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Chapter 9

Conclusion

In this book, we have explored two key concepts in Mises's project of building an economics based on praxeology: entrepreneurship and equilibrium. Our conclusion discusses each of these in turn.

1. ENTREPRENEURSHIP

We have developed a theory of praxeological entrepreneurship. We first identified the properties of distinctly human action. Then we defined entrepreneurship as distinctly human action under the conditions of the market economy. To elucidate its properties, we used the method of the counterfactual suggested by Mises. According to this method, as we applied it to the market economy, we identify and elucidate the properties of entrepreneurship by contrasting the behavior of robots in a robot economy, which we called the robot rotating economy, with what we know about how distinctly human actors would act under the conditions of the market economy. By doing this, we deduced three properties of entrepreneurship: appraisement, undertaking, and uncertainty-bearing. We introduced the terms imagination, creativity and inventiveness to distinguish the action of entrepreneurship in performing the behavior

associated with these properties from the assumed behavior of robots in the robot rotating economy, or static equilibrium.

The purpose of this definition of entrepreneurship was to maintain the tightest possible connection between our images of economic interaction under the conditions of the market economy and praxeology. The praxeological economist needs a way to assure that her images of the market economy are praxeological. She can do this, we have maintained, by employing the concept of entrepreneurship that was gradually developing in the more praxeological economics literature before Mises and for which Mises himself provided the methodological foundation. She must always use the term entrepreneur to mean behavior that one is assuming to be caused by action, or choice, and use other terms like producer, consumer, and factor supplier to refer to other behavior. In this way, we assure that when we say that individuals act as entrepreneurs, we mean that they appraise, undertake, and bear uncertainty individually or in concert with others. Moreover, we assure that unlike other behavers in our image, they possess the characteristics of imagination, creativity and inventiveness.

We confirmed the importance of this image of entrepreneurship in praxeological economics by using it to identify errors and shortcomings in Mises's treatment of the same subject.

Mises's Place in the History of Entrepreneurship

Mises's contribution to the concept of entrepreneurship should be viewed in the context of the history of economic thought on the subject. From this perspective, his closest predecessor was Knight. Knight's *Risk, Uncertainty, and Profit* (1921) had maintained that uncertainty in the market economy:

> exerts a fourfold tendency to select men and specialize functions: (1) an adaptation of men to occupations on the basis of kind of knowledge and judgment; (2) a similar selection on the basis of degree of foresight, for some lines of activity call for this endowment in a very different degree from others; (3) a specialization within productive groups, the individuals with superior managerial ability (foresight and capacity of ruling others) being placed in control of the group and the others working under their direction; and (4) those with confidence in their judgment and disposition to "back it up" in action specialize in risk-taking (*ibid*.: 270).

Knight did not use the term "entrepreneur" to refer to the actions implied by this classification. He reserved this term for the appraising and uncertainty-bearing producers in already-formed business organizations (Gunning 1993: 40-41). His image of the entrepreneur, like Mises's

promoter, was narrower than the praxeological entrepreneur. On the other hand, Knight's treatment of the relationship between entrepreneurship, appraisement, and uncertainty-bearing was superior to that of Mises. Knight made the appraisement of other human actors a central feature of his image of entrepreneurial interaction.[1] Mises gave it short shrift.

Mises's contribution was to expand the concept of the entrepreneur and to point the way toward a praxeological definition. Specifically, in some passages, he implicitly used the term "entrepreneur function" to refer to the distinctly human element in economic interaction. Properly extended, such a usage would lead economists to consider the creative actions that cause the discovery and introduction of new products and the discovery of techniques of production, including new forms of business organization, new types of contractual relationships, and even new forms of legal rights to control actions.

Sidetracked by the Theory of Imputation

A careful reading of *Human Action* can leave no doubt that Mises placed entrepreneurship at the center of his descriptions of the market economy. He also provided pregnant hints about how to develop an image of praxeological entrepreneurship. Nevertheless, he did not himself develop the concept and did not use it in his descriptions. Instead, he gave preference to a concept he labeled the "promoter." He would have made a major contribution to efficiency in communication among economists if he had persuaded his readers to *always* use the praxeological concept of the entrepreneur in economic theory. Before presenting images of competing promoters, venturers, and intermediaries; Mises could have systematically employed what he called the "method of imaginary constructions," in conjunction with his definition of the market economy, to build the image of the praxeological entrepreneur. Doing this would have left no doubt that economics is indeed a branch of praxeology.

