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Chapter 8

Literature on Equilibrium and Misesian Entrepreneurship

Mises's preoccupation with the Austrian theory of imputation -- and, therefore, prices -- has misled a number of neoAustrian economists about the proper way to build economic theory on a praxeological base. The purpose of this chapter is to review the works of two writers who discussed praxeology and economics: Selgin and Salerno. In the process, we shall review Mises's remarks about how to do economics. Part 1 discusses a paper on "Praxeology and Understanding" by Selgin. Part 2 discusses a brief characterization of Mises's theory of the market made by Salerno in his effort to distinguish Mises from Hayek and other neoAustrians.

1. SELGIN ON EQUILIBRATING

Selgin's 1988 paper on praxeology helped to launch the first journal devoted exclusively to neoAustrian economics. In it, Selgin made an important contribution to praxeology by reiterating Mises's distinction

between theory and history and between conception and understanding. When he turned his attention to economics, however, he faltered. He meticulously derived a concept of equilibration from a theory of individual choice which, while meaningful to the individual, is useless in achieving the goals that, according to Mises, praxeological economics aims to achieve: i.e., the unbiased evaluation of arguments for and against market intervention. He went on to criticize other uses of the equilibrium concept as lacking meaning. In effect, in light of the necessary role of equilibrium in praxeological economics, Selgin denied that a praxeological economics is possible and, in doing so, implicitly criticized Mises for trying to develop one. Although this book argues that there are a number of errors and omissions in Mises's praxeological economics, it never questions the feasibility of it. On the contrary, it has embraced the few remarks that Mises made about the subject.

The purpose of this part is to criticize Selgin's discussion. We begin by identifying Selgin's stated purpose, by presenting his subjectivist view of equilibrating, and by introducing his critique of economists who go beyond this to infer what he calls "social causation." Next we present Mises's justification for going beyond the theory of individual choice. We explore what Mises regarded as the goal of praxeological economics and the methods he derives from that goal. In light of this and of the praxeological economics presented in this book, we end with a general critique of Selgin's notion of equilibrium and its implications.

The Stated Purpose of Selgin's Exercise

Selgin's description of the relationship between praxeology and economics is based on what he regards as a crucial distinction between the theory of the action of a single actor and the theory of what he calls *social causation* -- a theory about how actions in the social world can achieve the desired results (Selgin 1988: 29). Indeed, insofar as one is concerned with the concept of equilibrium, Selgin's goal seems to be to build a conceptual wall between what he calls praxeological theory (the deductions of praxeology) and theories of social causation like those of "knowledge dissemination" and the "market process." He does this by introducing a strictly individualistic and subjective concept of equilibration, which he later contrasts with the concept of equilibrium or

comparable concept employed by various authors.[1] Building such a wall serves the purpose of helping him to rebut Austrian writers like Hayek, George Shackle, Lachmann, and Kirzner, who have criticized praxeology and/or offered substitutes for it. Selgin argues that the claims of these authors are misconceived. Regarding Hayek, he writes:

> contra Hayek...the "pure logic of choice" has a great deal to say about the prerequisites for successful action -- notwithstanding our ignorance as to the mechanisms of social causation. Moreover, although we shall see that the absence of such causation would have serious implications, it will be argued that Hayek's suggestion that praxeological conclusions need the support of *an explanation* of social causation (that is, of why it should be that people are ever right [in their interaction with others]) is not very good advice after all (*ibid*.).[2]

In his conclusion, he writes about the relationship between the theories of social causation and praxeology. He says that he aimed to show, on the one hand, that "[s]o long as there can be meaningful experience of social phenomena, then this experience will be one for which the deductions of praxeology are valid. To imagine otherwise is to imagine a social environment free from meaningful experience altogether" (Selgin: 50). On the other hand, he aimed to show that the

> theories of "knowledge dissemination" and of the "market process," however informative they may be, can no more "replace" praxeology than they can undermine the

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[1]Following his presentation of the equilibrating concept, he writes:

> The praxeological view just presented attempts, where those of Kirzner and Lachmann have failed, to make sense out of the idea of a tendency toward equilibrium while totally rejecting Walrasian criteria and their implications. By adopting a strictly subjective approach, praxeology also immunizes itself from Lachmann's skepticism (insofar as the *logical* validity of its inferences is concerned -- the empirical question of coordination must be addressed later on), preserving the apodictic status of its conclusions which rest upon the premise that entrepreneurial action is equilibrating (*ibid*.: 39).

