

Consumer Sovereignty: the Key to Mises's Economics

©J. Patrick Gunning
Visiting Professor of Economics
Bryant University
1150 Douglas Pike
Smithfield, RI 02917

Please send feedback:
Email: gunning@nomadpress.com

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Abstract

The praxeological view of the isolated farmer's action is that he identifies and employs factors of production (means) to meet his ends. The result, in the absence of error, is that he satisfies his wants in the best way he knows. Analogously, Mises's economic view of economic interaction under the conditions of the pure market economy is that the entrepreneur role identifies and employs factors of production. The result, in the absence of error, is that the wants of individuals in the consumer role are satisfied. This statement implies consumer sovereignty. The entrepreneur is the mandatory of the consumer. The statement also reflects a view of entrepreneur role that is uniquely praxeological. By taking this view and following a specific analytical mode of deconstruction, one can trace all want-satisfying (i.e. all entrepreneur) actions in a market economy back to the category of action – the use of means to achieve ends.

If a pure market economy could exist, it would enable the members of a group to take the greatest advantage of the gains due to the "division of labor." The entrepreneurs in such a system would produce the quantities of goods and distribute those quantities in ways that consumers are most willing and able to buy. As a result, it would be the desired system from the perspective of both the classical and early neoclassical economists. This judgment is not based on values; it is not an ethical judgment. It is based on the classical insight of the higher productivity associated with the division of labor, which Mises dubbed the principle of the harmony of rightly understood interests. Mises incorporated this insight into his principle of consumer sovereignty.

I submit that this, in a nutshell, is the core of Mises's economics. The economics is built on the foundations of the deduction that consumer sovereignty prevails in a pure market economy. The burden of this essay is to defend this interpretation of Mises's economics by examining Mises's treatise *Human Action* (1966). It pays special attention to the part of this book in which he presents the image of the pure market economy. The essay also discusses previous literature on Mises's consumer sovereignty concept. Its goal is to renew interest in Mises's economics, albeit from a different point of view from that from which it has previously studied.

Consumer Sovereignty: the Key to Mises's Economics

Ludwig von Mises was the first to build an epistemological foundation for a value-free economics based on praxeology. In other words, he presented the rudiments of a logic of distinctly human action under market economy conditions that could be applied in a setting where the values, or ethics, behind the theory are not in question. The link between praxeology (the logic of distinctly human action) and economics was provided by the concept of consumer sovereignty and the complementary concept of the entrepreneur function. This is the basis for the title of this essay. Its purpose is to document this claim.

Let me elaborate. In his treatise, *Human Action* (1966), Mises regarded economics as a value-free science the aim of which is to evaluate arguments in favor of and against market intervention.¹ To evaluate an interventionist argument, one needs an image of a *pure market economy*. So Mises built an image of this economy in the spirit of the Austrian theory of value and cost and marginal productivity theory of distribution, which had been evolving since the latter half of the 19th century. He added to this theory by recognizing the unique function of the concept of the entrepreneur, presumably as it had been defined in the works of J. B. Clark and Eugen Bohm Bawerk and elucidated in the writings of Herbert Davenport and Frank Knight. He defined this function in such a way that it was a perfect complement to the concept of *consumer sovereignty*. The dual concepts of consumer sovereignty in the pure market economy and the entrepreneur function enabled him to incorporate the criterion for evaluating interventionist arguments that had traditionally been used by the vast majority of the classical economists, who also had the goal of evaluating interventionist arguments. These criterion were derived from the acceptance of the *principle* that individuals

¹I am disregarding the aim of evaluating the socialist society since this evaluation takes a somewhat different path and because this aim is not so relevant to modern professional economics.

benefit from trade through specialization and the division of labor. Given that the maker of an interventionist argument accepts this principle, the criterion could be used to make value-free evaluations of the arguments.

To my knowledge only one neo-Austrian economist, Israel Kirzner, has acknowledged the importance Mises attached to consumer sovereignty. Also a non-Austrian, Richard Gonce, has picked this up. Neither has recognized the full significance of the concept. Accordingly, they could not elucidate its contribution to Mises's goals.

Part 1 presents my claim in greater detail. Part 2 attempts to document my claim. It describes how the economics portion of Mises's treatise was organized and attempts to demonstrate with quotations that my interpretation is reasonable. Part 3 discusses interpretations by Kirzner and Gonce. Part 4 presents a brief conclusion.

1. THE CLAIM: CONSUMER SOVEREIGNTY IS THE KEY

To identify the role of consumer sovereignty, one must appreciate two goals that Mises aimed to achieve in his treatise. The first is to link praxeology to economics by requiring that all economic theorems be capable of being traced back to distinctly human action. The second is to develop value free economic theorems by assuming that all economists have a single purpose: to evaluate interventionist arguments according to the principle of the "harmony of rightly understood interests." The goal of this part is to present the reasoning behind these points and then to show how and why consumer sovereignty was an integral part of achieving both of these goals.

Linking Praxeology to Economics

Mises regarded economics as a branch of praxeology.² Praxeology is the study of action in its most abstract form. More specifically, it is the elucidation of all that is implied in the self-evident concept that distinctly human beings act. The praxeologist says that the human actor *in general* is driven by his desire to remove uneasiness and that he possesses the power to remove it.³ This implies the actor's imagination of a future state at which uneasiness is removed. Action further implies ends and means, a concept of causality, time and uncertainty (Mises 1966: chapters 4-6).

The Analogy Between Action in General and Entrepreneurial Action in the Market Economy

Consider the isolated farmer. In an effort to satisfy his wants as a *consumer*, the isolated farmer acts in the role of a *producer* and a *resource supplier*. This, we suppose, is what Mises had in mind when he wrote that:

every allocation of goods – even those in the processes of production – is an exchange, and consequently the basic law of economic action can be comprehended also in the conduct of the isolated farmer (1933 [1981]: 146).

This construct is more than an actor in general. It is thus more than a pure praxeological construct. We form the image of the isolated actor by combining the praxeology-derived properties of action with assumptions that reflect our interest in resource supply, production, and consumption of goods. We make these assumptions because of our ultimate interests in exchangeable goods and behaviors.

Economics is not concerned with comprehending the action of a solitary actor or the isolated farmer. The economist aims to understand market interaction – action with respect to others under the conditions of

²The idea that economics is a branch of praxeology should be evident to every close reader of *Human Action*. Unfortunately, however, Mises states this clearly only at the very end of his treatise (Mises 1966: 885). It is stated more clearly in his 1978b book. See Mises 1978b: 73.

³Mises 1966: 13-4.

private property rights, free enterprise and the use of money. Since the ultimate goal of the actors in market interaction is the consumption of goods, economists proceed to acquire this understanding by building an image that incorporates the knowledge that these roles must also exist in market interaction. The purpose of building such an image is partly to simplify the complex problem of envisioning the interaction. Thus we try to conceive of market interaction by looking at the extent to which the actions of numerous individuals, under market economy conditions, can also be conceived in terms of a resource supplier role that is employed by a producer role that tries to satisfy the wants of individuals acting in the consumer role.

By means of this analogy and by assuming that production and resource supply are directed by a single role – the entrepreneur – one can assure that propositions about economic interaction are also propositions about distinctly human action. Then analogy leads directly to the employment of consumer sovereignty and the entrepreneur function. The entrepreneur role in this image becomes director of the market interaction. It directs the means (the resources). It corresponds to the causal aspect of the isolated farmer's use of means to achieve his ends. It causes the means to be employed such that they cause consumer wants to be satisfied. The other roles – the consumer-saver, the resource supplier, and the hired manager – correspond to the performing aspect. They merely respond to price offers made by the entrepreneurs. The analogy thus helps maintain a link between praxeology and economics.

Why Make Praxeology the Foundation for Economics

Mises had an important reason for making praxeology the foundation of his economics. It was to protect economics from criticisms made by materialists, behaviorists and others who denied that economics could be both a subject concerned with distinctly human action and scientific. He conceived of an economics in which every statement in the theory is capable of expression in terms of the assumptions about distinctly human action. Anyone who accepts the proposition that human action is distinct could not deny the

usefulness of building theorems about it in general or, more specifically, about interaction under the conditions of the market economy. Whatever results one might achieve by studying the objects of action or merely behavior, economics as a branch of praxeology could maintain its position among the distinct and potentially useful types of knowledge.

Value Freedom Based on the Single Purpose of Economics

Mises solved the problem of value freedom by assuming a single purpose for economics: to evaluate interventionist arguments, including the argument for socialism, on the basis of the principle of the harmony of rightly understood interests (henceforth represented by the acronym HRUI). He recognized that the evaluation of an interventionist argument requires criteria. If different people use different criteria, there is no hope for achieving value freedom. However, he asserted that economics traditionally used a single criterion – subjectivity utility, as understood in relation to the gains from exchange, specialization and the division of labor. If this is true, economics could achieve the single purpose by building an image of an economy in which these gains were achieved. That economy – which Mises called the imaginary construction of the pure market economy – would then be the starting point of all evaluations.