We have argued that on his way to building a praxeological economics, Mises apparently got sidetracked by his desire to follow Menger in presenting what he regarded as the Austrian version of the theory of imputation. As a result, he failed to develop a sufficiently praxeological definition of entrepreneurship. Mises's work clearly pointed to a procedure that would define and elucidate praxeological entrepreneurship by contrasting an image of a robot economy with what

[1]The relationship between Knight, Mises, and other economists who preceded them on the meaning of entrepreneurship is further developed in Gunning 1992.

we know about how distinctly human actors would act under market economy conditions. However, he did not pause to do this. He did not identify the personal properties of entrepreneurship and he disregarded its imagination, creativity and inventiveness. These omissions were particularly evident in his so-called "final state of rest analysis" and in his focus on the promoting entrepreneur, which we discuss below.

Other Omissions

Other errors and omissions seem to have also resulted from his following Menger. Like Menger, Mises presented an errorless theory of imputation, based solely on price relationships, the centerpiece of his economics. In this theory, the behavior of the producers and factor suppliers has the function of satisfying consumer wants. There is consumer sovereignty. But this is not realistic. Although individuals do attempt to satisfy what they perceive to be consumers' wants, they also try to take advantage (1) of others' propensity to make decision-making errors and (2) of the specific techniques they use to process information and to avoid errors. Fraud, deceit and passive parasitic positioning are absent from Mises's discussions of the pure market economy.

This theory also focuses disproportionately on pricing. The result of this is a systematic disregard for the broader form of interaction -- transacting. Pricing is one characteristic of transacting. But the other characteristics -- choosing the nature of the good to be exchanged and setting the conditions of exchange -- are also important characteristics, particularly if one is concerned with evaluating modern arguments for and against intervention in the market economy.

Finally, his focus on the pure market economy led him to relegate property rights problems to a subsidiary position. As a result, his descriptions of competition, entrepreneurial profit and loss, the selective process, and the market process appear lopsided and biased to the modern reader. If the socialist and Marxist arguments that wages are a consequence of a class conflict or monopoly conspiracy had not already been refuted many times, this approach would have been more understandable. However, economics during the first half of the 20th century was ready to move beyond this. It needed a praxeological foundation to be sure. But it also needed a praxeologically-based economics that was based on

realistic assumptions about the market conditions under which actors interact.[2]

Commentary

Mainstream economics during the period when Mises was most productive had also faltered. It also placed an undue emphasis on price, as opposed to transacting, and produced a model of interaction that largely disregarded the property system. Moreover, it tended to represent the market and pricing in formal, mathematical terms employing equilibrium constructs that were basically images of robot economies. Arguments for and against intervention that emerged from the literature during the period neglected transactions and failed to couch interventionist arguments in the framework of an incomplete property system. In addition, unlike Mises, most mainstream economists neglected entrepreneurship.

The transactions costs described in Coase's 1937 paper and the means of comparing institutional frameworks described in his 1960 paper were not part of either Misesian economics or the mainstream economics of the pre-1960s. However, although these ideas have gradually penetrated the mainstream, they have not yet achieved wide acceptance in neoAustrian economics and are strongly opposed by some of the more extreme natural rights theorists.

Suppose that Mises's goal in presenting his theory of the market had been to build an image that could be used to make a realistic description of market interaction under the conditions of the pure market economy in order to deal with the common interventionist arguments of today. Then he surely would have founded his image of the pure market economy on the following central concepts: (1) imagination, creativity and inventiveness; (2) interaction related to the propensity to make decision-making errors; (3) transacting; and (4) an incomplete property system. And he would surely not have made so many unqualified, praiseworthy statements about the market economy so early in his presentation of the theory of markets and prices.

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[2]One should also recognize that Mises used the grand image of prices and quantities to make two original contributions to economics: the Austrian trade cycle theory (in his 1935 [1912] book) and the delimitation of the role of interest (1966, ch. 19). The simple image of prices and quantities greatly simplify both the discovery and the presentation of these ideas.

2. EQUILIBRIUM

Praxeological economics identifies two major uses for the ideas usually associated with the term "equilibrium." The first is as a counterfactual to help identify the properties of entrepreneurship and to show how imagination, creativity and inventiveness are manifest in the various specialized entrepreneurial tasks, such as intermediation and providing guaranty. The second is a part of the procedure for giving examples of economic interaction. Beginning with an image of fully synchronized plans, economists introduce a change in the data that upsets the plans. Then they model the behavior that would be necessary to reach a new image of fully synchronized plans. Finally, they contrast the modeled behavior with the actions they can imagine being performed by imaginative, creative and inventive human actors in the same roles.

Since every good economist does praxeological economics, one can find these uses of the equilibrium concept in many mainstream and Austrian writings. However, because the procedure of praxeological economics has not previously been described, the use of the concept is often misunderstood. Moreover, its use often leads to errors by those who have little interest in or understanding of the praxeological foundations of economics but who aspire to become distinguished members of an economics profession. In this part, we discuss each of these uses of equilibrium in turn.

