revolution of Science* (Indianapolis: Liberty Fund, 1980 [1955]); and Murray N. Rothbard, *Individualism and the Philosophy of the Social Sciences* (San Francisco: Cato Institute, 1979).

¹¹ For a contrast of the Austrian and neoclassical conceptions of man in relation to action and choice, see Richard M. Ebeling, *Austrian Economics and the Political Economy of Freedom*, pp. 3–7.

Those ends and means that neoclassical economics take as “given” are, in fact, created and compared in the actor’s mind. They change and are modified as man experiences successes and failures. They are not static. Nor is man a hopeless victim or captive of history. He makes his own history by reflecting on what has happened in the past and mentally projecting himself into the future. He decides what past course of action is worth trying to continue or what might be a better course as he looks ahead.

3 Imperfect Knowledge and Market Opportunities

This is why Mises insisted that in every man there is the element of entrepreneurship. In all his actions, man searches for and creates profitable opportunities to improve his lot and tries to avoid losses, that is, circumstances worse than they need to be. By necessity, man is, therefore, a speculator in everything he does.¹²

Creating profitable opportunities and avoiding losses are concepts that have no meaning in the traditional neoclassical conception of “perfect competition,” in which every market participant is assumed to possess perfect or sufficient knowledge of all possibilities that might be relevant to his decisions. What is the meaning of “opportunities discovered” or “losses avoided” when the actors already know from the beginning what are the best and, indeed, the only options that should be followed, given perfect and sufficient knowledge of all relevant circumstances?¹³

From the Austrian perspective, to choose is to select from alternatives, and to select from alternatives must mean that, at least from the individual’s perspective, the

¹² Ludwig von Mises, *Human Action: A Treatise on Economics* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996), p. 254: “Entrepreneur means acting man in regard to the changes occurring in the data of the market.” And Mises, The *Ultimate Foundations of Economic Science* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 2002 [1962]), p. 51: “Every action is a speculation, i.e., guided by a definite opinion concerning the uncertain conditions of the future.”

¹³ For the classic Austrian criticisms of the neoclassical mathematical general equilibrium approach, and the theory of perfect competition, see Hans Mayer, “The Cognitive Value of Functional Theories of Price” [1932] in Israel M. Kirzner, ed., *Classics of Austrian Economics: A Sampling in the History of a Tradition* (London: William Pickering, 1994), pp. 55–168; F. A. Hayek, “The Meaning of Competition” [1946] *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), pp. 92–106; Mises, *Human Action*, pp. 350–57, and Mises, “Comments on the Mathematical Treatment of Economic Problems,” [1953] *Journal of Libertarian Studies*, vol. I, no. 2 (1977), pp. 97–100.

future is not preordained. If that future is not preordained, but can be influenced by the choices he makes, then perfect knowledge is logically inconsistent with the very concept of acting and choosing man. Otherwise, man would know already all the decisions he will make and the necessary outcomes. But what then remains of any commonsensical notion of choice? Even if we assume only knowledge of objective probabilities and not absolute certainties about the future, every man would still know what is the precise set of options from which he has to choose and the exact weight he should assign to each possible outcome; then, given his tastes and preferences for risk, he would again know from the start the only courses of action he could and should logically follow.

Many neoclassical economists may despair of a world in which imperfect knowledge and uncertainty prevail, a world in which their mathematically deterministic models lose their force. But for Austrians, this reality of the human condition is a reason for optimism about man and his world. The fact that man does not know for certain what the future holds, including what his own future actions may be, means that the world in which he lives is one of wondrous possibility. Individuals have incentives to experiment with creative new ideas precisely because they don't know for sure or with any probabilistic degree of certainty how those ideas may actually turn out. It is this element of uncertainty about the future that permits imagination and action to influence the shape of things to come – including all the advancements in the social, economic, and cultural condition of mankind.¹⁴

For the neoclassical economists, the market is reduced to a series of simultaneous equations of supply-and-demand functions, the properties of which specify whether a general-equilibrium “solution” exists for the market as a whole, and whether that solution is “unique” and “stable.” Prices are the quantitative ratios of exchange at which goods may be bought and sold, and which “objectify” the tradeoffs for which alternatives in the market may be obtained. Likewise, the theory of comparative advantage, in the neoclassical framework, merely determines the relative opportunity costs of potential trading partners so they may assume their highest-valued roles in the division of labor. In addition, property rights, money, and social and political institutions

¹⁴ Mises, *Human Action*, p. 105: “The uncertainty of the future is already implied in the very notion of action. That man acts and that the future is uncertain are by no means two independent matters. They are only two different modes of establishing one thing.”

are usually treated as “givens” in neoclassical analysis. They are merely the context in which the supply and demand functions interact.¹⁵