An Image of the Pure Market Economy Is Needed in Order to Achieve the Purpose

The purpose of economics, according to Mises, is to achieve a position where one can most easily evaluate interventionist arguments based on the principle of the HRUI. To make such an evaluation, it is obvious that we must compare two situations: a market economy that contains the intervention and one that does not. For the typical interventionist argument, neither of these is likely to be what Mises called a pure market economy.

A pure market economy has a complete set of private property rights, among other things. This means that every individual can appropriate the full benefits of his action while he must pay its full cost.⁴

Consider an example. If a person proposes an intervention to conserve whales or other large sea creatures, she would typically assume an economy in which ownership rights in such creatures are too costly to consider establishing. Assuming that her assumption matches reality, the correct comparison is between an economy that contains the intervention and the same type of economy that lacks it. We might say that we need images of *specific market economies*. What, then, is the purpose of an image of the pure market economy?

I wish that I could give examples of Mises's use of a specific market economy that he build for the purpose of making such a comparison. Unfortunately, the interventionist arguments he considered were relatively simple: production controls and price controls. Indeed, he defined intervention so strictly that it was unnecessary for him to develop a concept of a specific market economy. I could find no deep discussions of interventions to deal with problems of pollution, congestion, or other problems that entail high costs of establishing or enforcing private property rights. The same is true about interventions to deal with deceit and fraud. For the interventionist arguments he considered, the image of a pure market economy was sufficient.

For the purpose of this essay, the fact that Mises did not develop an image of a specific market economy is not a shortcoming. On the contrary, it allows me to avoid the difficult problem of defining consumer sovereignty for the more complex cases. Moreover, since a specific market economy that lacks the proposed intervention is a variation of the basic pure market economy, one who aims to achieve the single purpose

⁴Mises writes that “[t]he imaginary construction of a pure or unhampered market economy assumes that there is division of labor and private ownership (control) of the means of production and that consequently there is market exchange of goods and services” (1966: 237). And: “Carried through consistently, the right of property would entitle the proprietor to claim all the advantages which the good's employment may generate on the one hand and would burden him with all the disadvantages resulting from its employment on the other hand” (*ibid.*: 655).

described above would need to build an image of it in any event. Thus, I propose to avoid the problem of building an image of an “impure” market economy because it is not essential to achieve my purpose of presenting the key to Mises’s economics.

The Two Tasks Faced by the Builder of an Image of the Pure Market Economy

In attempting to build an image of the pure market economy, the main challenge is to account for the full range of possible assumptions about the properties and character of actors. To properly meet this challenge, the image builder must attribute to all actors the same general properties and characteristics that any reasonable maker of an interventionist argument would do. To achieve this entails two tasks. First and most fundamentally, one must define action in a way that it incorporates all that any distinctly normal human actor would regard as implicit in the concept. Mises accomplished the first task by exploring and elucidating the properties of all action – or action, in general. In other words, he started his treatise with an exploration of the propositions that human actors have means and ends and that they experience time and uncertainty. He proved the necessity of these properties by making a series of contrasts. These contrasts entailed comparing an image of a being that has no motivation to act or a robot with an initially vague image of an actor. Such a contrast reveals, through intuition and experience, distinct properties of all that the reasonable mind attributes to distinctly human action.⁵

The second task is to make the properties of action relevant to the market economy. This requires two successive steps. On the one hand, one must define action in terms of production, consumption and saving in a money economy. On the other hand, due to complexity, he must divide actors into roles while not losing sight of the necessity of incorporating the properties and characteristics of distinctly human action into the

⁵He makes these contrasts in chapters 4, 5 and 6 of *Human Action*.

image. Mises achieved the second task by means of his complementary concepts of consumer sovereignty and the entrepreneur function.

The Concept of Consumer Sovereignty and the Entrepreneur Function

In a market economy, the vast majority of people find it necessary to supply resources or to produce goods for others in order to satisfy their own wants as consumers. In doing so, a person acts in the interests of the person or persons whose buying actions enable him to earn income. If the buyers are consumers, his actions benefit them directly. If the buyers are producers of consumer goods, his actions benefit consumers indirectly through his supply of a resource. From this point of view the actions of practically all people are dictated by consumers. Even if a person already possesses enough purchasing power to buy all the things necessary for what he regards as a comfortable life, he may have to give up a somewhat *more* comfortable life if he does not lend out his purchasing power. In using his own purchasing power for whatever purpose, he balances the satisfaction of future wants without lending and investing with satisfaction he would expect if he earns additional money by means of lending and investing. Again, he acts in the interests of the consumer role. Only if he is a hermit or an ascetic – who is not part of a market economy – can he avoid accounting for the consumer role. Following W. H. Hutt (1935), Mises named this idea the *sovereignty of the consumer*.

The idea of consumer sovereignty is a modern version of Adam Smith's invisible hand theorem. It is deeper than Smith's idea because it entails dividing individuals into roles that perform functions. The early neoclassical economists – Stanley Jevons, Leon Walras, and Menger – had developed a systems approach to the market economy and had introduced the concepts of role and function to summarize the system they had in mind. The consumer sovereignty concept is an allusion to that. Mises pointed out that the idea can be traced to Gössen (Mises 1966:334).

Mises used the concept of consumer sovereignty to refer to the producers of consumer goods and producer goods at each link in each resource supply chain in a pure market economy. Each producer, or supplier, is compelled by self interest to serve the interests of individuals acting in the consumer role.

In describing consumer sovereignty in Mises, one should recognize its connection to the greater productivity of the division of labor. In recurring dyadic exchange, individuals come to specialize and, to gain from the greater productivity of the division of labor. Similarly, in identifying a niche in a supply chain – i.e, in filling a role in the market economy – each actor expands the division of labor and, therefore, increases labor productivity. By keeping this connection in mind, one also keeps in mind the value freedom entailed in the statement that entrepreneur action in the pure market economy is complete subject to the principle of consumer sovereignty.

The Monopoly Exception

The only exception to consumer sovereignty in a pure market economy is monopoly. In her capacity as an owner of a consumer good or resource, a person may withhold some amount of it in order to charge a higher price for the remainder. This is not an exception to the theorem that the entrepreneur function is a mandatory of the consumer. The exception refers to an individual as a good or resource owner.

Mises and Hutt

For both Mises and Hutt, consumer sovereignty was a means to rebut a critique of the capitalist system.⁶ Hutt wanted to deal with “confusions concerning the essentially ruinous nature of competition.” Hutt asked: “Is it true, as Proudhon alleged, that ‘competition kills competition’?” (1935: 299)

⁶See Hutt 1940: 70 and Mises 1966: 357-8.

In using the consumer sovereignty term, Hutt defined his purpose clearly – to deal with the monopoly problem as an exception.⁷ Mises also used the concept to deal with the monopoly problem but, in the section where he introduced this concept and in numerous other sections in which he used it, he did not define his more fundamental purpose. One may, at first, think that his purpose was similar to that of Hutt. A more careful reader of *Human Action*, however, would discover that his purpose was to frame all descriptions of market interaction under the conditions of the pure market economy around the dual and complementary concepts of consumer sovereignty and the entrepreneur function. His more fundamental purpose was to incorporate the principle of the HRUI into the Austrian theory of value and cost.

The Entrepreneur Function

The entrepreneur function is performed by an imaginary role. This role performs all consumer want-satisfying activity in a market economy. We could imagine a role that hires all resources and produces all goods. Such a role would finance all resource employment and thereby bear all of the uncertainty about future demand and supply conditions. A market economy that contains such a role would have no financial markets. This is not realistic. We know that in real market economies, two separable incentives would exist for individuals to form financial markets. The first is the prospect for gain to people who have different demands for nearer and more distant future goods. Those who want to consume comparatively more goods than otherwise in the more distant future would have an incentive to lend to those who want to consume comparatively more goods in the nearer future. The second is the prospect for gain to people who possess different combinations of beliefs about profit prospects and wealth. Producers who believe that they can earn a high rate of profit but who possess insufficient purchasing power to make the desired investment have

⁷See Hutt 1935: 299 and 1940: 70.

incentives to borrow from owners of wealth who lack such beliefs but who have purchasing power. Loans or financial investments for either purpose would introduce uncertainty for the lender or investor.

An individual who performed the complete entrepreneur function in a praxeology-based economics would have to cause all goods to be produced and would have to bear all uncertainty. However, the lender in a financial market is not herself a producer; yet she cannot avoid bearing some uncertainty. It follows that so long as we want to include financial markets in our image of the pure market economy, we cannot build a complete image of the entrepreneur function. We must maintain a distinction between the lender and the borrowing producer of goods or resources.

