

Praxeology and Understanding: An Analysis of the Controversy in Austrian Economics

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PART 1

Austrian Economics emerged in rebellion against the skepticism of the Historical School (no universal and exact economic laws, but historical description and interpretation and induction), but is nowadays [at the time of writing. KS] challenged by a new sort of skepticism (G. L. S. Shackle c.s) who charge that the future is unknowable and 'kaleidic' (dominated by patternless change) and since then economic theory cannot explain how actors in the market can successfully anticipate the behavior of others, the idea that action is purposeful (is basis for AE) and thus the possibility of an economic science is undermined.

Praxeology: The Method of Economic Theory

Mises, who battled logical positivism (LP) developed his ideas on methodology on the basis of Menger who battled the HS. Mises saw LP and HS as having a common epistemological root: the denial of universal and necessary laws of economics. Empiricism tried to rescue the ideas of 'law' and 'theory' by using *induction*, but it cannot explain why generalizations will apply equally well to future events, and so is not a true alternative to HS.

Mises used Kant's epistemology, in particular the idea of the synthetic a priori, the idea that reason could give universal and necessary knowledge, to battle LP. Mises's apriorism did not differ fundamentally from Menger's Aristotelian essentialism. Praxeology deduces the inviolable laws of human action from the action axiom that is not analytic (empty, nonempirical) but synthetic (based upon the reality of pursuit of ends by means). It is a priori in the sense that it is independent of any particular time or place, but it is not independent of experience. But the experience is an *inner* experience, it is *reflective* rather than based on sensory experience. Such experience cannot invalidate praxeology, but can only serve to establish the appropriateness of the theory's *application* to a particular event. Since denying the action axiom involves an action doing so is contradictory. The action axiom is epistemologically different from the *postulates* of neoclassical economics that are supposedly empirical and may as such in fact be admittedly false, but they may help in predicting events.

Mises was heavily influenced by Max Weber from who he took 1) the notion of purposefulness, 2) the idea of methodological individualism and 3) his insistence upon the necessity and possibility of an entirely value-free science of human action. This allowed Mises to extend Menger's development of the subjective theory of value. His work here can be seen as a limited version of the doctrine of epistemological subjectivism or idealism: within the realm of human action there are phenomena (value, profit, loss, etc.) that exist only by virtue of the consciousness of purposeful individuals. Praxeology itself does not say anything about or pass judgment on the *content* of values and choices in particular circumstances but takes them as they appear in actions as a given. Praxeology then is distinct from both ethics and psychology., it concerns itself only with the pure *logic of choice*.

Ideal Types and "Exact Laws"

To distinguish its universally valid content from history, praxeology had to show that its most fundamental theoretical conclusions were not based on the imputation of some "typical" motivations or values to acting people, which would make praxeological statements empirical, contingent and uncertain. Weber's "Ideal Types" were thus seen by Mises as irrelevant to the development of pure theory. Alfred Schutz followed Mises and (implicitly? KS) made a distinction between two Ideal Types: the first concerned statements about the necessary aspects of anyone's actions, lacking any specific content about person or circumstance, which made them similar if not identical to Mises's praxeology. The second was significantly *narrower*, and was used to derive a "common sense" understanding of social phenomena: "In order to explain human actions the scientist has to ask what

model of an individual mind can be constructed and what typical *contents* must be attributed to it in order to explain *observed facts* as the results of the activity of such a mind in an understandable relation.” This would be a *historical* (one of *verstehen*, making behavior *understandable*) and not a *praxeological* procedure. For Weber this difference is merely one of degree, based on their proximity to reality, their fullness of content and the purity of their ideal-typical construction. For Mises the difference is one in epistemology: history deals with the concrete manifestations of action whereas praxeology deals with the logical patterns that underlie the actions of all “understanding” individuals.

Praxeologists are also constrained by historical considerations in the sense that praxeological theories may or may not be relevant to some particular situation. Praxeologists may sometimes refer to *actual* historical events in order to *illustrate* theoretical results. This involves doing not just praxeology but also history. “Common sense” *verstehen* is used not just by social scientists but by all actors in the social world: entrepreneurship requires understanding of other people’s motives and intentions.

Now if action *implies* understanding of other men’s reactions and if no action can be planned or executed without an understanding of the future then how can praxeology proceed to the elucidation of market phenomena unless it first addresses the main epistemological problem of *understanding*? Some maintain that if praxeology cannot solve this problem its principles are indeed vacuous referring to a hypothetical society of *understanding* man, not man as such.

