

## LUDWIG VON MISES

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**Ludwig von Mises, one of the most important academic personalities of the 20th century, is undoubtedly most famous as the most principled proclaimer and defender of liberalism and as the most consistent critic and opponent of any form of statism. As a continuer of the Austrian School, he experienced much contempt and rejection of his liberal views in the first half of the 20th century. The teaching of liberalism came into the centre of attention of economic science and economic practice only after 1974, when F.A. Hayek became the first non-Keynesian to win the Nobel Prize for Economics. It is true to say that at the time of his death in 1973, the Austrian Ludwig von Mises was recognized by all – both friends and enemies – as one of the outstanding intellectual personalities of the radical anti-statist, libertarian – conservative movement. In the USA, „liberal“ means approximately what „social democrat“ means in Europe. Therefore, classic liberals such as Mises began to call**



**their conceptions „libertarian“. Economics was Mises' passion, because he was convinced, that the future of human civilization depended on it. In his work „Human Action“ (1949), he wrote that „knowledge of economics is a basic element in the structure of human civilization“. It is the basis on which the moral, intellectual, technological and therapeutic successes of the last centuries have been built. It depends only on people, whether they correctly use the wealth this knowledge gives them. However, if they do not use this knowledge in the best way, and ignore its lessons and warnings, they will not remove economics, but destroy our society and the human race. By his research work, Mises significantly contributed to the further development of the Austrian Economic School by applying so-called praxeology, by his conception of liberalism, theory of money, theory of economic calculation and Austrian theory of the economic cycle.**

Ludwig von Mises was born at L'vov in 1881. He studied law and economics at Vienna University from 1900 to 1906. After gaining a doctorate of law, he worked as an advocate for a few years, and up to 1934 as secretary of the Vienna Chamber of Commerce. He qualified as a senior lecturer in 1913, and from 1918 he worked as an unpaid extraordinary professor at Vienna University. The teaching of C. Menger and of Böhm-Bawerk, who was his teacher until 1913, had great influence on the formation of his economic views. After Böhm-Bawerk's death, Mises had the ambition to become a full professor at Vienna University, but as a result of the discrimination prevailing in Austria in that period, he never succeeded. The focus of Mises' teaching activity lay outside the university at his private seminars at the chamber of commerce, which he organized and led every two weeks from 1920 to 1934. In 1927 he founded the Austrian Institute for Research into Economic Cycles, in which Hayek, Morgenstern, Haberler and others were also active. In 1934, he left for Geneva, where he worked at the Department of International Relations until 1940, when he emigrated to the USA, where he had serious problems with his means of support until the end of his life in 1973. From 1945 until 1969,

when he retired at the age of 87, he worked as a visiting professor at New York University. His life-long wish to become a regular university professor was not fulfilled either in his native Austria or in his second homeland – the USA. From 1948 to 1969, as during his life in Vienna, he organized and led regular theoretical seminars for students of New York University and interested outsiders. Many participants in these seminars later became widely known and recognized personalities in economics, such as Israel Kirzner and Murray Rothbard. In 1947, Mises, together with F.A. Hayek and W. Röpke founded the Mont Pelerin Society, an international association of market (liberally) oriented economists and other social scientists. Until the beginning of the sixties he actively participated in the annual sessions of the society, but then he criticized the growing influence of M. Friedman and the economists of the Chicago School for their statist views. He rejected Friedman's erroneous view, according to which the welfare state and freedom can be combined.

L. Mises ended his active work at the university in 1969. He died in New York on 10th October 1973, soon after returning from a holiday in the Swiss Alps.



### Starting points and pre-conditions for economic analysis

Ludwig von Mises is known to the expert economic public as the most important representatives of the orthodox form of liberalism and individualism. In his view, the main cause of all economic problems lies in state intervention in the economy, which destabilizes the market system and prevents the creation and renewal of economic equilibrium. Therefore, he strongly rejected the Keynesian economic theory and the economic measures derived from it. His economic analysis started from the subjective theory of Karl Menger and Böhm-Bawerk. In contrast to his predecessors, he assumed that if utility is exclusively a result of subjective evaluation, this means that it represents the ordinal arrangement of the preferences of the consumer.