4 Minds, Markets, and the Entrepreneur

For Austrians, the essence of the market is missed when reduced to a skeletal representation in the form of mathematical functions. The market is where the minds and the meanings of men meet. It is the place where the plans of multitudes of individuals overlap, enabling people mutually to improve their situations through discovered and created gains from trade. It is where the wants of men find greater degrees of satisfaction than in isolated self-sufficiency, and where achieving things never conceived of before is practicable. In the Austrian conception of the market, prices are not simply quantitative ratios of exchange; they are also the encapsulation of the market participants’ valuations and appraisements, which result from the participants’ buying and selling.¹⁶ As Carl Menger, the founder of the Austrian School, expressed it in 1871:

[Prices] are by no means the most fundamental feature of the economic phenomenon of exchange. This central feature lies rather in the better provision two persons can make for the satisfaction of their needs by trade... Prices are only incidental manifestations of these activities, symptoms of an economic equilibrium between the economies of individuals [and consequently are of secondary interest for the economic subjects]... The force that drives [prices] to the surface is the ultimate and general cause of all economic activity, the endeavor of men to satisfy their needs as completely as possible, to better their economic positions.¹⁷

¹⁵ It should be pointed out that there has developed what is now referred to as the “new institutional economics,” which attempts to explain the emergence, evolution, and significance of the underlying institutional order in which market processes operate. Some of these economists have consciously incorporated elements of the Austrian perspective in their theories; see, especially, Wolfgang Kasper and Manfred E. Steit, *Institutional Economics: Social Order and Public Policy* (Northampton, Mass.: Edward Elgar, 1998), and Eirik G. Furubotn and Rudolf Richter, *Institutions and Economic Theory: The Contribution of the New Institutional Economics* (Ann Arbor, Mich.: University of Michigan Press, 1998).

¹⁶ Mises, *Human Action*, pp. 327–33.

¹⁷ Carl Menger, *Principles of Economics* [1871] (New York: New York University Press, 1981), pp. 191–192. The bracketed clause was restored by the present author from Menger’s original German volume, *Grundsätze der Volkswirtschaftslehre*, 2d ed. (Vienna: Holder-Pichler-Tempsky, 1923), pp. 182–83.

In neoclassical theory, prices are usually taken as “given,” with any changes coming, somehow, from the “outside,” with market participants responding accordingly. In the Austrian approach, prices emerge out of the interactions of market actors. They initiate price bids and offers, and competitively move prices up or down. In Eugen von Böhm-Bawerk’s famous horse market, any resulting equilibrium between suppliers and demanders arises out of their efforts to attract trading partners by offering better terms than their rivals.¹⁸

Thus the Austrian focus is on *the logic and sequential process of price formation*, rather than only on any final equilibrium price that may result from this active market rivalry. It is why one prominent member of the Austrian school referred to the Austrian theory of price as *the causal-genetic approach*: the purpose of the theory is to explain the “causal origin” of prices in the valuations and actions of market actors, and the process by which prices adjust to reach a final equilibrium.¹⁹

The theory is also the basis for the later Austrian emphasis on the role and significance of the entrepreneur. In the division of labor, entrepreneurs are not only the “undertakers of enterprise” who imagine the patterns of future consumer demand, conceive of ways of organizing production processes to better satisfy that demand, oversee the stages of production to the completion of finished goods, and bring the goods to market. They also set and change consumer prices when they discover that they over- or underestimated how intensely consumers want the goods.²⁰

It is the “promoting and speculating entrepreneurs” who are “the driving force of the market,” Mises wrote. Their “social function” is to coordinate the use of resources, capital, and labor with the demands of consumers through the rewards of profits and the penalties of losses.²¹ Again, as Mises concisely put it, “It is the entrepreneurial decision that creates either profit or loss. It is mental acts, the mind of the entrepreneur, from which profits ultimately originate. Profit is a product of

¹⁸ Eugen von Böhm-Bawerk, *Capital and Interest*, vol. 2: *The Positive Theory of Capital* (South Holland, Ill.: Libertarian Press, 1959), pp. 216–35.

¹⁹ Mayer, p 57.

²⁰ See the much-neglected analysis on this point by Philip Wicksteed, *The Common Sense of Political Economy*, vol. 1 (London: Routledge & Kegan Paul, 1933 [1910]), pp. 212–37.

²¹ Mises, *Human Action*, pp. 328–29.

the mind, of success in anticipating the future state of the market. It is a spiritual and intellectual phenomenon.”²² The intentionality of entrepreneurship, the creative mental processes that are the essence of the enterpriser’s activities, are drained of all understanding if the market is reduced to a simplified and barren mathematical function.