Specialist guarantors may emerge to reduce the uncertainty to some lenders. However, in the event that the guarantor must pay off, he would have to voluntarily transfer rights to money. There is no way in a free society to assure that he would make the required voluntary choice to pay what he promised in the guaranty agreement. As a result, there is no way for a lender to completely avoid uncertainty. Thus, the concept of an individual who directs all of the consumer want-satisfying activities and bears all of the uncertainty cannot be completely formed so long as we aim to include all gain-from-exchange actions in a market economy.

This fact should make us mindful of a limitation and potential shortcoming and pitfall of every economic analysis that makes use of the concept of the entrepreneur function. To deal with complexity requires that we divide the market economy into functions and roles. Yet the entrepreneur role cannot be completely specified without eliminating the financial system.

Since the role of the entrepreneur as a function and consumer sovereignty are complementary, the same principles apply to the building a complete image of consumer sovereignty. The contribution of the consumer-saver's uncertainty bearing cannot be neatly fitted into economic theory. At the same time, the Austrian economics espoused by Mises cannot do without the uncertainty-bearing consumer-saver because the image of the market economy must include a financial system. We use the term "entrepreneur as a

function” to represent all distinctly human want satisfying action under market economy conditions. But we cannot afford to ignore the fact that the lender must also partly contribute to the performance of the function.

Review

Mises sought to build an economics that incorporates two core elements: (1) a praxeological foundation and (2) value freedom via the principle of the HRUI as manifest in the concept of consumer sovereignty. In review, I discuss each in turn. The first is that economics is a branch of the study of distinctly human action. As such, it is a new science that deals with phenomena different from that of the natural sciences. The second is that every normal human being is capable of recognizing the higher productivity of specialization and the division of labor. One who incorporates these two elements in her economics could reach a position where she could make unbiased evaluations of arguments for or against intervention. The procedure for building this economics begins with the construction of an image of a pure market economy. The complexity of such an image enjoins the economist to employ roles and functions. The entrepreneur function captures all of the action under market economy conditions that entails the allocation and direction of means, along with the uncertainty-bearing that is a necessary characteristic of market interaction, while the role of the consumer embodies all of the enjoyment of well being. That the entrepreneur role acts as the mandatory of consumers is a principle that helps incorporate the principle of the HRUI in the market economy image.

2. DOCUMENTATION

The purpose of this part is to document the claim I presented in Part 1 of this essay. I begin with the claim about how Mises solved the problem of value freedom in the construction of economic theorems. To do this cannot be a straightforward exercise because Mises does not introduce his economics by clearly referring to the purpose he assigns to it. For documentation, one must skip around his treatise and even refer to other works. I begin with the criterion of the HRUI. Later I return to the issue of how his introduction to economics reflects this purpose.

The Criterion Used to Evaluate Interventionist Arguments

I said that the criterion used to evaluate arguments is derived from the traditional view of exchange, specialization and the division of labor. Mises presents this view in two places in his treatise, although he refers to the HRUI in only one of these. The first is in a section on ideology, which occurs prior to the presentation of his economic theory. The second is near the end of the Part 4 of his treatise. Part 4 is the part where he builds his pure economic theory. I discuss these in reverse order, since I want to begin by documenting the importance of HRUI, then each in turn.

HRUI

In the last chapter of part 4 of *Human Action*, Mises writes the following about the HRUI:

What makes friendly relations between human beings possible is the higher productivity of the division of labor. It removes the natural conflict of interests. For where there is division of labor, there is no longer question of the distribution of a supply not capable of enlargement. Thanks to the higher productivity of labor performed under the division of tasks, the supply of goods multiplies. A pre-eminent common interest, the preservation and further intensification of social cooperation, becomes paramount and obliterates all essential collisions. Catallactic competition is substituted for biological competition. It makes for harmony of

the interests of all members of society. The very condition from which the irreconcilable conflicts of biological competition arise – viz., the fact that all people by and large strive after the same things – is transformed into a factor making for harmony of interests. Because many people or even all people want bread, clothes, shoes, and cars, large-scale production of these goods becomes feasible and reduces the costs of production to such an extent that they are accessible at low prices. The fact that my fellow man wants to acquire shoes as I do, does not make it harder for me to get shoes, but easier. What enhances the price of shoes is the fact that nature does not provide a more ample supply of leather and other raw material required, and that one must submit to the disutility of labor in order to transform these raw materials into shoes. The catallactic competition of those who, like me, are eager to have shoes makes shoes cheaper, not more expensive.

This is the meaning of the theorem of the harmony of the rightly understood interests of all members of the market society. When the classical economists made this statement, they were trying to stress two points: First, that everybody is interested in the preservation of the social division of labor, the system that multiplies the productivity of human efforts. Second, that in the market society consumers' demand ultimately directs all production activities (*ibid.*: 673-4).⁸

He does not express what he sees as the relationship between the HRUI and utilitarianism in this section of his treatise. He does this much earlier in his treatise, long before he tells us the more precise meaning of the HRUI. “The utilitarian economist [economists from Hume to Ricardo],” he writes, “does not...ask a man to renounce his well-being for the benefit of society. He advises him to recognize what his rightly understood interests are” (*ibid.*: 147).

To economists who are trained in mainstream modern welfare economics, it must seem strange to suggest that utilitarianism can be employed as a criterion for evaluating public policy while at the same time espousing value freedom. Yet utilitarianism is not exactly the criterion that Mises uses. He adds to this the recognition of the higher productivity of the division of labor and specialization. His contention is simple and apparently incontestable. So long as (1) one does not evaluate the policy itself but the argument of the policy advocate and (2) the policy advocate employs the utilitarianism associated with the classical economists' idea of the HRUI; the evaluation of arguments can be value free. The evaluator of arguments simply determines whether the argument is logical and relevant to the facts to which it claims to be relevant. The logic of the argument can be determined by contrasting it with the logic of economic theory, the starting point of which is the theory of the pure market economy. Relevance is determined by contrasting the pure

⁸Mises's section on “The Harmony of Rightly Understood Interests” is largely about socialism. This may be the reason why readers of *Human Action* have failed to realize its relevance to interventionist arguments and, therefore, its significance to Mises's economics.

market economy with the type of economy assumed in the argument and, if that type differs from the pure market economy, with the type of economy that exists in reality.

Ascetic and Non-ascetic World Views

Mises's other, and perhaps more systematic, treatment of the criterion is in his discussion of ideology. There he distinguishes between ascetic and non-ascetic world views. Neither pure reasoning nor experience can resolve disputes about whether a particular means will achieve ascetic goals because no agreement can be reached on the goals.

But where earthly things are involved, the natural affinity of all men and the identity of the biological conditions for the preservation of their lives come into play. The higher productivity of cooperation under division of labor makes society the foremost means of every individual for the attainment of his own ends whatever they may be. The maintenance and further intensification of social cooperation become a concern of everybody. Every world view and every ideology which is not entirely and unconditionally committed to the practice of asceticism and to a life in anchoritic reclusion must pay heed to the fact that society is the great means for the attainment of earthly ends. But then a common ground is won to clear the way for an agreement concerning minor social problems and the details of society's organization. However various ideologies may conflict with one another, they harmonize in one point, in the acknowledgment of life in society (*ibid.*: 179-80).

The "common ground" of which he writes in this passage is the principle of the HRUI, although he does not say so. That this is so is evident from the way he defines "society. "Society is division of labor and combination of labor" (*ibid.*: 143).⁹

Mises, Utilitarianism and Value Freedom

Mises's claim of value freedom has occasionally been disregarded by the neo-Austrian economists who associate themselves with him. In evaluating such post-Misesian writings, it is crucial to take Mises's claim seriously and, accordingly, not to treat it as some sort of casual or devious insertion of his own value

⁹See also the discussion on society at *ibid.*: 2.

judgments. That Mises took it seriously and that he understood fully what he was doing is evident from his remarks in his *Notes and Recollections* (1978a), which he wrote in 1940. He writes:

In my analysis of [the problems of socialism and intervention], I introduced a new point of view, the only one that allows a scientific discussion of these political questions. I inquired into the effectiveness of the chosen means to attain the avowed ends, that is, whether the objectives which the recommended measures were to attain would actually be achieved by the means recommended and employed (Mises 1978a: 114).

He does not mention his criterion here. But he discusses it two pages later when he writes about his critique of socialism. He writes that regardless of what argument is presented for socialism, the proponent of socialism must determine the extent to which “economic well-being” is reduced. Although we cannot measure economic well-being, we cannot ignore it either. “If the socialist system leads to chaos because economic calculation is impossible,” then it is “pure trifling” to present other arguments in its favor (*ibid.*: 116).