From Mises to Lachmann: Austrian Revisionism

Hayek

In his “Economics and Knowledge” Hayek stated that praxeology was a mere collection of empirically empty tautologies and that applications of praxeology to catalytic phenomena involved unacknowledged auxiliary assumptions about the dissemination and use of *knowledge* by market participants, which makes economics as the science of exchanges on the market at least partly an empirical or psychological science, and thus subject to falsification. Economics as such must explain *social causation*, how actors in the social world may become reasonably informed of the valuations of others so that they may see the impact and success of entrepreneurship and direct their actions well enough to achieve certain results. But it will be argued below that praxeology *does* have a lot to say about the prerequisites for successful action, even though it says nothing about the mechanisms of social causation.

Shackle

While Hayek criticized praxeology for being unable to give an account of how market participants get informed about the results of their past actions, Shackle is concerned with the market’s supposed inability to harness and disperse knowledge about the *future*, i.e. the problem of *expectations*.

His critique can be analyzed into two parts:

1. the *weak thesis* that economic theory neglects the existence of uncertainty
2. economic theory cannot deal with the implications of a kaleidic future

(1) only applies to neoclassical economics, wherein perfect certainty and knowledge are assumed. Such theories are relevant only to general equilibrium schema which necessarily exclude the passage of *time*. But praxeology is fully applicable to a world of time and uncertainty. Action would not even be possible without them because that would mean everything is predetermined which would make behavior automatic, not purposeful action. Some Austrians like Lachmann think Shackle’s critique also applies to praxeology, contrasting Mises’s alleged “static subjectivism” with ‘dynamic subjectivism’, but by doing so they overlook the difference between the praxeological and the neoclassical approach.

(2) claims that economic theory fails to recognize the alleged *implications* of the problem of time and uncertainty and so this criticism, and not (1) *may* be applicable to praxeology. It holds that since the future is unknowable the praxeological ideal of rationalism is unfounded. Praxeology then

should explain what makes entrepreneurial prediction possible at all.

Lachmann

Lachmann combines 1. Hayek's points about the supposed emptiness of praxeology and the need for an account of the dissemination of knowledge (about *past* events) and other empirical auxiliary assumptions, 2. Schutz's use of "common sense" Ideal Types in building up economic theory, and 3. Shackle's point about the future being kaleidic (a concern about knowledge of *future* events). Lachmann then becomes skeptical of praxeology as it supposedly is dependent on the empirical assumption of the market's tendency toward equilibrium. Even if we have knowledge of the success of our past actions through the dissemination of knowledge this does not help us to solve the problem of *future* events, of *divergent expectations*. Praxeology would only be applicable to *anticipating man* and so economics must first show that real people are of this kind.

Equilibration and Coordination

The question whether the market has a tendency toward equilibrium is thus central to the above controversy. Lachmann says it doesn't exist, Kirzner who defends more traditional praxeology says that it does. But both of their views are based on a misunderstanding of what it *means* for there to be a tendency toward equilibrium.

Equilibration

In an autarkic economy of one individual every action is equilibrating in the *ex ante* sense.: actions are aimed to the removal of felt uneasiness. "disequilibrating" action is the logical equivalent of irrational action (non-action) If the individual stops acting, there is equilibrium. In an economy of two equilibrium is reached when there is no basis for mutual profit (from the actor's perspective) anymore and exchange ceases.

The praxeological notion of equilibration states that in an economy with indirect exchange and numerous individuals entrepreneurial profit and loss are *subjective* phenomena having no "objective" basis outside of the minds of market participants. We cannot conceive of these phenomena apart from *actions* of market participants that at once imply imagination of and response to the phenomena in question. For every profit "opportunity" then there exists an action that eliminates the opportunity (or proves it to have been illusory). So only *action* by an entrepreneur allows us to distinguish praxeologically profits from compensation for opportunity costs and from mere rent. Upon the fact of action these imagined/understood (rather than *perceived* which would imply other observational criteria for the existence of profit) profits are logically and temporally destroyed. Thus action is per definition equilibrating. (Equilibration then makes no reference to the state of knowledge of market participants, which is the problem of *coordination* and as such is not dealt with by praxeology.)

It follows from this that praxeology must refrain from grouping the services of enterprising people according to "objective" (external, non-subjective) standards, referring to earning differentials as entrepreneurial profit. It instead assigns these differentials to the category "rent to labor services" and such rent may include an element of profit *only insofar* as it actually gives rise to imitation by other entrepreneurs or replication by the same one. Such people then identify what had previously been regarded as service rent as "profit" and the resulting efforts to replicate the profit. Once imitation or replication ceases any remaining money surpluses are then again only to be viewed as rent or other elements of compensation of opportunity costs. Money surplus is then not to be identified with profit, and the tendency toward equilibrium then is not to be seen as the whittling away of money surpluses. This *praxeologically speaking* implies that if markets are unhampered there can be no "unexploited" profit opportunities or lacunae in the competitive process.