[2]So far as the author can tell, Hayek did not make this claim about praxeology, at least in the paper to which Selgin refers. The word "praxeology" does not appear in Hayek's paper. He refers to the "Pure Logic of Choice," which he equates with the "economic calculus." Hayek uses this term to refer to the image of the economic system, such as the RRE or IFSP. He asserts the following about the economic calculus: "If we possess all the relevant information, if we can start out from a given system of preferences, and if we command complete knowledge of available means, the problem which remains is purely one of logic" (Hayek 1937: 519). So far as I can tell, this interpretation coincides with that of Kirzner (2001:84-88).

doctrine of the (radically) ka1eidic society. Nor should they be viewed as prerequisites to the drawing of valid praxeological conclusions (*ibid*.).

Selgin's Notion of Equilibration

Selgin presents a purely subjective definition of equilibration. He writes of a "strictly logical sense in which action may be said to be equilibrating (rather than disequilibrating), which may be interpreted as implying a tendency toward equilibrium" (*ibid*.: 33). He goes on to define this idea for an "autarkic economy." In this situation,

> [a]ll action is equilibrating in the ex ante sense; that is, it is expected by the actors involved to lead to the removal of felt uneasiness. In this context 'disequilibrating' action...is the logical equivalent of 'irrational action' For the solitary individual, a tendency toward equilibrium means a tendency for action to systematically eliminate perceived sources of uneasiness.

In the market economy, equilibrium has a similar meaning. He writes:

> The praxeological notion of equilibration applied in catallactics can be summarized as follows: entrepreneurial profit and loss are subjective phenomena, having no "objective" basis outside of the minds of market participants. The praxeologist cannot, therefore, conceive of these phenomena apart from actions of market participants that at once imply imagination of and response to the phenomena in question. Thus, for every profit "opportunity," there corresponds an action that eliminates the opportunity (or proves that it was illusory) (*ibid*.: 34).

In other words, to say that an entrepreneurial action is equilibrating means only, and exclusively, that the entrepreneur herself believes that it is profitable to perform and, therefore that it will result in a situation of less or no profit *to her*. Whether others happen to perceive a profit is irrelevant to her choice and therefore to equilibration as it applies to her. He concludes: "Thus, action leads to the systematic elimination of entrepreneurial profit and loss; it is *equilibrating*" (*ibid*., emphasis in original). Regarding prices, he writes that:

> praxeology recognizes price discrepancies among *identical* goods only to the extent that such discrepancies may be identified with subsequent acts of successful arbitrage. In the same manner, entrepreneurial profit opportunities in general are ephemeral phenomena, formed in the imagination of enterprising people and *defined* by the very actions that "'eliminate" them...Every entrepreneurial action therefore begins with the subjective imagination of a profit opportunity (or belief that a loss may be avoided) and ends with the destruction of the imagined opportunity. This, to repeat, is what praxeology means when it asserts that all action is "equilibrating," i.e., that action leads to the systematic elimination of profit and loss (*ibid*.: 35, emphasis in original).

Thus he defines both the concepts of equilibrating and prices by referring exclusively to the minds and actions of particular individuals. Consider a second context in which he uses the equilibrium concept.

> The claim that all action is equilibrating does not imply that actors are ever actually in a state of equilibrium proper. The concepts "equilibrium" and "disequilibrium" have for the praxeologist a purely heuristic significance. Theorists wishing to explain a process of market price adjustment require a framework upon which to hang the components of their analysis. Thus, they adopt a terminological expedient: they refer to the outmoded price, a price that has become incompatible with changes in the apprehended ends-means framework, as a "disequilibrium" price. The appropriate price, that which ineluctably replaces the disequilibrium price as a consequence of actions manifesting the revised understanding of means and ends, is labeled the "equilibrium" price. The process of price adjustment can only be comprehended by viewing it as a dynamic process of prices which are at once equilibrium prices in relation to those that they have replaced and disequilibrium prices in relation to those that will follow. Because individuals' understandings of ends and means are in constant flux, prices undergo constant revision. But their adjustment is always in the direction of, and never away from, equilibrium, so long as it reflects free entrepreneurial acts. As each price adjustment is itself a vehicle of information about means and ends, it follows that the adjustment of one price may lead to the obsolescence of others. The statement that action is "equilibrating" merely refers to the logical proposition that action continuously accounts for changes in the imagined framework of means and ends, i.e., changes in the structure of imagined profit opportunities (*ibid*.: 38).