Note also that this quotation relates to the single purpose that makes value-freedom possible. Another indication of single purpose and the seriousness of value-freedom to Mises is in his *Critique of Interventionism*, which he wrote in the 1920s (Mises: 1996). In that book he writes: “The problem at hand is, What are the consequences of government and other interventions in the private property order? Can they achieve the result they are supposed to achieve?”

I claim then that Mises maintained that disputes about the benefits of a market intervention can be resolved so long as the disputants agree that to evaluate the interventionist argument on the basis of whether the proposed intervention promotes the division of labor. The assumed single purpose of economics, then, is to evaluate socialism and interventionist arguments on the basis of whether they promote the division of labor. A proposed intervention that does not satisfy this criterion is deficient.

The terminology used by Mises is that of the classical economists. Today we would refer to the division of labor as specialization of the human capital resource. Thus peoples’ rightly understood interests refer to

the interests that they would know have been served if they recognized the greater utility, subjectively evaluated, of human capital specialization.

Once one acknowledges the purpose of evaluating interventionist arguments, the question might arise of how he does this. The answer is that he incorporates the assumption that individuals benefit from a division of labor into his image of the pure market economy. His pure market economy contains an entrepreneur function that must conform to the principle of consumer sovereignty. He justifies this by pointing out that the modern theory of value and cost locates the source of value squarely with the evaluations of consumers. The entrepreneur function, as conceived by early non-mathematical neoclassical economists, appraises factors of production entirely on the basis of their contribution to profit, which in the pure market economy depends on its catering to the interests of the consumers (Mises 1966: 291). Basically, he equates the creation of society to take advantage of the greater productivity of the division of labor with the actions of the entrepreneur function, which cater to consumers' wants (see the discussion below in the section on "Harmony and Conflict of Interest").

Direct Evidence from the Treatise

If consumer sovereignty is the key to Mises's economics, one should be able to identify it in practically every economic theorem that Mises fact, it is present. Moreover the structure of the economics part of his text reflects the concept of consumer sovereignty. In the following I show that this is so.

The Structure of Mises's Economics in Human Action

Mises's treatise consists of seven parts. Parts 1-3 are clearly on praxeology, epistemology, and the meaning of human action under various non-economic conditions. Toward the end of part 3, he introduces economic calculation. Part 4, entitled "Catalactics or Economics of the Market Society" presents the economic

theorems for the pure market economy. Parts 5-6 apply the theorems and develop new ones, respectively, for socialism and the hampered market economy. Part 7 is entitled “The Place of Economics in Society.” It contains two eclectic chapters on the profession of economics plus a concluding chapter.

The structure of the middle, economic theorem chapters is a reflection of the only apparent hint of a road map for the economics part of his book. In Chapter 14, his chapter on scope and method, he writes:

The imaginary construction of a pure or unhampered [pure] market economy assumes that there is division of labor and private ownership (control) of the means of production...Starting from these assumptions economics tries to elucidate the operation of a pure market economy. Only at a later stage, having exhausted everything which can be learned from the study of this imaginary construction, does it turn to the study of the various problems raised by interference with the market on the part of governments and other agencies employing coercion and compulsion (*ibid.*: 237-8).

He says here that the pure market economy is an imaginary construction. A major part of the economist’s task, he says, is to elucidate this construct. At a later stage, one turns to the real world and to the question of how market interaction is affected by intervention. Unfortunately, he does not also tell us that he plans to use practically all of his Part 4 to elucidate interaction under the pure market economy. Only afterwards, he neglects to say, does he expect to be in a position to evaluate arguments favoring socialism and interventionism (the hampered market economy), respectively. In other words, he does not tell his readers that the statement quoted above in this paragraph describes how he has structured the economics part of his treatise. Part 4 is about the pure market economy, while parts 5-6 are about socialism and market intervention, respectively. This is a significant omission since he does not describe the structure elsewhere either. In a book filled with challenges to the reader, one might overlook this passage and completely miss a critical message about how the book is structured.

Note his statement about how the pure market economy assumes a division of labor. Now recall my discussion about the relationship between the classical economists’ use of this concept in conjunction with the principle of the HRUI. In light of this relationship, it seems that his statement indicates that he aims to incorporate the classical insight directly into his definition of the pure market economy. From here on, there

can be little doubt to the careful reader that he will be searching for a way to define and elucidate the pure market economy in a way captures this insight. That his next major topic is the entrepreneur suggests that he finds this way in the concept of the entrepreneur as a function.

The Entrepreneur Function

I have established that Mises had the goal in part 4 of his treatise of elucidating market interaction under pure market economy conditions. The simplest such image is one that contains a class of individuals whose choices to act consist of directing the production of all goods and who bear all of the uncertainty. Mises did not, in fact, completely define the entrepreneur function. His approach consisted of trying to conceive of what he called a pure entrepreneur. This is an entrepreneur whose choices direct all production but who possesses no funds of his own to finance production (*ibid.*: 253). He distinguishes between this role and that of the capitalist, who merely finances production. Since production requires financing and since the pure entrepreneur cannot bear uncertainty, Mises concludes that capitalists are also entrepreneurs.

It would appear strange to a reader that such a crucial concept as the entrepreneur function could not be defined strictly for the likewise critical pure market economy. But this is, in a sense, the end of the definition story. No clearer definition is specified. In future discussions of the entrepreneur function he uses the combination term “entrepreneurs and capitalists.”¹⁰

¹⁰The interpretation is complicated by the fact that while he denies that a clear definition of the “pure entrepreneur” is possible, he still says implies that the entrepreneur function can be defined with “praxeological rigor” (*ibid.*: 255). For some references to his usage of the entrepreneur function see the appendix.

The Market and Prices

Following chapter 14 on scope and method, Mises begins his description of what he calls *the pure or unhampered market economy*. He introduces chapter 15 logically enough in section 1 by distinguishing between “the market” and socialism. Next, in section 2, he introduces the concept of capital goods as Mengerian higher-order goods which people take into account when they act. The apparent reason for distinguishing capital goods is, first, to dispel some common errors among economists who use the concept of capital and, second, to prepare the reader for Section 3, which is entitled “Capitalism.”¹¹ Section 3 is intended to dissociate the analysis of the pure market economy from the negative connotations of the word “capitalism.”

One must conclude that the first three sections of the chapter are meant to clear the ground for his goal of analyzing “the problems of the market society” (*ibid.*: 266). In this analysis, “economists place the study of the pure market economy in the center of their investigations” (*ibid.*: 266-7).

The real economic analysis starts with his section on consumer sovereignty. In the market economy individuals are subject to the mandate of the consumer. The

capitalists, entrepreneurs, and landowners...are not free to spend money which the consumers are not prepared to refund to them in paying more for the products. In the conduct of their business affairs they must be unfeeling and stony-hearted because the consumers, their bosses, are themselves unfeeling and stony-hearted.

The consumers determine ultimately not only the prices of the consumers' goods, but no less the prices of all factors of production. They determine the income of every member of the market economy (*ibid.*: 270-1).

There is only one exception to consumer sovereignty: “Monopoly prices are an infringement of the sway of the consumers” (*ibid.*: 272).

Mises’s section on consumer sovereignty is only the first thrust, so to speak. He follows it with sections on “Competition,” “Freedom,” and “Inequality of Wealth and Income.” These sections, with the minor

¹¹Readers who use the 1949 edition or the newer 1988 “Scholar’s edition” as a reference should be aware of three crucial paragraphs that clarify Mises’s capital theory.

exception of a brief part of the section on competition, are also ground-clearing. The real meat of the chapter – the application of the concept of consumer sovereignty – comes in sections 8-14, where he describes how entrepreneurial activity and competition among entrepreneurs lead to consumer sovereignty. The following quote from Section 8 characterizes the approach:

The specific entrepreneurial function consists in determining the employment of the factors of production. The entrepreneur is the man who dedicates them to special purposes. In doing so he is driven solely by the selfish interest in making profits and in acquiring wealth. But he cannot evade the law of the market. He can succeed only by best serving the consumers. His profit depends on the approval of his conduct by the consumers (*ibid.*: 290-1).

Here he labels consumer sovereignty the “law of the market.”

As pointed out, Mises identified the monopoly exception to consumer sovereignty. He deals with monopoly in the next chapter, chapter 16, entitled “Prices.” The discussion of monopoly encompasses about half of the chapter. The extensive treatment of monopoly is another indication of the significance of consumer sovereignty. In other parts of the chapter he also confirms the centrality of the consumer sovereignty concept. For example, at the start of his discussion about how the prices of higher-order goods are determined, he writes: “The ultimate source of the determination of prices is the value judgments of the consumers” (*ibid.*: 331). Numerous other examples can be found by searching the word “consumer.”

