

**AUSTRIAN SUBJECTIVISM
AND THE EMERGENCE OF
ENTREPRENEURSHIP THEORY**

THE COLLECTED WORKS OF ISRAEL M. KIRZNER

The Economic Point of View

Market Theory and the Price System

Essays on Capital and Interest

Competition and Entrepreneurship

Austrian Subjectivism and the Emergence of

Entrepreneurship Theory

The Essence of Entrepreneurship and the Nature and

Significance of Market Process

Competition, Economic Planning, and the

Knowledge Problem

Discovery, Capitalism, and Distributive Justice

Reflections on Ethics, Freedom, Welfare Economics, Policy,

and the Legacy of Austrian Economics

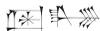
Ludwig von Mises: The Man and His Economics

ISRAEL M. KIRZNER

Austrian Subjectivism and the Emergence of Entrepreneurship Theory

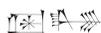
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PETER J. BOETTKE and FRÉDÉRIC SAUTET



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The cuneiform inscription that serves as our logo and as the design motif for our endpapers is the earliest-known written appearance of the word “freedom” (*amagi*), or “liberty.” It is taken from a clay document written about 2300 B.C. in the Sumerian city-state of Lagash.

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INTRODUCTION TO THE LIBERTY FUND EDITION

This volume gathers papers on two fundamental themes in Israel Kirzner's work: methodological subjectivism and entrepreneurship theory. We decided to put these subjects in the same volume because in Kirzner's work the latter cannot be understood well without knowing the former.

Throughout the nineteenth century, scientists labored to eliminate all forms of anthropomorphism and animalism from chemistry, physics, and biology. After Lionel Robbins's definition of economics in the 1930s and the rise of the mathematical method, on the basis of same methodology, economists developed an explanation of human action. Imitating the natural sciences, economists expunged from their science man with his purposes and plans. Such an exercise resulted in the mechanomorphism of modern economics, reducing thinking creatures to mechanical automatons and turning a social science into "social physics."

Ludwig von Mises, reacting to these developments and reflecting on the epistemology of economics and the view of man, reaffirmed the purposive nature of human action and the role this principle plays at the core of economics. Man's purpose, according to Mises, defines economics' subjective character. Kirzner followed in Mises's footsteps and stated in *The Economic Point of View* that "purpose is not something to be merely 'taken into account': it provides the sole foundation of the concept of human action."¹ According to Friedrich Hayek, Mises carried out the idea of subjectivism more consistently than any other economist. It is no exaggeration to add that Kirzner refined Mises's insights on subjectivism and entrepreneurship more consistently than any contemporary writer in the Austrian tradition.

The scientist who treats human beings as purposeless cannot ultimately understand economic phenomena and their causalities. He is in the same situation as a Martian without knowledge of how humans use buses to go to work who would just be observing bodies jumping into moving boxes every morning: it would be difficult to understand what is going on beyond bodies and boxes moving with certain

1. See *The Economic Point of View* (Indianapolis: Liberty Fund, 2009), 168.

regularity.² By ascribing purpose, the scientist applies subjectivism, that is, the idea that whatever means and ends an individual may select, he selects them because of the way he perceives and understands their relevance to his situation.

The disincarnated view of man has led economists to a focus on maximization within given constraints, which produced an incomplete, if not misleading, mechanistic view of the market. Kirzner has consistently fought against this approach, arguing that economists should concentrate their efforts upon explicating processes rather than end states. Indeed, to understand the capitalistic mode of production, the theorist must trace economic phenomena back to the initial purposes and plans of individuals.

Once purpose is understood to be at the foundation of the concept of human action, it becomes clear that methodological individualism and methodological subjectivism are two major planks of economics. The objects of human action as the external observer sees them do not matter to economics; only how the actors themselves perceive them does. To understand why people use buses every morning, one must take into account the knowledge and beliefs individuals hold about the usefulness of buses and how this knowledge and those beliefs shape their decisions. Economics makes the world intelligible in terms of human motives and purpose, not simply in quantitative terms.

Moreover if one assumes individuals as merely solving an optimization problem, it is impossible to understand how, over time, new information (from the point of view of the actors themselves) is generated in the economic system. In Kirzner's framework, entrepreneurial activity is fundamentally about the introduction of novel information. It follows that only a consistent pursuit of a subjectivist approach can account for the discovery and the emergence of new information, in the sense relevant to economic theory.

It is only through the consistent application of subjectivism that one can understand why the entrepreneurial function is an aspect of all action, and not just a special ability of the few. We are all entrepreneurs in our capacity as human actors. This is also why the entrepreneur in Kirzner is alert to profit opportunities, and not (primarily at least) a profit

2. Kirzner uses this example in his paper "On the Method of Austrian Economics," reprinted in this volume.

maximizer. Utility and production functions do not exist independently of valuing agents in their particular setting of time and place.

This subjectivist approach provides the foundations to explain the market process as the outcome of the purposeful actions of individuals. In pursuing their ends, individuals make use of the signals of the market, such as money prices and profits and losses, which serve as guideposts to decision-making helping transform subjective phenomena of the mind into objective signals.

These issues of epistemology and methodology possess profound implications for practical policy. As Kirzner states in the foreword to Ludwig von Mises's *The Ultimate Foundation of Economic Science*, at the core of those discussions rests the defense of a free society. It is only by bringing back into economics "those insights that positivist thought treats, in effect, as meaningless nonsense"³ that one can fully realize the advantages of the unhampered market.