Mises regarded economics as an axiomatic-deductive science. The basic assumption of all economic theories is the axiom that people are active: they deliberately pursue their aims and prefer higher aims to lower, so that they maximize their utility. Mises thought that this axiom is true. Anyone who wanted to cast doubt on it or refute it, would have to act himself. From this he concluded that it is a non-hypothetical axiom – a priori correct, so that all the claims, which can be directly or indirectly deduced from it are correct. This is also clear from the theory of limit utility, according to which every acting person always prefers that which subjectively gives him greater utility, rather than that giving a lower level of utility, under the assumption that the supply of goods will increase by an additional unit. It follows from this that the additional unit of the product can be used only to satisfy such a need, which is situated lower than all the preceding needs, which were satisfied by units of the same product. It is a law of diminishing limit usefulness, which applies and is correct and does not need to be empirically proved. Mises also applied his axiom about human action to the theory of money and the economic cycle, as well as to his whole system of theoretical economics, which he conceived as praxeology – the logic of action. According to Mises, economics is not a science by itself, but an integral part of the general science of human action, that is, praxeology.

The application of praxeology provides Mises with consistent knowledge of existing economic phenomena and processes. Then individual economic subjects use this knowledge in their economic decisions.

Praxeology is one of the greatest contributions of L.v. Mises. He understood economics in a praxeological sense. Praxeology is the science of human action. He regards the person as an acting person and his actions as rational and purposeful. The most important feature of human action is that it is purposeful action in the

sense that the individual endeavours by his action to achieve a subjectively better situation, than that in which he already is. The main cause of human action is purpose and reason. Purpose, which is determined by the subjective preferences of the person, stimulates the action of people and reason directs this action so that the purpose is achieved. Mises distinguished between human action and human plans. A person is directed in his action by his own individual subjective plan. The action of a person is determined by his own plan, since only he has a good knowledge of his needs and possibilities. Therefore, only such a plan is rational.

Such an understanding of economics is in sharp contrast to the views of those economists, who think that human action is decisively determined by the external environment (social, economic, natural, historical, institutional) or by customs and traditions.

Many critics of praxeological economics cast doubt on the rationality of human action, and appeal to historical experience, with many tragic proofs of human fallibility and irrationality.

Praxeological economics understands human rationality differently. According to praxeological economics, human rationality cannot be understood *ex post*, in the results of human action, but *ex ante*, as the aim or purpose of human action oriented towards the future. Human action oriented towards the future includes the factor of expectation, but also the factor of uncertainty. Since the future is unknown and uncertain, according to praxeological economics, the possibility of error does not contradict the rational action of people.

Mises' human action has a dynamizing effect. The aim of human action is to achieve a better situation than that already existing. A person's action changes his situation and puts him in a new situation, which he may not have expected, but which he evaluates to form a new plan for his future action.

If we take into consideration specific data about human action, for example, the price of goods expressed in money, according to Mises we leave the area of economics and come into the area of economic history, although it would be history only of the final factor. All numerical data about future prices are only speculative expectations. We can expect good and bad, but we can never be entirely certain in advance.

### The liberalism of Ludwig von Mises

Ludwig von Mises was not only a continuer of the development of the theoretical postulates of the Austrian School of neo-classical economics, but also included Smith's economic teaching, especially his theory of the so-called invisible hand, in his theoretical starting points.



The starting point for the economic teaching of L. von Mises is the existence of a division of labour, private property and the non-intervention of the state in economic life. On these foundations, he created the model of the so-called circular flow or the economy of continual change. The market is the main mechanism in the functioning of this model. On the basis of the functioning of the price mechanism, the producers obtain information about what and how much to produce. The functioning of individual components of the market mechanism has the result that the whole system is constantly in motion, or to be more exact spinning round. The aim of the economic system is to make the most effective use of limited productive resources. This assumes that indicators of their rarity are known. If the indicators of rarity are not determined, it is not possible to determine the effectiveness of use of the existing productive resources. According to von Mises, rarity can be determined with the help of prices, which originate on the basis of the free entry of all the productive resources and enable their effective combination.

L. von Mises rejected the administrative bureaucratic model of the economy, because it does not have a market for productive resources, that is the mechanism, which measures their rarity, so there is no criterion for rational choice. If market prices do not exist, nobody, not even an all-powerful ruler can know what to produce, how to produce and for whom to produce. Disorder, waste and uneconomicness occur in such an economy. It is clear that the idea of economic liberalism permeates the whole of his economic teaching.

Mises was one of the most important supporters of liberalism in the 20th century. He refused to understand liberalism as a religion or world view. According to him, liberalism is a teaching about the connections of social life and it represents the application of this teaching to the behaviour of people in society. It promises nothing that society cannot achieve. To reduce suffering and increase happiness is the aim of liberalism. Mises explained that the aim of liberalism is to support the external material well-being of people. It is not directly interested in their spiritual needs. Liberalism is directed exclusively towards the material aspect, not because it does not value spiritual life, but from the conviction that the deepest interior aspects of man cannot be touched from outside by external interventions and influences. Liberalism does not want to create anything other than the external conditions for development of the internal spiritual life. Mises rejected the view that liberalism promotes the interests of businessmen and places their interests above those of other social groups. Liberalism always tends towards the social good. According to Mises the principles of liberalism have never been consistently and fully applied. He maintained that the small part, which