An important discussion in this chapter concerns a distinction between the entrepreneur in his entrepreneur capacity and the resource owner (*ibid.*: 358). Mises says that the entrepreneur in this capacity “is always subject to the full supremacy of the consumers. But it is different with the owners of vendible goods.” That the entrepreneur capacity refers to the entrepreneur function can be inferred from passages earlier in the text, before he even defines the entrepreneur function (*ibid.*: 81-240). In the passage at *ibid.*: 81, he refers to the capacity of entrepreneur and capitalist. Although he does not cite pages, this is clearly a reference to the section of Chapter 14, where he attempts to define the entrepreneur function by attempting to “think the

imaginary construction of a pure entrepreneur to its ultimate logical consequences” (*ibid.*: 253). The pure entrepreneur is penniless. Since a penniless entrepreneur cannot bear uncertainty, the attempt fails. A financing “capitalist is always also virtually an entrepreneur and speculator” (*ibid.*).

Time Preference and the Theory of the Trade Cycle

The chapters on markets and prices make up the core of Mises’s elucidation of economic interaction under pure market economy conditions. He follows these with four chapters that culminate with his most well-known contribution to economics – his theory of the trade cycle in chapter 20. The theory of the cycle, too, is based on the assumption of consumer sovereignty. To understand this one must take account of time preference – the notion that consumers have wants for goods in the near and in the more distant future.¹² Entrepreneurs adjust to this property of action by producing both consumer goods for the near future and capital goods, which are defined as goods that their producers or other producers farther down a supply chain, ultimately plan to use in satisfying wants in the more distant future. An unexpected increase in the quantity of money distorts the entrepreneurs’ calculations by causing interest rates to change in a way that is similar to how they would change if there was a decrease in consumer demands for near-future goods and a corresponding increase in their demands for more distant-future goods. When entrepreneurs adjust to the change, they make decisions that are bound to be regarded as errors in the future. Specifically, the entrepreneurs borrow more money than otherwise to increase their production of capital goods. Their efforts bid up the prices of the resources that are specialized in producing the capital goods and they bid down the

¹²Mises used the term time preference in this generic sense. To refer to the evaluation of near future goods in terms of the evaluation of more distant future goods, he used the term “originary interest.” This distinction has recently been clarified by Gunning (2005c) and by Walter Block et. al (2006). The following discussion is based on Mises 1966: 550-65.

prices of resources specialized in producing consumer goods. The capital goods structure shifts as entrepreneurs adjust to what they perceive to be a relative decrease in the demands for near future goods.

Since real consumer demands for goods at different times have not changed, we can say that the entrepreneurs (i.e., the entrepreneur function) use the borrowed money to produce relatively too many capital goods. Their “malinvestments” get revealed when consumers use their incomes to demand more goods for the nearer future and to save than the entrepreneurs expect. Responding to these consumer choices, entrepreneurs reverse their decisions to produce capital goods. In doing so, they increase their bids for resources to supply near future goods and decrease their bids for resources specialized in helping to produce more distant future goods. The produced, specialized resources that lose value are regarded as malinvestments. The capital goods structure shifts again. A readjustment, which is interpreted by observers as a contraction, is necessary. Thus, the unexpected increase in money causes a business cycle.¹³

Mises’s theory of the cycle is based squarely on consumer sovereignty. The proof of this are his preliminary remarks about the cause:

It is in influencing this primordial function of the rate of interest that the driving force of money can become operative in a particular way. Cash-induced changes in the money relation can under certain circumstances affect the loan market before they affect the prices of commodities and of labor. The increase or decrease in the supply of money (in the broader sense) can increase or decrease the supply of money offered on the loan market and thereby lower or raise the gross market rate of interest although no change in the rate of ordinary interest [demand for near future goods in relation to goods in the more distant future] has taken place. If this happens, the market rate deviates from the height which the state of ordinary interest and the supply of capital goods available for production would require. Then the market rate of interest fails to fulfill the function it plays in guiding

¹³Mises’s presentation of the trade cycle theory may confuse modern readers who are accustomed to defining money in terms of statistical aggregates like M_1 (currency plus checkable deposits), M_2 (M_1 plus near monies), and so on. Mises’s theory is about an increase in commodity money or money substitutes, which correspond most closely to M_1 . Thus he refers to “cash-induced changes in the money relation” (*ibid.*: 555). When Mises uses the term “credit expansion,” he is referring to a change that most closely resembles a change in M_1 . However, since the appearance of new M_1 may not entail an increase in loans, he restricts the term credit expansion to increases in M_1 that enter the economy via an increase in loans (*ibid.*: 551). A theory of the trade cycle based entirely on commodity money is mentioned by Mises (*ibid.*: 537). However, “[e]ven a rapid increase in the production of the precious metals can never have the range which credit expansion can attain. The gold standard was an efficacious check upon credit expansion, as it forced the banks not to exceed certain limits in their expansionist ventures” (*ibid.*: 574).

entrepreneurial decisions. It frustrates the entrepreneur's calculation and diverts his actions from those lines in which they would in the *best possible way satisfy the most urgent needs of the consumers* (*ibid.*: 547, italics added).¹⁴

Thus Mises points out that, under particular circumstances, an increase in money can interfere with consumer sovereignty as it applies to the choices of entrepreneurs to cause nearer vs. more distant future wants to be satisfied. It does this by altering the market interest rate, which is the signal that the entrepreneurs are assumed to ultimately use to make such choices. The entrepreneurs do not satisfactorily coordinate the satisfaction of demands for near future consumer goods with the satisfaction of demands for more distant future consumer goods.

Mises presents a revealing discussion in this chapter on why he included the theory of the trade cycle in Part 4 of his book. He first points out that if the increase in quantity of money is due to government intervention – for example, by a central bank (Mises calls this the “monetary authorities”) – one might want to “relegate” a discussion of the problems “to the analysis of interventionism.” He discusses interventionism in Part 6 of his treatise. He defends his decision by saying that

the right place for the analysis of the problems involved is not in the theory of interventionism but in that of the pure market economy. For the problem we have to deal with is essentially the relation between the supply of money and the rate of interest, a problem of which the consequences of credit expansion are only a particular instance (*ibid.*: 573).

Here he recognizes that a non-government, cash-induced change in the quantity of money could also cause market interest rates to fall under particular circumstances. So there is no need to wait until he analyzes intervention to present the theory. This statement thus helps to confirm that practically all of part 4 of Mises’s treatise is about the pure market economy.¹⁵

¹⁴See also the discussion at *ibid.*: 553, 564, and 565. Note: the term “originary interest” refers to consumers’ tradeoffs between near and distant future goods.

¹⁵I say “practically” all because, as we shall see shortly, he includes in this part a theory of economic interaction under conditions in which private property rights are incomplete.

Theory of Resource Prices

In the next chapter, chapter 21, on “Work and Wages,” Mises approaches the determination of wages (the price of labor) and unemployment from the point of view of the consumer. Regarding how wages are determined, he writes: “It suffices to observe incidentally that the employers deal with labor as they do with commodities because the conduct of the consumers forces them to proceed in this way” (*ibid.*: 593). In his discussion of catallactic unemployment, he writes: “Wage rate fluctuations are the device by means of which the sovereignty of the consumers manifests itself on the labor market” (*ibid.*: 599). He also refers to the pure market economy which, of course, is the context within which he considers issues relating to work and wages. He writes:

Unemployment in the unhampered market is always voluntary. In the eyes of the unemployed man, unemployment is the minor of two evils between which he has to choose....The final wage rate is that rate at which all job-seekers get jobs and all employers as many workers as they want to hire. Its height is determined by the marginal productivity of each type of work (*ibid.*).

An “unhampered market” is a less precise name than the pure market economy. But since he had previously used this term (see the appendix), it is clear that he is writing about the pure market economy.

Mises’s chapter 22 is about natural resources, or land. Consumer sovereignty is also the unifying element in this chapter, although he does not actually say this. He writes:

The modern theory of value and prices is not based on the classification of the factors of production as land, capital, and labor. Its fundamental distinction is between goods of higher and of lower orders, between producers' goods and consumers' goods (*ibid.*: 636).

This idea refers back to how the prices of all of the higher-order goods are determined. As we noted above, Mises says that they ultimately derive from the valuations of consumers.

Other Exceptions to Consumer Sovereignty

In chapter 23, Mises introduces the possibility of external effects (*ibid.*: 653-63). The fact is, he points out, that market economies in everyday life lack a complete set of private property rights (*ibid.*: 655). As a result,

there are external effects. The significance of this part of the book to my claim is that it represents the relaxation of one of the conditions of the pure market economy. In this case, it is the condition of complete private property rights. Upon realizing this, the reader is led to ask about the other conditions of the pure market economy.

Recall that a second condition was the use of money. This condition has a deeper implication than it appears at first. We can understand this implication by referring to how Mises introduces the theory of the trade cycle. He begins with the concept of neutral money (*ibid.*: 538). This is a money for which the demand for and supply of is constant. In his terms, there would be no change in the “money relation.” In every real market economy, however, the situation is different. Every change in the data leads to changes in the money relation.