In this passage, Selgin defines a disequilibrium price as an "outmoded" price, a "price that has become incompatible with changes in the apprehended ends-means framework," and an "inappropriate" price. These adjectives refer to the actor's situation as she perceives it. An individual acting in the entrepreneur role perceives a price and determines that it is outmoded. She then envisions replacing it. The actions she takes that cause such a replacement are equilibrating in the sense that she believes that if she takes those actions, the price discrepancy will no longer exist. When Selgin writes that these prices are "in the direction of equilibrium," he means only that the goal in each entrepreneurial act is to earn profit by replacing what the actor sees as an outmoded price with what she sees as a more correct price. If she perceived the price as not being "outmoded," she would have no grounds for taking an entrepreneurial action. The "dynamic process of price adjustment" that he describes refers not to some external view of the behavior of actors. It refers to the goals that each individual actor, separate from her fellow actors and with her own distinct knowledge and abilities to make judgments, aims to achieve with her action.

In his definition of equilibrium, Selgin one bit concerned with whether entrepreneurial action, as he defines it, leads prices in the market (i.e. the prices perceived by many actors) to come closer and closer to some set of prices constructed in the mind of the economist. Indeed, he is not concerned with market prices as economists ordinarily define them. He is only concerned with the prices that exist in the minds of "enterprising people" as they choose their courses of action. Accordingly, his aim in dealing with the concept of equilibration is vastly different from that of Mises in the latter's use of the ERE. Mises's main goal was to elucidate the Austrian theory of imputation. Selgin is similarly unconcerned with the broader question of whether economics needs a concept of equilibrium like a robot economy as a counterfactual or an image of a final state of rest or synchronized plans.

The Status of "Coordination"

Selgin deals with social causation in his section "The 'Common Sense' of Coordination." He begins by asserting that while "equilibration" is a praxeological concept, "coordination" is not (*ibid*.: 43). A concept is praxeological, he seems to argue, only if it is implied by the a priori assumption that individuals act. Thus he writes that "[w]hile we cannot think of free action as nonequilibrating, we can conceive of actions that are noncoordinating."

> In order to establish whether a particular concrete state of affairs exemplifies coordination or the compatibility of plans, social scientists must resort to the common-sense method of specific understanding employed in historical analysis. They must therefore abandon the strict subjectivism of praxeology and allow themselves to impute specific ends and aspirations to individuals. Then, in order to determine whether the actions of individuals are compatible with one another, they contrast them with an ideal-typical "plan" of their own construction. In other words, they treat the actions of other individuals as means and judge their efficacy with regard to a set of imputed ends (*ibid*.).

Thus Selgin argues that in order to characterize a situation as one in which plans are coordinated -- or, as he later says, one in which social actions are successful or that they cause progress -- it is necessary to make a judgment based on some "constructed plan" or definition of success or progress. On this basis, he appears to argue that there is a wall between praxeology, which is strictly subjectivist, and economics, which requires a theory of social causation and, therefore, an auxiliary construct

that is based on assumptions or beliefs about the ends people have or that the economist has.

Critique

The aim of this subsection is to show that Selgin's definition of equilibrium neglects the method and procedure of economics and that his apparent accompanying effort to build a wall between praxeology and economics neglects the goal and traditional definition of economics. Moreover, his claim that the auxiliary constructs used in economics must be based on assumptions or beliefs about peoples' ends is correct only in the broad sense that the economist's choice of subject matter dictates that he be concerned with wants the satisfaction of which requires the intermediary of money. We argue first that his notion of equilibration is not only redundant, its focus on price repeats the mistake of leading readers away from conceiving of economic action as transacting instead of pricing. Then we show that the wall he builds is not representative of Mises thought on the relationship between praxeology and economics. In the process, we discuss the equilibrium constructs of economics.