were applied, moved humanity forward significantly. Therefore in his view, liberalism is a viable and progressive theory, which is successfully applied in the capitalist social system. Precisely liberalism wants to remove poverty. According to Mises, liberalism always aims at the good of society. This can be achieved only in conditions of private ownership, freedom, peace and equality of all before the law. Only in a social system based on the inviolability of private property can free citizens endeavour to achieve their interests and desires in conditions of voluntariness and peace. On the other hand, casting doubt on and not respecting private ownership provokes violence, lack of freedom and violation of democratic principles. According to Mises, human rights, freedom and democracy cannot exist without private property. Only a social system based on private ownership can satisfy human needs and secure the free life of citizens.

Mises was an open critic of socialism. He proved that rational economic calculation is not possible in socialism, because the productive factors are in the possession of the state, and so cannot be subject to exchange. Therefore, market prices expressing their rarity do not exist. Without market prices, calculations comparing profits and costs are not possible. According to Mises, socialism tends towards chaos and means the absence of any rational, calculating planning and action. This situation means that the erroneous and ineffective allocation of production factors is inevitable and there is waste of capital and reduction of the wealth of society. On the basis of analysis of all forms of state intervention, he came to the conclusion that there is no third way, apart from capitalism and socialism. He proved that all interventionist systems, where private property and private business formally exist, but the state has a significant right to intervene in the market system and correct it, tend either towards socialism or back to capitalism. State interventions simply produce a greater quantity of the problems they aim to remove. According to Mises, state interventions directed towards redistributing income in favour of the poor in the form of social aid or support for the unemployed, cause even greater poverty and unemployment. In a system, which chooses this route, there is constant pressure to increase these forms of social assistance until private property almost disappears or these social payments are gradually reduced or completely abolished. It is not possible to continue for a long with the original level of state interventions.

### **Mises' theory of money as the starting point for the theory of the economic cycle**

In 1912, Mises published the „Theory of Money and Circulation“, the aim of which was create a scientific



theory of money in harmony with the theoretical starting points of the Austrian School. Mises' predecessors – Menger and Böhm-Bawerk – had not succeeded in explaining a clear and comprehensive theory of money. Mises supplemented and developed the theoretical system of the Austrian School in precisely this area. Menger explained the historical and logical process of the origin of money as the result of the spontaneous behaviour of people, who sought the most rational method of producing and exchanging goods. He understood money as a universal medium of exchange, a universal valuable, which all people accept, and which can be used always and everywhere. Therefore, economic entities do not have to keep large stocks of heterogeneous goods, it is enough to have a supply of money and exchange it for the necessary goods according to need. However, Menger did not explain the value of money in accordance with the theory of limit utility. Therefore, Mises' aim was to explain the value of money in the same way that the value of anything else is determined. In this way, Mises attempted to unite the macro-economic conception of money with the micro-economic theory of utility. Mises explained that money as a medium of exchange, held with the aim of use in future exchange, could not arise other than in the form of product money. Mises understood money very broadly. He regarded as money, everything, which helps to mediate exchange, including goods, precious metals, later coins, banknotes, but also bills of exchange, cheques, obligations, shares and so on.

According to Mises, the basis for the theory of money is the claim that the value of a monetary unit is determined by the subjective value of the goods, the individual can buy with the given monetary unit. That is, the value of a given monetary unit depends on the purchasing power of the money, that is, on the quantity of goods, which can be bought with the given monetary unit. Mises proved that, if the quantity of produced consumer goods and investment goods increases, this represents an increase in overall social wealth, but this does not apply to money. He proved that if the quantity of money in circulation increases, it brings no social benefit, but only causes a decrease in the purchasing power of money, that is, a decline in the value of money. It was clear to Mises that the purchasing power of money depends on demand for money, but demand for money depends on the purchasing power of money, since if prices are lower, people will wish to hold a smaller quantity of money. Mises attempted to solve this charmed circle with the claim that the present demand for money is determined by the purchasing power of money in the past period. The present purchasing power of money is, therefore, determined by the rela-

tions between the present demand for money and the present supply of money.