The Robot Economy as a Counterfactual

Our discussion of equilibrium has not only confirmed the importance of the equilibrium concept as a counterfactual, it has elevated this use. We have shown that the robot economy is a necessary step in the economist's effort to shift from an understanding of an isolated action to the understanding of distinctly human interaction under the conditions specified in the definition of the market economy. We have argued that the image of the rotating robot economy is needed to mentally organize the variety of specialized behaviors that people in the market economy choose to perform. Because the RRE contains these behaviors but, at the same time, is completely devoid of distinctly human interaction; it functions as a counterfactual in helping one identify the distinctly human action and interaction that must exist for the behaviors to be performed. By contrasting the RRE with what we know *a priori* and from experience about how human beings would act with regard to supplying factors,

producing, consuming and saving; we are able to isolate the distinctly human action of the market economy -- i.e., the entrepreneurship. Once we define praxeological entrepreneurship, we can proceed to show its facets and consequences under market economy conditions.

This book's inspiration for the use of the RRE as a counterfactual was Mises's writings about the evenly rotating economy. After saying that the method of imaginary constructions is the method of praxeology and after using the method to identify the necessary properties of action (ends and means, time, uncertainty), Mises implicitly suggested that one could develop a more complete understanding of the abstract function of the entrepreneur by using the ERE as a counterfactual. He wrote that "[i]n order to grasp the function of entrepreneurship and the meaning of profit and loss, we construct a system from which they are absent" (Mises 1966: 248). He also wrote that "[t]he term entrepreneur as used by catallactic theory means: acting man exclusively seen from the aspect of the uncertainty inherent in every action" (*ibid*.: 253). And he wrote: "In any real and living economy every actor is always an entrepreneur and speculator" (*ibid*.: 252). In these statements, he suggested a line of inquiry into the nature of entrepreneurship that to my knowledge had not previously been taken. He did not take this line, however, in his writings about economic interaction and its driving force.

The Endpoint and the Final State of Rest

As mentioned, the second concept of equilibrium is part of the procedure of giving examples of entrepreneurship. We build the deductions of economic theory by (1) building images of the programmed behavior needed to change from one endpoint, or image of fully synchronized plans, to the next and (2) contrasting those images with what we know to be the imagination, creativity and inventiveness of distinctly human actors in their adjustment to and anticipation of data change. We need not worry about such images being overly simplistic so long as we keep one eye on the ultimate goal of our work -- evaluating specific arguments for and against intervention in the market economy.

The inspiration for the use of the equilibrium concept as part of the procedure for giving examples also came from Mises, albeit not from his descriptions of the market process. To Mises, the market process was, on the one hand, the behavior that would have to be performed in order to bring about the ERE endpoint (final state of rest) and, on the other hand, the set of behavior that is performed because the real world is characterized by a constant change in the data. Such behavior may be anticipatory or responsive, different behaviors are assumed to be

differently motivated, and behavers are assume to be differently able to anticipate and respond.

But Mises's market process neglected imagination, creativity and inventiveness. We use these terms to represent the unique characteristics of human beings that differentiate them from animals and robots. Although all actors possess these characteristics by definition, they need not use them. We can imagine a complacent isolated actor who is content to live out his life in a comfortable natural environment without making his distinctive mark. But such complacency is not possible under the freedom of enterprise of the market economy. Because of the competitive nature of entrepreneurship, otherwise complacent individuals are likely to face, at one time or another, a declining standard of living. Their desire to avoid this prompts their imagination, creativity and inventiveness just as we surmise it would for an isolated actor whose material environment is continually deteriorating. Mises's market process contains nothing like this. His notion of the non-stop agitation of the promoting entrepreneurs seems very different. Mises's promoters are not the same as praxeological entrepreneurs.

The concept of equilibrium used in praxeological economics stands in opposition to the various uses of equilibrium that exist in the professional economics literature. Correspondingly, that literature has been criticized for lacking the "dynamic" element that is traditionally associated with the entrepreneur concept. The models of equilibrium used by econometricians and policy advisors are basically models of behavior. They represent either an image of behavior that has occurred in the past or the economist's projection of the behavior that will occur in the future. Praxeology demonstrates that in using them to predict the future, one would be committing the methodological sin that F. A. Hayek has aptly labeled "the pretense of knowledge" (Hayek 1975). To give policy advice on the basis of such models suggests an arrogance that is unwarranted due to the limitations of the behavioristic models. Yet this is also true of the Misesian market process models, which use promoters. The obvious way to avoid the temptation to write about behavior instead of distinctly human action is to use the praxeological procedure of first drawing a stark contrast between behavior and action and then assigning all distinctly human action to entrepreneurship.

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