The Redundancy of Equilibration

Although Selgin develops a consistent and subjective definition of equilibration, he does not tell us why the terms "equilibration" and "equilibrium" are necessary. Let us put ourselves in the shoes of a producer-seller of a consumers' good -- a pure entrepreneur, as described in Chapter Two. According to Selgin's usage, a consumers good's price would not be in equilibrium if the pure entrepreneur believed that she could earn a profit from producing it. In this event, the entrepreneur would aim to produce the product in an effort to earn the profit. By acting in accord with her perception of the profit opportunity, the actor would destroy the profit opportunity. In this sense, her action can be called equilibrating (*ibid*.: 35, as quoted above). However, of what use is the term "equilibrating" here? Why not describe the pure entrepreneur's choice with the statement that when she anticipates a profit from producing a good -- i.e., when she believes that the future price will be greater than costs of production plus interest -- she will produce the good and offer it for sale. By definition, she will avail herself of every profit opportunity she perceives. Why introduce another term -- most especially one that is widely used by modern economists to mean something

completely different?[3] Indeed, to use such a term to refer to the personal and subjective choices of particular actors is to invite confusion by anyone who is not committed to learning how to describe the theory of individual choice in a market context by using Selgin's special "equilibrating" terminology. Finally, since the use of this terminology demands that a reader focus on the price aspect of transactions, it threatens to lead the reader who is interested in market economy choices away from a more adequate transacting approach.

A Wall Between Praxeology and Economics?

The wall that Selgin builds between praxeology and economics is based on the assertion that, unlike praxeology, economics requires the making of assumptions about peoples' ends before it can even get started. If this was true, it would not be possible to do economics without receiving guidance from someone who provides a constructed plan for comparison or who defines "success" or "progress." It is on this basis that Selgin criticized Hayek, Lachmann, Shackle, and Kirzner.

What is remarkable about this argument is that it totally ignores Mises's own discussion of the relationship between praxeology and economics. Mises does not start with his own constructed plan or definition of progress or success, although some of his remarks -- particularly those about consumer sovereignty -- seem to suggest that he is doing this implicitly. On the contrary, he defines economics as a branch of praxeology that is concerned with action under market economy conditions. And he points out that it can avoid making judgments of value because its goal is to help one evaluate the logic and relevance of others' arguments. In other words, economics can be purely logical yet useful because of its goal. We can agree with Selgin that the shift from the theory of individual, or isolated action, to a theory of economic interaction requires subsidiary assumptions beyond the priori assumptions used to derive the properties of the category of action. However, we must insist, following Mises, that economics can be purely logical and even praxeological. Instead of building a wall between praxeology and economics, economists interested in evaluating interventionist arguments must integrate (1) the logic of choice in a praxeology that deals with action at the most abstract level with (2) assumptions about interaction that are derived from our understanding of actual action. The images that economists aim to build and, therefore, the subsidiary assumptions they

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[3]Of course, the term does not have a uniform meaning in modern economics. But this fact does not affect the thrust of the argument presented here.

try to employ, are the ones best suited to evaluate the arguments to which they direct their attention. Thus, the economist builds the image of the robot economy because he aims to evaluate arguments relating to the production and consumption of goods in a market economy. And he builds an image of fully synchronized plans because he realizes that, in order to evaluate such arguments, he must give examples of entrepreneurship. Which of the more specific subsidiary assumptions he makes depends on the particular arguments he aims to evaluate. Although Mises did not follow through by building an economics that readers could readily identify as emanating from these methodological considerations, his comments on how to do this are suggestive enough to the discerning reader.

Mises on the Aim and Scope of Economics

As pointed out in Chapter One of this book, Mises began with the argument that the goal of economics is to to try "to influence public opinion in order to make sound policies prevail in the conduct of civic affairs" (Mises 1966: 869). Economics does not employ its own definition of "sound policies." In other words, it does not aim to produce a body of knowledge of sound policies. Its aim is to assesses the policy arguments of others by (1) identifying their goals and (2) determining whether the policies are likely to accomplish those goals.

Economists are not concerned with all policies. The scope of economics is limited. Mises writes that the scope of economics is determined by the traditional concern with "market phenomena." The economist has already decided that he is concerned with catallactic problems.

> Ever since people have been eager for a systematic study of economics or political economy, all have agreed that it is the task of this branch of knowledge to investigate the market phenomena, that is, the determination of the mutual exchange ratios of the goods and services negotiated on markets, their origin in human action and their effects upon later action (*ibid*.: 232).

The question emerges, says Mises, "of how to distinguish precisely, within the broader field of general praxeology, a narrower orbit of specifically economic problems" (*ibid*.). Mises answers that "[t]he subject matter of catallactics is all market phenomena with all their roots, ramifications, and consequences" (*ibid*.: 233). After some discussion, he concludes that

> [a]ll that can be contended is this: Economics is mainly concerned with the analysis of the determination of money prices of goods and services exchanged on the market. In

> order to accomplish this task it must start from a comprehensive theory of human action (*ibid*.: 234).