5 Economic Calculation and the Market Process

The social institutions of private property and monetary exchange are not simply conceptual backdrops to the determination of equilibrium prices and outputs, as has tended to be the view in neoclassical economics. In the standard textbooks, from which most economists learn the core concepts of their discipline, private property is described as an “incentive mechanism” for work and the conserving of scarce resources; and money is explained as a “unit of account” that serves as a common denominator for comparing the value of goods bought and sold in the market. Both descriptions are true and important. But they fail to capture the institutions’ profundity for the functioning and coordinating of the complex and ever-changing market order.

Private property and money are, instead, the core – the indispensable features – of the market economy and the civilization that develops with it. The evolution of private property rights and a medium of exchange has made possible the economic calculation without which rational market decision-making would be impossible. And, again, it is Mises who articulated this most clearly:

Monetary calculation is the guiding star of action under the social system of division of labor. It is the compass of the man embarking upon production. He calculates in order to distinguish the remunerative lines of production from the unprofitable ones... Monetary calculation is the main vehicle of planning and acting in the social setting of a society of free enterprise directed and controlled by the market and prices.²³

²² Ludwig von Mises, “Profit and Loss,” [1951] in *Planning for Freedom* (South Holland, Ill.: Libertarian Press, 1980), p. 120.

²³ Mises, *Human Action*, pp. 229–30.

We can view the whole market of material factors of production and of labor as a public auction. The bidders are the entrepreneurs. Their highest bids are limited by their expectation of the prices the consumers will be ready to pay for the products... The competition between the entrepreneurs reflects these prices of consumers' goods in the formation of the prices of the factors of production... To the entrepreneur of capitalist society a factor of production through its price sends out a warning: Don't touch me, I am earmarked for the satisfaction of another, more urgent need.²⁴

Only private property enables all marketable commodities and means of production to be available for sale and purchase in the area of exchange. Only a medium of exchange provides the means by which heterogeneous things may be reduced to a valuational common denominator. Only the competitive market enables every participant in society to contribute to the formation of prices through his bids and offers.²⁵ Only economic calculation enables the integration of billions of people's actions into a network of mutually beneficial market relationships and coordinated plans.

Yet every man is free to make his own decisions, guided by his own hopes, dreams, goals, and plans. The money prices that make economic calculation possible are used by each individual for his own purposes. He weighs their significance for the ends he has in mind. He uses them to evaluate his past actions and to plan his future actions.²⁶ He is at liberty to integrate himself into the division of labor on the basis of his own evaluations of the costs and benefits of alternative courses of action – while bearing the consequences, good or ill, for the choices he makes.

It is through economic calculation in the free market that individual freedom is made compatible with social order. It is through economic calculation that billions

²⁴ Ludwig von Mises, *Bureaucracy* (New Rochelle, N.Y.: Arlington House, 1969 [1944]), pp. 28–29.

²⁵ Ludwig von Mises, *Liberalism in the Classical Tradition* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1985 [1927]), pp. 71–72. On p. 75 Mises wrote: "This is the decisive objection that economics raises against the possibility of a socialist society. It must forgo the intellectual division of labor that consists in the cooperation of all entrepreneurs, landowners, and workers as producers and consumers in the formation of market prices. But without it, rationality, i.e., the possibility of economic calculation, is unthinkable."

²⁶ Mises, *Human Action*, p. 229: "Monetary calculation is entirely inapplicable and useless for any consideration which does not look at things from the point of view of individuals... The premeditation of planned action becomes commercial pre-calculation of expected costs and expected proceeds. The retrospective establishment of the outcome of past action becomes accounting of profit and loss."

of individual plans are combined into patterns of rational social coordination. No wonder Mises concluded that “Our civilization is inseparably linked with our methods of economic calculation. It would perish if we were to abandon this most precious intellectual tool of acting.”²⁷

6 The “Law of Association” as the Foundation of Society

Austrians see more in the theory of the division of labor and comparative advantage than simply the determination of specialization at various prices, given the capital and labor available. Once again it was Mises who insightfully clarified the implications of the eighteenth- and nineteenth-century classical economists’ views on the benefits of the division of labor. The theory of the division of labor, Mises explained, is really the basis of what he called the *law of human association* and, therefore, the foundation of a theory of society. Based on Adam Smith’s and David Ricardo’s expositions of the benefits from specialization, it was possible to show how society emerged and took form over the centuries as the result of individuals discovering the mutual benefits from trade.²⁸ The additional gains through specialization resulted in an expanding network of human relationships. The theory of the division of labor, therefore, is able to serve as the analytical tool for explaining the emergence of society as the result of human action but not of human design. As Mises explained this process:

The law of association makes us comprehend the tendencies which resulted in the progressive intensification of human cooperation. We conceive what incentive induced people to not consider themselves simply as rivals in a struggle for the appropriation of limited supplies of means of subsistence made available by nature. We realize what has impelled them and permanently impels them to

²⁷ Mises, *Human Action*, p. 230.