It is necessary to understand this fact before one can analyze cash-induced changes in this relation. Thus, in introducing the trade cycle, Mises first relaxes the assumption of the pure market economy that the money relation does not change. Then he analyzes the effects of one specific cause of a change in the money relation – a cash-induced change caused by an increase in the quantity of money.

The combination of his introduction to his trade cycle chapter and his discussion of external effects associated with incomplete private property rights gives one a perspective on part 4 of *Human Action* that might not otherwise be gained. It suggests that he uses portions of that part not only to describe the pure market economy but also to introduce some theorems associated with economies that do not satisfy the conditions of the pure market economy. In my view this further reinforces my claim.

Let us return to Mises’s discussion of external effects in order to see its relation to consumer sovereignty. Consider a reader who had interpreted Mises’s consumer sovereignty discussion in chapter 15 as biased

because it did not take into account external effects. If such a reader tried to check his interpretation by reading ahead to chapter 23, he would discover that he was mistaken.¹⁶

Harmony and Conflict of Interest

Mises ties most of part 4 of his treatise together in his concluding chapter. In the early part of the chapter he points out that the market economy is characterized by changes in the data. Such changes are the source of entrepreneurial profit and loss (*ibid.*: 664). The function of the entrepreneur, he writes in effect, is to anticipate and adjust to such changes.¹⁷ In doing this, the entrepreneurs are the mandatories of the consumers. Accordingly, there are no conflicts of interest in the market economy. Of course, entrepreneurs make errors. Moreover, the entrepreneurs' identification and deployment of resources to make adjustments inevitably harm some individuals. However, to inhibit the adjustment process in order to avoid such harm would reduce the advantages to be gained from the higher productivity of the division of labor (*ibid.*: 664-6). His section on the HRUI appears in a later part of the chapter.

One might view this chapter as the culmination of Mises's achievement of one of his a major goals – to show how a theory of the pure market economy can be used to incorporate the principle of the HRUI into the Austrian theory of value and cost, or marginal productivity theory of distribution. Since these theories were largely accepted by the economics profession at the time when he was writing *Human Action*, Mises

¹⁶Mises does not deal explicitly with the third exception to consumer sovereignty – “producers’ propaganda.” However, he does not ignore it. He merely rules it out of economics by assuming that the task of government is to control fraud. Specifically, he writes that “within the sphere of private property and the laws protecting it against encroachments on the part of violent or fraudulent action, there is no antagonism between the interests of the individual and those of society” (*ibid.*: 726). Regarding the possibility of a producer persuading a consumer to buy a product that she will regret buying, by means of a hard sell or subliminal persuasion that is not as strong as deceit, he deals with this under the subject of advertising. An advertiser may succeed in this, he writes. However, it is such a small problem that we would not want a law against advertising (*ibid.*: 321).

¹⁷He uses the concept of entrepreneurial profit and loss rather than the entrepreneur function.

might well have hoped that the best economists of his age would come to appreciate the critical insight about how to keep economic theorems value free, which he developed during his early explorations of interventionist arguments.¹⁸ A very, very competent and close reader – perhaps a genius – would recognize right away that he both planned to achieve this goal and that his discussion of the HRUI in the chapter was an announcement of his achievement. That the chapter has not been perceived in this way, to my knowledge, is a testament to the consequences of Mises’s failure to provide his reader with suitable road maps throughout his treatise.

Why Link Economics to Praxeology?

Mises believed that by making economics a branch of praxeology, he could secure economics “against many fallacious criticisms but clarify many problems hitherto not even adequately seen, still less satisfactorily solved.” The criticisms he had in mind were those made “on the part of irrationalism, historicism, panphysicalism, behaviorism, and all varieties of polylogism” (*ibid.*: 7). To achieve this goal, the economist must be capable of tracing

back all theorems to their unquestionable and certain ultimate basis, the category of human action, and to test by the most careful scrutiny all assumptions and inferences leading from this basis to the theorem under examination...[This] procedure is [not] a guarantee against error. But it is undoubtedly the most effective method of avoiding error (*ibid.*: 68).

Maintaining a strong link between praxeology and economics is necessary, then, in order to avoid the criticisms leveled against classical and early neoclassical economics by a variety of critics.

How does Mises propose to trace the theorems back? The entrepreneur function plays an important part, although Mises does not tell his readers this. Because the entrepreneur function is defined in such a way that it directs all resources, one can capture the command over resources in the pure market economy by means

¹⁸See the discussion earlier in the essay on value freedom.

of the entrepreneur function. The task of tracing economic theorems amounts, then, to identifying the entrepreneurship entailed in the entrepreneur function.

Due to the complexity of a real market economy, the effort to build an image of it must identify functions and employ roles to perform those functions. The pure entrepreneur role plays an integral part. It encompasses the truly “active” element in the employment of means to achieve ends. The consumer role passively receives satisfaction over time by means of consumer spending and saving. The resource supplier roles, including that of the hired manager and the capitalist saver, passively maximize the income they earn from their ownership of resources or purchasing power.

3. RELATED LITERATURE

Kirzner on Mises’s Consumer Sovereignty

So far as I know, only two authors, Israel Kirzner and Richard Gonce, have previously made claims about the centrality of consumer sovereignty in Mises’s economics.¹⁹ I first discuss Kirzner. In at least three of his writings, Kirzner discusses the centrality of consumer sovereignty (1996: 170-72; 1999:220-1; and 2001: 108-110, 169-170). The following is probably his most representative statement:

Mises believed, as a proposition of positive economics, that, with certain exceptions, market outcomes are determined by consumer preferences. Decisions by producers and by resource owners are, in a free market society, motivated by the desire to anticipate the spending decisions of consumers...There are grounds for believing that, in his criticism of what he judged to be unsound

¹⁹Murray Rothbard has written critically about the concept of consumer sovereignty, although the object of his criticism was not Mises but Hutt (Rothbard 2004: p. 619ff). His critique does not apply to Mises because it fails to recognize the strict complementarity between consumer sovereignty and the role of the functional entrepreneur. In addition, like Kirzner and Gonce, Rothbard imputes a value element into the concept, failing like the others to realize that in *Human Action*, at least, Mises meant consumer sovereignty to only apply, strictly speaking, to the entrepreneur function in the imaginary construction of the pure market economy.

economic policies, Mises was simply assuming that his readers held consumer sovereignty to be a desirable feature in an economic system...A free market will tend to generate decisions that can be successfully implemented and which respect and do express consumer sovereignty (2001: 169-170).

The positive proposition implicit in the notion of consumer sovereignty, says Kirzner, is that prices tend, with the exception of monopoly, toward a level that corresponds to consumer preferences.²⁰ The normative judgment is provided by “readers,” namely, that such prices are desirable.

There is *a sense* in which Kirzner’s interpretation is correct. Mises does, in fact, assume that readers regard pure market economy prices as desirable. Nevertheless, by investigating this sense in greater depth, we can see the shallowness of Kirzner’s interpretation. Mises did not first build an image of the market economy and then say that it exhibits a property that readers would regard as good. More fundamentally, he assumed that readers – and all makers of arguments favoring or opposing market intervention – accepted the classical economists’ insight that the division of labor yields greater labor productivity. One might add that he also assumed that readers would agree with his decision to link praxeology to economics by means of building an image of the pure entrepreneur that embodies the identification and use of means to satisfy the wants of consumers.

The evaluation of interventionist policy proposals, says Mises, must take account of potential consumer gain due to the actions of others that are motivated by the others’ desire to gain from exchange and specialization. I do not see this requirement as imposing a normative judgment. I see it as demanding that

²⁰In more than one place, Kirzner associates this proposition with Menger. Although Kirzner is correct about Menger on the issue of the relationship between consumer preferences and the prices of goods of different orders, Menger wrote nothing of which the author is aware about the pure market economy or the entrepreneur function. Thus, there is no reason that I can see to connect Menger to the consumer sovereignty that Mises assumed to exist in a pure market economy.

the reader define the subject matter of economics in the traditional way.²¹ One may be inclined to describe traditional economics as “normative.” To do this, however, suggests that some other type of economics is possible and perhaps derivable.

Why one would want to claim that market outcomes are determined by consumer preferences without including the knowledge that exchange leads to the division of labor and greater productivity is not easy to tell. Any definition of “outcomes” in terms of consumer preferences would seem to be inherently normative, as Kirzner uses this term. Only outcomes that were devoid of any referent to the properties of action – e.g., behaviorist and material outcomes – could qualify as “positive.” In other words, if one wants economic analysis to acknowledge that to be meaningful, outcomes must be evaluated by consumers, why would one not also want to acknowledge the higher productivity of the division of labor?