We have already noted Mises's price bias. A more correct statement would be that economics is mainly concerned with the determination of transactions, one characteristic of which is money price. We can separate the study of transacting under the conditions of the market economy from the study of action in general only by referring to particular conditions. We can say that economics

> in the narrower sense is the analysis of the market phenomena. This is tantamount to the statement: Catallactics is the analysis of those actions which are conducted on the basis of monetary calculation. Market exchange and monetary calculation are inseparably linked together (*ibid*.: 234).

In short, economics is concerned with mutually determined market transactions in which individuals make decisions by using money to compare the alternative courses of action.

In an isolated two-person trade, a transaction is the consequence of two people mutually deciding to exchange. Both parties mutually determine it. In a market with many buyers and sellers, a price can also be the consequence of a mutual decision by two people. However, experience and our ability to conceptually interchange positions tell us that the actions of those two are, even in the simplest case we can imagine, influenced by the competing factor suppliers, producers, and consumers. Although the mutual exchange ratios in the market economy are perceived subjectively by the exchanging parties, we need not and indeed should not -- if we aim to do economics -- confine our images solely to subjective viewpoints of individuals making personal choices. The choice of one individual has effects on others. We know this partly from experience but also partly from our exercise of the human ability to conceptually interchange positions with others. It is true that we can imagine a person who lacks such ability and who still acts. But economics (and praxeology, to the extent that it aims to deal with economic phenomena) is not concerned with such people.

Those who make interventionist arguments take these points for granted. And so do praxeological economists, who aim to evaluate their arguments. The problem we face as economists (in the traditional sense described by Mises) is how to build an image of this interaction without compromising the necessary subjectivism of praxeology. This is a problem that Selgin does not acknowledge or address.

Procedure

We discussed Mises's remarks on procedure in Chapter Four. He wrote that after completing the task of identifying and elucidating the general properties of action, the praxeologist goes further and defines "the less general conditions required for special modes of acting" (*ibid*.: 64, as quoted above). Economics proceeds as follows:

> From the unshakable foundation of the category of human action praxeology and economics proceed step by step by means of discursive reasoning. Precisely defining assumptions and conditions, they construct a system of concepts and draw all the inferences implied by logically unassailable ratiocination. With regard to the results thus obtained only two attitudes are possible; either one can unmask logical errors in the chain of the deductions which produced these results, or one must acknowledge their correctness and validity (*ibid*.: 67, as quoted above).

Mises's statements are satisfactory only at a most general level. A more detailed description of the procedure of economics is contained in the author's work, and especially in the present book. We have proceeded in a way suggested by Mises and employed by Selgin himself. Consider our concept of praxeological entrepreneurship. We defined it by making a contrast with a robot economy -- a system that contains no action.

We saw in Chapter Two that the robot economy is needed in order to elucidate the properties of praxeological entrepreneurship. By using this image as a counterfactual, we determine that action under the conditions of the market economy implies the personal properties of entrepreneurship. In using the robot economy, we need not define coordination, success or progress. We need make no judgments of the type that Selgin claims we must make once we move away from considering subjective choice in general.

To take the next step in understanding market phenomena, we build the image of the pure entrepreneur economy. This is the simplest image of interactive entrepreneurship. Due to complexity, we proceed step by step to build images of other entrepreneur economies, depending on the interventionist argument we aim to evaluate. We use these images in conjunction with the image of fully synchronized plans to give examples of entrepreneurship. But at each step we try to guarantee that all of the interactive phenomena we describe -- competition, consumer sovereignty, selection of the factors of production, the employment compact -- can be traced back to the fundamental concept of action, viewed subjectively. We cannot derive interactive entrepreneurship from the a priori assumption that individuals act. We must make assumptions about how others perceive one person's actions and how they act when they believe

that her action will or may affect them. As members of a body of professional economists and teachers, our goal at first, in the step-by-step procedure of building economic theory, is to identify the most fundamental types of interaction -- types that are present in the vast majority of arguments for and against market economy intervention. Later, we may proceed to identify less fundamental types.

It is true that the image of fully synchronized plans is an image of coordination. We use it on the one hand to help give examples of entrepreneurship and on the other to help understand coordinating actions. Examples require assumptions about specific ends. But this is also true about examples of the action of the isolated actor. We can define the abstract properties of action and the abstract personal properties of entrepreneurship without making such assumptions. But we cannot do anything useful with the knowledge we gain in this way until we make such subsidiary assumptions.