Mises also devoted attention to the inflationary consequences of increasing the amount of money in circulation. He explained that increasing the amount of money does not cause a simultaneous and proportionate increase in the prices of all types of goods, but causes a change in the whole system of relative prices and incomes. Mises thought that inflation represents a form of hidden taxation and redistribution of income in favour of the state and in favour of individuals and companies advantaged by the state. He explained why governments and central banks prefer tendencies to act and decide in an inflationary way. He started from the knowledge that increasing the quantity of money in circulation is not equally advantageous for everybody. The government and the central bank decide about the increased quantity of money. On the basis of their decision, the prices of an ever larger quantity of goods progressively rise. During this process, there is a systematic redistribution of income in favour of the original owners of the money and to the disadvantage of those, who acquired the money later or did not acquire it at all. According to Mises, inflationary development can be avoided only if the state or central bank loses the monopoly on the issuing of money and the position of the central bank is replaced by the gold standard based on free and competitive banking.

For Mises, the theory of money was the basis and starting point for his monetary theory of the economic cycle. Although J.M. Keynes and K. Wicksell were concerned with these questions in the same period as Mises, the difference between the approaches of these economists and Mises lies in their views on the roles and responsibilities of the government and the central bank. Knut Wicksell, a representative of the Swedish School (1851-1926) thought that the central bank can correctly tune monetary policy to moderate the fluctuations of the economic cycle. Mises had the opposite view, he even claimed that the monetary policies of governments and central banks help to create and deepen the economic cycle. Mises regarded changes in the quantity of money as the main cause of the cyclical development. When a central bank increases the quantity of money in circulation, it leads to expansion of credit from the commercial banks, which leads to a fall in interest rates and increased investment activity by businessmen. However, credit expansion and investment expansion do not have corresponding coverage in real savings. The result of the investment activity is an increase in the production of investment goods. This activity is characteristic of the phase of expansion. After a time, it is found that the tendencies to consume and to save have not changed, and that the tendency to





invest is too high and does not correspond to the real possibilities of the economy. With a certain time delay, many investments turn out to be bad and ineffective, which leads to a phase of recession, when the bad investments are weeded out, there is a period of disinvestment, increased unemployment, decline of demand and decreased production. All this results from forced savings and bad investments, caused, according to Mises, by the incorrect monetary policy of the central bank. Mises finally proposed that it is necessary to prohibit the issuing of banknotes backed by gold, in the interest of excluding the possibility of cyclical development. On the basis of his theoretical research, Mises came to the firm conviction that every intervention by governments and central banks is counterproductive and really only deepens the problems they originally wanted to solve and remove.

In the 1950s and 1960s, the period of the so-called

Keynesian revolution in theory and practice, the liberal teaching of Mises and the Austrian School were on the margins of the interest of the expert public. The break came only after 1974, when F.A. Hayek was awarded the Nobel Prize for economics. From that period, we can speak of a renaissance of the Austrian School and growing interest in the economic teaching of Mises. It became fashionable to criticize Keynes and the Keynesians and to study and declare support for the theoretical message of the Austrian School. Since the beginning of the 1980s, Mises' pupil Murray N. Rothbard has explained, popularized and developed his teaching. In 1982, Rothbard founded the Ludwig von Mises Institute at Auburn University in Auburn, Alabama. It is financed exclusively from private resources. Its main aim is to spread and popularize the ideas of liberalism by means of academic conferences, seminars, and by publishing books and magazines.

#### The most important works of Ludwig von Mises

- Die Entwicklung des gutsherrlich-bäuerlichen Verhältnissen in Galizien (1772-1848), 1902.
  - This work was written under the influence of statism. However, the first doubts about its influence appear here.
- Theorie des Geldes und der Umlaufmittel, 1912.
  - Mises completely detached himself from the historical school and established himself as the chief representative of the third generation of the Austrian School. He integrated the theory of money in a macro-economic conception with a general theory of utility.
- Die Gemeinwirtschaft – Untersuchungen über den Sozialismus, 1922.
  - He proves that in socialism, rational economic calculation is not possible, because all the productive factors are in state ownership and so cannot be bought and sold. Therefore, there are no market prices, which would express their rarity.
- Liberalismus, 1927.
  - He analyses various forms of state interventions and describes the theory of social cooperation, the bases of liberal economic policy and the future of liberalism.

- Kritik des Interventionismus, 1929.
  - He proves that all interventionist systems tend either towards socialism or back to capitalism. He proves that the third way „between capitalism and socialism“ does not exist.
- Grundprobleme der Nationalökonomie, 1933
  - Mises rejects the historical and positivist theory of knowledge as essential for economic science and therefore erroneous.
- Nationalökonomie. Theorie des Handelns und Wirtschaftens, 1940.
  - It represents the culmination of his academic work up to then. He summarized and widened his views on economic action, the theory of money and economic cycles.
- Human Action. A Treatise on Economics, 1949.
- Theory and History. An Interpretation of Social and Economic Evolution, 1957.
  - He explains the basic relationship between economics and economic laws, between deductive science and history, sociology and psychology.
- The Ultimate Foundations of Economic Science, 1962.