Gonce on Mises’s Consumer Sovereignty

So far as I know, only one other author – a non-Austrian who was largely critical of Mises – has previously promoted the centrality of consumer sovereignty in *Mises’s economics*.²² In 1988, Richard Gonce published an essay in a history of economics collection. In his introduction, he wrote:

The thesis of this essay is that the idea of consumer sovereignty, assured by a principle of harmony of rational interests in the long run, but engendered by a notion of entrepreneurial driving-force, is the overarching doctrine identifying [Mises’s version of substantive Austrian economic theory] (Gonce 1988: 136).

After a fine elucidation of the concept, Gonce concludes that *Human Action*

is a brilliant polemical accomplishment. As an example of results produced by the method of laying down axioms and proceeding by ratiocination, it is ingenious and admirable. As a contribution to technical economic theory, however, it is less impressive:

²¹It would not be correct to limit this traditional definition to that espoused by the classical economists. A similar definition was employed by non-mathematical neoclassical economists mentioned earlier in the essay.

²²The centrality described by Kirzner was not in Mises’s economics but in Mises’s beliefs about policy.

focusing on the case of pure capitalism and the long-run time period, it draws on existing economic theory, but sets up a series of definitions, distinctions, and assumptions, and on them mounts arguments that pass over or eliminate any considerations that might compromise consumer sovereignty, harmony of interest, and optimality of consumer satisfaction.

The greatest value of his contribution lies in its provocativeness (*ibid.*: 144).

Unlike Kirzner (and every other student of Mises of whom I am aware), Gonce understood the centrality of consumer sovereignty to Mises's economics and the foundation upon which it is based. He did not appreciate its praxeological foundations and did not try to evaluate Mises's success at preempting those who use economic theory to support interventionist arguments. If economics is not an effort to evaluate interventionist arguments, he could have asked, then what constitutes a contribution to technical economic theory? His dispute with Mises, if he could have had one, would have been over the purpose and subject matter of economic theory.

A more reasonable conclusion for Gonce to have reached is that Mises did not complete his project. Mises failed, Gonce could have argued, to more fully explore the implications of the fact that a real market economy differs from the image of the pure market economy. For one thing, Gonce could have argued that Mises did not expand on his brief discussion of incomplete private property rights in his chapter on "The Data of the Market." Second, Gonce could have criticized Mises for giving insufficient treatment to deception and fraud. Third, Gonce could have pointed out that entrepreneurship and ownership cannot be separated in a real market economy. Therefore, every monopoly entails entrepreneurship.²³ Nevertheless, I can only marvel that someone outside of neo-Austrian economics was able to achieve a better grasp of the key role of consumer sovereignty in Mises's economics than all of the insiders of whom I am aware.

²³The closest Mises comes to recognizing the limitations of using the pure market economy to evaluate interventionist arguments is to say that for people who consider a definite restrictive measure as justified, "[t]he decision about each restrictive intervention is to be made on the ground of a meticulous weighing of the costs to be incurred and the prize to be obtained. No reasonable man could question this rule" (Mises 1966: 748).

Eshelman on Harmony of the Rightly Understood Interests

In a 1993 paper, Larry Eshelman aimed to place what he claimed was Mises's utilitarianism in a broader moral philosophy framework. Eshelman was able to flush out the fact that Mises's evaluations of policy were based on a moral principle derived from the theorem of the rightly understood interests. He deserves high marks for this, since a number of Austrians had asserted that his evaluations were based on a utilitarian moral philosophy (Gunning 2005a and 2005b). He was not concerned with the fact that Mises attributed this theorem to the classical economists' evaluations of interventionist arguments and that Mises made the evaluation of interventionist arguments the goal of his economics. Nor has any neo-Austrian economist put Eshelman's recognition of the theorem in its proper context.

Mises Partly to Blame

Mises himself is partly to blame for the subsequent misinterpretation of his economics. First, he neglected to describe the relationship between value judgments and economic theory to his readers in the appropriate places. Second, he neglected in his evaluations of interventionist proposals to deal with the more complex cases, particularly those associated with incomplete private property rights. He seems to have implicitly assumed, albeit incorrectly, that if he provided the guiding light, as it were, his readers would make the appropriate applications.

4. CONCLUSION

The discussion of part 4 of *Human Action* demonstrates that Mises used most of this part to present economic theorems for market interaction under pure market economy conditions. He also used portions of

it to present theorems for economies in which the money relation was not constant and in which private property rights were not complete. Thus practically all of his economic theorems that pertained to economies in which government intervention was absent were presented in part 4.

On the basis of the structure of his treatise and various references, I have argued that the key to understand his economics is consumer sovereignty. He referred repeatedly to consumer sovereignty throughout part 4. Besides this, I have shown that he established a connection between the principle of the HRUI and consumer sovereignty. This is important because Mises had stated his desire to incorporate the principle in of HRUI into his framework for evaluating interventionist arguments.

The first section in part 1 of this essay demonstrated Mises's value-freedom. It then went on to present my claim that consumer sovereignty is the key to understanding the economics. The burden of part 2 was to support my claim that consumer sovereignty is the key to understanding Mises's economics. I used five pieces of evidence. I identified a specific passage in his chapter on scope and method that describes his plan. It was to build an economic theory of the pure market economy and then, later to apply it to the evaluation of interventionist arguments. To carry out this plan, he needed to build the image of a role that directs all production and that bears all uncertainty. For this purpose, he borrowed the early neoclassical entrepreneur function. Second, I showed that the economics chapters in his book were arranged in precisely the way that one would want to arrange them in order to complete the broader project. The theory of the pure market economy part was followed by parts, respectively, on socialism and on the hampered market economy. Third, I showed that in the consumer sovereignty subsection of an early chapter in his economics part, Mises was concerned only with elucidating the concept under the conditions that he defined as the pure or unhampered market economy. The concept of the entrepreneur, which is required for this elucidation, was also introduced in his first and second chapters of the economics part. Fourth, I showed with text references that all of the remaining sections in the economics part were based on the pure market economy and, correspondingly, the

concept of consumer sovereignty. Finally, I showed that the concluding chapter in his part 4 on the harmony of interests tied together the important strands of his thesis.

I also showed in this essay the connection between HRUI and consumer sovereignty. This connection is important for Mises because it links (1) the classical principle of the greater labor productivity due to the division of labor to (2) the neoclassical ideas of the entrepreneur and consumer sovereignty.

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APPENDIX

MISES'S CONFUSING DISCUSSION OF CONSUMER SOVEREIGNTY

I believe that I have made a very strong case that consumer sovereignty was the foundation of Mises's economics. Yet this has not been recognized by anyone to my knowledge. This includes Mises's presumed best US students, Israel Kirzner and Murray Rothbard. Why? My answer, on the basis of *Human Action*, is that Mises's treatment is confusing.²⁴ To support this explanation, this appendix extracts several pertinent quotes from his 4-page subsection entitled "Consumer Sovereignty." It pays special attention to the term "market." On the one hand, it is concerned with whether a reader who is more sympathetic to Mises is likely to see where his concept of consumer sovereignty fits into his grand scheme. On the other hand, it is concerned with whether a typical mainstream economist is likely to get an accurate view of his discussion.

What is the Market Society?

Mises introduces his section on consumer sovereignty with the following paragraph.

The direction of all economic affairs is in the *market society* a task of the entrepreneurs. Theirs is the control of production. They are at the helm and steer the ship. A superficial observer would believe that they are supreme. But they are not. They are bound to *obey unconditionally* the captain's orders. The captain is the consumer. Neither the entrepreneurs nor the farmers nor the capitalists determine what has to be produced. The consumers do that. If a businessman does not strictly obey the orders of the public as they are conveyed to him by the structure of *market* prices, he suffers losses, he goes bankrupt, and is thus removed from his eminent position at the helm. Other men who did better in satisfying the demand of the consumers replace him. (Mises 1966: 269-70, italics added).

In this paragraph, Mises argues that all producers and financiers in *the market society* are subject to consumer sovereignty. We have already noted that he recognizes the exception of monopoly *for the pure market economy*. He mentions this exception later in the section. He also recognizes the exception of externalities, which exist when private property rights are incomplete (*ibid.*: 654-663). And he recognizes the exception of fraud, which he had ruled out earlier in the text for the pure market economy by assuming the absence of

²⁴There may, of course, be many other reasons including the different agendas of the students and Mises's failure to communicate in person the ideas that he aimed to communicate in his treatise.

fraud.²⁵ Thus, his statement appears to be about the *pure market economy*. Does he really mean for it to apply to the *market society* also?

In the section immediately preceding the “consumer sovereignty” section, he seems to distinguish between the market society and the market economy:

The analysis of the problems of the *market society*, the only pattern of human action in which calculation can be applied in planning action, opens access to the analysis of all thinkable modes of action and of all economic problems with which historians and ethnographers are confronted. All noncapitalistic methods of economic management can be studied only under the hypothetical assumption that in them too cardinal numbers can be used in recording past action and planning future action. This is why economists place the study of the *pure market economy* in the center of their investigations (*ibid.*: 266-7).