General Assessment

Our most basic argument against Selgin is that once we commit to the aim of evaluating policy arguments that assume interaction under the conditions of the market economy, we must *apply* praxeology in a particular way. What is missing from Selgin's analysis is an appreciation for the aim of economics, as expressed in Mises's work.

Selgin argues that in order to go beyond praxeology, it is necessary to have a theory of social causation and, therefore, a construct that contains assumptions about the ends people have. Yet we have derived concepts of competition, consumer sovereignty, selection of the factors of production, the employment compact and others without referring to specific ends. We mainly had to assume that action occurs under the conditions of the market economy.

Selgin rejects the use of equilibrium constructs in their usual sense on the grounds that they are not subjectively meaningful. He associates equilibrium as used by economists other than himself with an image of coordination, which he says requires a judgment based on some "constructed plan" or definition of success or progress. We identified three uses of the equilibrium concept in a praxeologically-based economic theory, however, as described in Chapter Six.

People who make interventionist arguments make assumptions about individuals' ends. As economists, our aim is to evaluate such arguments. In order to achieve this aim, we proceed to build images that contain the assumptions made in a particular argument. In doing so, we are led to build constructs that correspond to those that would have to exist to achieve the ends that are specified or implicit in the argument. But this

does not compromise the praxeological foundation of our economics in any way. Nor is it evidence that we are operating outside the boundaries of praxeology. The judgments we employ are not ours but those of the people whose arguments we aim to evaluate.

It is clear from our discussion that Mises did not aim to erect a wall between praxeology and economic theory. We have seen that, for Mises, economics "adopts for the organized presentation of its results a form in which aprioristic theory and the interpretation of historical phenomena are intertwined (*ibid*.: 66). This mode of procedure "is enjoined upon economics by the very nature and essence of its subject matter. It has given proof of its expediency" (*ibid*.). In other words, this step-by-step procedure involving discursive reasoning has proven itself in its evaluation of arguments for and against for market intervention. Two puzzling questions are raised by Selgin's exercise. First, why did he think that praxeology and economics should be separated? Second how could he have expected to persuade others to accept his thesis without accounting for the pertinent ideas of Mises himself.

2. SALERNO'S CONCEPTION OF THE MARKET PROCESS

The discussion here will focus on what Salerno calls "the most salient features of Mises's understanding of the dynamic market process as the outcome of calculable actions" (Salerno 1993: 121). He describes three of these features: (1) the fact that prices "are generated by the market process and serve as the data for economic calculation" (*ibid*.), (2) the market process is open-ended (*ibid*.: 122), and (3) the market process is "coordinative" (*ibid*.: 124).

Prices as Data for Economic Calculation

It is easy to agree with Salerno that for Mises, prices serve as data for economic calculation. Mises writes that "the structure of prices appears as a datum to which [an actor in the market economy] must adjust his own conduct" (1966.: 331). As we pointed out in Chapter Three, however, this way of describing the factors taken into account by entrepreneurship is not only old fashioned, it is misleading. It was suitable for presenting the theory of imputation; but that theory, although it teaches a lesson that many socialist and Marxist sympathizers still need to learn, belongs in the books on the history of economic theory.

Prices are not the only data "generated by the market process." Mises defined data as

> the bodily and psychological features of the acting men, their desires and value judgments, and the theories, doctrines, and ideologies they develop in order to adjust themselves purposively to the conditions of their environment and thus to attain the ends they are aiming at (*ibid*.: 646, as quoted in Chapter Four).

In making a choice, an isolated actor employs data about herself. In a market economy, she tries to take account of the data about others if she expects to earn high income in a competitive situation. In other words, she tries to account for their desires, judgments, etc.. This is especially important in pre-transaction actions, where individuals try to discover others' wants and abilities and where they first conceive of the potential from deceit, fraud and parasitic positioning. It is also important when they try to produce legal rights and other non-legal constraints on their respective actions. In producing these, they aim to deal with the agency problem and to facilitate teamwork in entrepreneurship. One way to accomplish this is to build an effective governance structure. To determine whether a particular set of transacting actions will yield a higher money income than its alternative, an actor must consider all of the data. The choice she eventually makes is not only about what prices to announce, accept, or expect to prevail in the future. It is also about the nature of the good or service being exchanged and the accompanying conditions of exchange, in particular the legal rights that are exchanged in the transaction.