²⁸ Adam Smith, *The Wealth of Nations* Book I, Chapters 1–3 (New York: The Modern Library, 1937 [1776]), pp. 3–21; Piero Sraffa, ed., *The Works and Correspondence of David Ricardo*, vol. I: *On the Principles of Political Economy and Taxation* (Cambridge: Cambridge University Press, 1951 [1821]), pp. 128–49; Jean-Baptiste Say, *A Treatise on Political Economy, or the Production, Distribution, and Consumption of Wealth* (New York: Augustus M. Kelley, 1971 [1821]), pp. 90–99; John R. McCulloch, *The Principles of Political Economy, with Some Inquiries Respecting Their Applications* (New York: Augustus M. Kelley, 1965 [1864]), pp. 37–46, 85–116.

consort with one another for the sake of cooperation... Thus we are in a position to comprehend the course of human evolution.²⁹

The theory of the division of labor and comparative advantage becomes the basis for a “science of society.” A foundation is laid for the theory of market relationships, the interconnections between supply and demand, and the network of market prices for finished goods and the factors of production. The way is opened to understanding the “inevitable laws of the market and exchange,” which is “one of the greatest achievements of the human mind.”³⁰

Out of the classical economists’ theory of the division of labor there now comes the classical-liberal “philosophy of peace and social cooperation,” which is the basis “for the astonishing development of the economic civilization of [our] age.”³¹ The greater material productivity of a peaceful division of labor, Mises explained, provides the means for the development of what we call civilization. The means are now provided for leisure and the peace of mind required for art, literature, and scientific and philosophic reflection.

Men increasingly become differentiated from one another, but not only in the specialized tasks and skills through which they find their place in the division of labor. They also differentiate themselves by developing their individual personalities, thanks to the greater abundance of resources and free time with which they can cultivate the pursuits that most interest them. Individualism, meaning man as distinct from the tribal mass and unique in his character and qualities as a singular human being, is a product of the extension and intensification of the division of labor.³²

At the same time, the division of labor and its law of association are the foundation for a philosophy of world peace. Through specialization and exchange, men become allies against the niggardliness of nature. No longer are individuals and nations opponents, where the improvement of one requires a loss to another. Instead, all benefit from everyone’s talents, industry, and creativity.

²⁹ Mises, *Human Action*, pp. 160–61.

³⁰ Ludwig von Mises, *Interventionism: An Economic Analysis* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1998 [1941]), p. 24.

³¹ Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (Indianapolis: Liberty Classics, 1981 [1922]), pp. 55–56, 268–69.

³² Mises, *Socialism*, pp. 256–72; *Human Action*, pp. 157–74.

Competition, both within and between nations, is no longer a life-and-death struggle. The competitive market process becomes the peaceful procedure through which each member of society finds his most productive and profitable niche for improving his own circumstances by furthering the ends of others. Again, Mises captured the essence of this great social process:

All collaborate and cooperate, each in the particular role he has chosen for himself in the framework of the division of labor. Competing in cooperation and cooperating in competition all people are instrumental in bringing about the result, viz., the price structure of the market, the allocation of the factors of production to the various lines of want-satisfaction, and the determination of the share of each individual.³³

The world, therefore, becomes one community of free men who, though separated by time, distance, and interest, are peacefully guided to assist one another by the information and incentives supplied by market prices. People's buying and selling determine the patterns of production that best serve the wants and needs of all humanity. The market economy thus is the means to the peaceful unity of mankind.

7 The Political Economy of Freedom

None of these Austrian insights about man and the market is compatible with the positivist, historicist, and neoclassical economic views of the world. Reduced to physical object or mathematical function, man is stripped of his most essential human qualities. What are intention and imagination, choice and creativity, if the human mind is banished from social and economic analysis? What meaning, therefore, does freedom have when man is merely a measured magnitude or a dependent variable in a system of simultaneous equations?

It should not be surprising that so many members of the Austrian School of economics have also been classical liberals – defenders of individual liberty, private property, and the market economy. Once you see the individual as thinking, creating, and acting man, with so much potential within him, who can tolerate the idea

³³ Mises, *Human Action*, p. 338.

of making him the slave to another's will – of denying him his humanness? Once you comprehend the majesty of the market order, in which each man is free to follow his own plans while advancing the welfare of others, who can want to restrict him to the dictates of a central planner or political intervener? Once one understands the significance of prices for social coordination within the market process, who can presume to have the knowledge and ability to command humanity's consumption and production?³⁴

It is no wonder, therefore, that so many of freedom's friends have been influenced by the Austrian economists. In the last 100 years, they have been the true political economists of liberty. The Austrian School of economics has enriched our understanding of the market economy and advanced the cause of freedom in our time.

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³⁴ See F. A. Hayek, "The Use of Knowledge in Society," [1945] *Individualism and Economic Order*, pp. 77–91; reprinted in Richard M. Ebeling, ed., *Austrian Economics: A Reader*, pp. 247–63.

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