In this quotation, he seems to be using the term “market society” to refer to “capitalism” as it has evolved through history. Also in the introductory section of the chapter, he uses the phrase “market society” to discuss the possibility of mixed system. Referring to a “society based on private ownership by the means of production,” he writes that there is no such thing as a mixed economy – a system that would be in part

²⁵Fraud is not mentioned in Mises’s definition of the pure market economy. Mises says only that the government protects “the market” against “encroachments” (*ibid.*: 237, as quoted above). This fact may be another source of confusion. At the beginning of Chapter 15, where he describes the “Characteristics of the Market Economy,” he writes the following:

The state, the social apparatus of coercion and compulsion, does not interfere with the market and with the citizens' activities directed by the market. It employs its power to beat people into submission solely for the prevention of actions destructive to the preservation and the smooth operation of the market economy. It protects the individual's life, health, and property against violent or *fraudulent* aggression on the part of domestic gangsters and external foes. Thus the state creates and preserves the environment in which the market economy can safely operate (*ibid.*: 257, italics added).

It seems to me that one is compelled to assume that the “market economy” at the beginning of Chapter 15 is the same as the “pure market economy” that he defined in Chapter 14 and that “the state” in this quote is the same as the government in his earlier definition. Given these assumptions, one can deduce that Mises means for this paragraph to help clarify the concept of protecting the market against encroachments. By encroachments, he is referring, among other things, to “fraudulent aggression.” It is difficult to interpret this paragraph in any other way. After all, it comes at the beginning of his chapter on the market and his chapter on the market is the first step in his task of elucidating the pure market economy. An opponent to this view could argue that Mises uses the term “market economy” elsewhere in his text in a broader sense. (Of particular interest is that in the earlier part of Chapter 14, the term “market economy” is prefixed by the term “pure.” In the latter part, where he broadens his discussion, there is no prefix.) I would rebut this first by pointing to the structure of his book and his stated goal in Chapter 14. Second, I would refer to his chapter on “The Government and the Market” (chapter 27), where he discusses a hampered economy. He writes: “What characterizes [the hampered market economy] is the fact that the government does not limit its activities to the preservation of private ownership of the means of production and its protection against violent or fraudulent encroachments” (*ibid.*: 718). I would have to assumed, of course, that “unhampered” in this quote means the same thing as “pure” in the earlier chapter.

Exercises such as this become tedious. This is why I say that Mises’s discussion is confusing. The most sensible way to get to the heart of it, I maintain, is to recognize the structure of *Human Action* and the ultimate purposes of the treatise.

capitalist and in part socialist (*ibid.*: 258). Later in treatise, he writes that so long as a government, or socialized sector of the society does not become entirely separated, it is part of the *market society* (*ibid.*: 716). Also read what he says when he introduces the term in *Human Action*:

The classical economists sought to explain the formation of prices. They were fully aware of the fact that prices are not a product of the activities of a special group of people, but the result of an interplay of all members of the *market society* (*ibid.*: 62).

Surely he could not assume that his readers at this stage of his discussion would associate the term “market society,” as he used it in this introductory statement, with his definition of the pure market economy in chapter 14.

Yet, if he means for the term “market society” in the consumer sovereignty section to have a broad meaning, there is an obvious conflict with the way he uses that term in the introductory paragraph of the “consumer sovereignty” section. Indeed, the use of the term in that section seems to be an anomaly. He presumably means to use “the pure market economy.”

Other Market Concepts

I now discuss other references to the pure market economy in his section on consumer sovereignty. Mises points out that there are many producers at different orders in the structure of production. Many of these do not produce goods for consumers. He thereby directs his readers’ attention to the notion that consumer sovereignty entails messages being communicated up and down each resource supply chain. Taking account of all of the producers and resource suppliers who help produce a product, Mises writes that consumers “determine the income of every member of the *market economy*” (*ibid.*: 271, italics added). Here he uses the term “market economy.” One assumes that he means the same thing that he did when he used the term “market society” and “pure market economy.”²⁶ However, he does not actually say this and his introduction of yet a third term to mean the same thing is confusing.

Mises then digresses to discuss an idea promoted by Frank Fetter that the consumer is like a voter in a democracy. Mises says that a more correct version of the metaphor would be to say that “a democratic constitution is a scheme to assign to the citizens in the conduct of government the same supremacy the *market economy* gives them in their capacity as consumers” (*ibid.*, italics added). Here he uses “the market economy.” But he goes on:

It is true, in the *market* the various consumers have not the same voting right. The rich cast more votes than the poorer citizens. But this inequality is itself the outcome of a previous voting process. To be rich, in a *pure market economy*, is the outcome of success in filling best the demands of the consumers (*ibid.*, italics added).

In making his point, Mises uses three different terms: “the market economy,” “the market” and the “pure market economy.” As in the previous case, he presumably means all of these terms to refer to the “pure

²⁶He also uses the term “market economy” in a more general sense in Chapter 14 where he seems to distinguish it from the pure market economy. To demonstrate these uses, one should search the term “market.”

market economy.” And again, his use of more than one term serves to confuse, especially since he uses those other terms more broadly elsewhere in his treatise.²⁷

Mises goes on to describe the one exception to the consumer sovereignty concept:

There is in the operation of a *market economy* only one instance in which the proprietary class is not completely subject to the supremacy of the consumers. Monopoly prices are an infringement of the sway of the consumers (*ibid.*: 271-2).

Here he uses the phrase “*a market economy*,” implying that the concept of consumer sovereignty applies to all classes of market economies. Clearly this cannot be what he means. He must be referring to the pure market economy. Failure to modify “market economy” with “pure” and his use of the generalized “a” is misleading again.

Mises goes on to refer to a metaphor that is often used by people who do not think deeply about the market economy. People often compare the bosses of businesses with the leaders of government. This type of comparison is shallow, he asserts. “The position which entrepreneurs and capitalists occupy in *the market economy* is of a different character. ‘A chocolate king’ has no power over the consumers, his patrons” (*ibid.*: 272, italics added). Here he writes about the market economy but, again, he would have been wise to confine his remarks to the “pure market economy.”

Finally, anticipating the argument that businesspeople may entice government officials to give them special privilege, he asserts that the capitalists and entrepreneurs *cannot* influence government officials. He writes that “[i]n an *unhampered market economy* the capitalists and entrepreneurs cannot expect an advantage from bribing officeholders and politicians” (*ibid.*: 272-3, italics added.) In the preceding chapter 14, he writes of “the pure or unhampered market economy” (*ibid.*: 237, as quoted above). Here he leaves out the term pure, presumably because he wants to stress the pure market economy’s nature of being unhampered by government. However, this procedure, which presumably would make sense to a Misesian scholar, reveals again a certain looseness of terminology that leaves a hint that Mises may be playing with words in order to manipulate the reader into supporting an ideology that she otherwise would not support. Clearly, it is an avoidable ambiguity that can have no other result but to detract from his message.

Conclusion

The main problem with Mises’s presentation is his failure to sufficiently assist his reader. There is nothing particularly novel about the idea of regarding market interaction under market economy conditions as a means of satisfying the wants of consumers.²⁸ The consumer sovereignty concept does not apply strictly to real world examples of the market economy because private property rights are never complete and because deception and “information asymmetries” are pervasive. Unfortunately for interpreters, Mises did not make

²⁷Referring specifically to his term “the market,” that is the title of chapter 15. However, the title is quite *inappropriate*. The reason is that his chapter is not specifically about the market or the market economy. It is about the pure market economy. See his chapter 12 for broader uses of the term “the market.”

²⁸I am not referring to Hutt here but to a much earlier exposition by Philip Wicksteed (1914). Wicksteed writes that:

organized production, which is the proper economic field, is a means only, and derives its whole significance from its relation to “consumption” or “fruition,” which is the vital field, and covers all the ends to which production is a means...(Wicksteed 1914a: 14).

it crystal clear that he was concerned with consumer sovereignty under very special conditions. In these passages, he began by referring to “the market society,” then shifted to “the market economy,” then referred to the “pure market economy” and “a market economy,” and then referred to the “unhampered market economy.” A Mises scholar who is aware of the structure of *Human Action* and of the grand scheme in his economics would presumably know that whenever Mises asserts consumer sovereignty, the only consistent interpretation is that he is writing always about the “pure, unhampered, market economy” and that, in this section on consumer sovereignty, he always has in mind only one exception: monopoly. His remarks about consumer sovereignty in other parts of the text often apply to the wider “market economy.” But the main concern of the section on “consumer sovereignty” is the pure market economy. In this economy, as Mises had defined it earlier in *Human Action*, (1) the only functions of government are to maintain order, to enforce private property rights and to prevent fraud by using its control over coercion and (2) there is a complete set of private property rights.