Individuals communicate knowledge about their personal data through their positioning and by making transaction commitments. Those who receive such communications come to incorporate them, including their prices, in their calculations of profit and loss. For example, department store managers form expectations about nearby residents' choices to enter the store and to accept various transaction offers made by the store.[4]

The calculations that an individual makes in the market economy are based on others' transaction commitments and positioning and upon her expectations about future commitments and positioning. Such expectations are, in some measure based on the commitments accepted and positioning taken in the past. However, the distinctive feature of an individual acting in the entrepreneurial role is not that she expects the commitments and positioning of the past to be repeated but that she can

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[4]See Chapter six.

anticipate actions that will cause those acceptances and positioning to be different from what she observed in the past.

Thus, we can agree with Salerno that the prices "generated by the market process" serve as data for market calculation. But the prices of the past are at best one of many sources of information about data that individuals use in attempting to calculate. Nor are they the most important.

The Open-Ended Market Process

Open-ended means that "the continual exogenous changes in the economic data preclude [the market process] from ever reaching an equilibrium" (Salerno: 122). In describing an open-ended market process, Salerno writes that "promoter-entrepreneurs...seek to profit by actively promoting adjustment to change...[T]hey regard change itself as an opportunity to meliorate their own conditions and aggressively attempt to anticipate and exploit it." He claims that this is the market process articulated by Mises.

In light of our discussion in earlier chapters of entrepreneurship and the market process, the first question we must ask about Salerno's interpretation of the Misesian market process is whether it is accurate. After this, we can proceed to the relationship between his interpretation and the economic interaction under the conditions of the market economy discussed in this book.

The author must confess that he cannot determine whether Salerno's interpretation is accurate or not. The reason is that Mises himself was fuzzy on the meaning of the market process. There is no mention of the market process in Mises's chapter on scope and method. Where he does use this term, he typically means either (1) what we have called in this book "economic interaction under the conditions of the market economy" or (2) a specific interaction the result of which would be an equilibrium (or in terms that both Mises and Salerno use, a "final state of rest") if there were no further changes in the data.

Salerno appears to base his view on Mises's writings about the promoter. Mises wrote that "[t]he driving force of the market, the element tending toward unceasing innovation and improvement, is provided by the restlessness of the promoter and his eagerness to make profits as large as possible" (Mises 1966: 254-5, as quoted above). His use of the terms "innovation" and "improvement" very much suggest an open-ended process. On the other hand, Mises did not tell his readers why the promoter is restless or even what restlessness means. One might surmise

that he had in mind the fact that some promoters are more eager to profit and more perceptive than others. However, this fact need not lead to innovation and improvement,[5] although it would lead to an open-ended interaction. Quickness of perception and eagerness to profit may merely make the promoters more alert to hitherto undiscovered price differences than others. The requirements of a tightly-reasoned logical argument suggests that, if Mises meant to write about an open-ended, entrepreneurial market process when he used the promoter concept, he should have established a link between (1) restlessness, eagerness to profit, and quickness of perception and (2) innovation and improvement. A more elaborate explanation than Mises provided would seem necessary. But there is none, so far as the author can tell. One concludes that whether the market process that Mises wrote about was open-ended in Salerno's sense is uncertain. The case made by Salerno is not strong.[6]

Of course, the praxeological economist has two good reasons to believe that, except for the possibility of a rapid deterioration in the material environment, a market economy will be characterized by material progress in the sense that most people use this term. The first is that in defining entrepreneurship by means of the counterfactual of the RRE, we are led to recognize its potential imagination, inventiveness and creativity. Because every actor possesses these characteristics, every actor has the capacity to identify new goods and methods of production. The second is the recognition that, in a competitive environment, an entrepreneurial act by one individual reduces the money earned by competitors, thereby putting them in a position analogous to Crusoe in a deteriorating environment. If they do not innovate or improve the methods of production or goods, they will be worse off than they were before the entrepreneurial act. We could use the term "restlessness" to refer to the continuing "creative destruction" of competing individuals acting in the role of entrepreneurs. But that is not what Mises had in mind when he used this term.

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[5]The notion of "restlessness" appears to correspond to the "eagerness to profit," a characteristic that Mises attributes to promoters. We dealt with this issue in part three of Chapter Four.

[6]Salerno also seems unaware of the logical error in claiming that the entrepreneurial action would lead to a "final state of rest" in the absence of changes in the data. As we have noted, every entrepreneurial act changes the data. Every entrepreneurial act may lead the actor to change his theories and is likely to lead other actors to change their theories. Given this, the only reason we can give for Mises's claim, repeated by Salerno, is that he was preoccupied with the goal of demonstrating the theory of imputation. Salerno may not have appreciated this goal.

Nor is it what Salerno has in mind when he writes of Mises's "open-ended market process." He writes that open-ended refers to exogeneous changes in the economic data. A praxeological definition of open-ended should refer not to exogeneous changes in the data but to entrepreneur-driven changes. On the other hand, Salerno writes that "promoter-entrepreneurs...seek to profit by actively promoting adjustment to change." He is on the right track by regarding the entrepreneurs as active "promoters." However, they do not promote change, they promote their own gain which, under certain conditions, corresponds to progress.

Market Prices as Coordinating

Salerno begins his discussion of the market process being coordinative by quoting Mises, not from *Human Action*, but from another source. In a discussion about the use of money to make calculations in a market economy, Mises had written that one may conceive of the market as "the essence of coordination of all elements of supply and demand" (Mises 1990: 65). Salerno interprets this statement in the following way:

> This means that the structure of realized (disequilibrium) prices, which continually emerges in the course of the market process and whose elements are employed for monetary calculation, performs the indispensable function of clearing all markets and, in the process, coordinating the productive employments and combinations of all resources with one another and with the anticipated preferences of consumers. Such "price coordination," by insuring that scarce resources are secured by the entrepreneurs bidding the highest prices, also insures that at each instant Bohm-Bawerk's "Law of Costs" prevails, that is, that the constellation of resource prices that emerges on a market unhampered by legal restrictions always reflects the circumstance that existing resources are devoted to their most valuable uses as determined by entrepreneurial appraisements of future output prices (Salerno: 124-5).

One problem with this description may be the language. Literally, Salerno is claiming that prices not only clear markets but also coordinate resources with anticipated consumer preferences. Obviously a *price* cannot clear a market or coordinate resources. Only actions can do this. So we might substitute *transacting* for "prices." However, once we make this substitution, we see that the notion that transacting clears markets is either a truism or incomplete. If "clearing markets" means only that the buyer and seller in an exchange prefer at the moment to make the exchange rather than not to make it, the idea is both a truism and

redundant.[7] If "clearing markets" is used in the mainstream textbook sense, it would be necessary to specify time parameters and to make assumptions about the haggling and other transactions costs that might lead individuals not to exchange even though they would both regard themselves as better off if they had. Presumably, when mainstream textbook writers refer to market clearing, they mean that all of the demanders and suppliers of a specific product during a specific time make all the transactions that they regard as profitable to make. Since we can be certain that this is not the kind of market Mises wrote about, the only reasonable interpretation of Salerno's statement is that it is redundant. To clear the market means nothing more than to make an exchange.[8]

The second part of the statement refers to how the exchange actions *coordinate* resource uses with anticipated consumer preferences. Here, Salerno is faithful to Mises's concept of consumer sovereignty, as described in Chapter Three. However, as we have noted, such a single-focused treatment of entrepreneurship is lopsided. It disregards conspiracies to monopolize, errors and related actions, and external effects.

The most significant deficiency in Salerno's presentation appears to be his association of Bohm Bawerk's "Law of Costs" with coordination and an open-ended market process. One must assume that the "law of costs" refers to the theory of imputation, the presentation of which Mises regarded as one of the "tasks incumbent upon the theory of prices of factors of production" (Mises 1966: 334, as quoted above). This law is not about the market process, in Salerno's terms, but about a relationship between prices that would exist if there were fully synchronized plans and no monopoly prices. The function of the law of costs in this context is to help us realize that wages in an unhampered market economy are not established through a class struggle or by a monopsony conspiracy but instead by competing, economizing individuals who aim to profit solely by satisfying consumer wants. The law was the answer to the socialists and Marxists.

Though not the first to do so, Mises built a model of a system in which the prices of the factors of production add up to the prices of the goods they are used to produce, less interest, because this simple model is all that he needed in order to refute the socialist and Marxian exploitation

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[7]It is similar in this respect to Selgin's notion of equilibrating.

[8]Kirzner (1999: 216-7) makes the same point.

hypothesis and because it helped him present the Austrian theory of the trade cycle. Surely, he recognized that entrepreneurship was imaginative, creative, and inventive and that it would manifest itself in innovation and progress. However, the "market process" that Mises described in the context of his theory of price determination is not the kind of open-ended market process that praxeological economics aims to depict.

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