In addition to eight papers on methodological subjectivism,⁴ this volume contains four articles by Kirzner on the history of entrepreneurship theory, including Kirzner's seminal paper on entrepreneurship, "Methodological Individualism, Market Equilibrium, and Market Process." It was in this paper presented at the Mont Pelerin Society meeting in Vichy, France, in 1967 that Kirzner conceptualized the role of the entrepreneurial function in the market process for the first time in his work. This paper opened the door to Kirzner's research on the market process, leading six years later to the publication of *Competition and Entrepreneurship*. In doing so, it paved the way to the modern Austrian theory of the market process.

ACKNOWLEDGMENTS

We would first like to thank wholeheartedly Israel Kirzner for his unparalleled contribution to economic science. Kirzner's research program has deeply enriched the discipline and has shed light on some of economics' most difficult puzzles. Economists owe him an immense intellectual debt.

3. See *The Ultimate Foundation of Economic Science* (Kansas City: Sheed Andrews and McMeel, 1978), vii.

4. Note that the editors have selected "Knowing About Knowledge: A Subjectivist View of the Role of Information," a paper on subjectivism and knowledge, for inclusion in *Competition, Economic Planning, and the Knowledge Problem* (Indianapolis: Liberty Fund, forthcoming), a volume in the present series.

The publication of the Collected Works of Israel M. Kirzner would not be a reality without the participation of Liberty Fund, Inc. We are extremely grateful to Liberty Fund, and especially Emilio Pacheco, for making this project possible. To republish Kirzner's unique oeuvre has been on our minds since our time spent at New York University in the 1990s—where one of us was a professor (Peter) and the other a post-doc student (Frédéric). We are thrilled at the idea that current and future generations of economists and other scholars will have easy access to Kirzner's works.

Finally, we wish to thank Emily Washington for her invaluable help in the publication of this volume, as well as Dr. Diana W. Thomas for providing her expertise in the translation of quotations from German to English.

Peter J. Boettke and Frédéric Sautet

AUSTRIAN SUBJECTIVISM

ON THE METHOD OF AUSTRIAN ECONOMICS

One of the areas in which disagreement among Austrian economists may seem to be nonexistent is that of methodology. Yet I shall attempt to point out that even with respect to method there are differences of opinion among individual thinkers. Some light may be cast on these differences by drawing attention to two distinct strands of thought that run through the writings of Austrian economists on the question of method. By separating these strands and then focusing on each in turn, we may discover and define different perspectives on economic method and perhaps more clearly understand how these different perspectives grow out of the unique view of method shared by all Austrian economists.

The general outline of the Austrian position on methodology is well known. Austrian economists are subjectivists; they emphasize the purposefulness of human action; they are unhappy with constructions that emphasize equilibrium to the exclusion of market processes; they are deeply suspicious of attempts to apply measurement procedures to economics; they are skeptical of empirical “proofs” of economic theorems and consequently have serious reservations about the validity and importance of a good deal of the empirical work being carried on in the economics profession today. These are the general features of the position that we know very well; yet within this general view we can distinguish two independent strands of argument. It is upon this debate that I should like to focus my attention in this paper.

TWO TASKS FOR ECONOMIC EXPLANATIONS

It will be helpful to cite two statements—by prominent Austrian economists—about what economics as a discipline is supposed to achieve. The first is by Friedrich A. Hayek, and the other is by Ludwig M. Lachmann. Hayek in his *Counter-Revolution of Science* contended that the function of social science, and by implication economics, is to explain how conscious, purposeful human action can generate unintended consequences through social interaction.¹ The emphasis here is on the

From *Foundations of Modern Austrian Economics*, ed. Edwin G. Dolan (Kansas City: Sheed and Ward, 1976), 40–51. Reprinted by permission of the Institute of Humane Studies.

unintended consequences of individual human decisions. To explain phenomena that are not the unintended consequences of human decision making is outside the scope of the social sciences in general and economics in particular. Hayek's position was cited by Alexander Gerschenkron in his contribution to the Akerman *Festschrift*, and I think Gerschenkron was perceptive in focusing on exactly what is, in Hayek's view, the fundamental task of economic explanation.²

Let us contrast the Hayek view with one expressed by Lachmann. Lachmann's position on the purpose of economic explanations is dealt with at length in his contribution to the Hayek *Festschrift*, *Roads to Freedom*.³ Here, however, I shall quote from a more recent statement of his position that appeared in his review of John R. Hicks's *Capital and Time*:

Economics has two tasks. The first is to make the world around us intelligible in terms of human action and the pursuit of plans. The second is to trace the unintended consequences of such action. Ricardian economics emphasized the second task, the "subjective revolution" of the 1870s stressed the urgency of the first, and the Austrian school has always cherished this tradition.⁴

Thus, we have here two tasks for economics. Besides the task that Hayek emphasized—the tracing out of the unintended consequences of action—we have the requirement that it make the world around us intelligible in terms of human action.

It is worth reminding ourselves that the two tasks Lachmann identified are to be found in Carl Menger's writings. In the third part of his 1884 book on methodology Menger pointed out that actions do have unintended consequences, and he made it very clear, as Hayek had done, that economics is the science that is able to explain how these unintended consequences emerge in the market place.⁵ But Menger was also aware of the other task Lachmann emphasized. In a letter Menger wrote Léon Walras, cited by T. W. Hutchison in several of his writings,⁶ Menger insisted that the economist is not merely after the relationships between quantities, but the *essence* of economic phenomena: "the essence of value, the essence of land rent, the essence of entrepreneurs' profits, the essence of the division of labor."⁷ This view is what Kauder meant when he described Menger as holding that economics deals with social essences,⁸ and what Hutchison called "methodological essentialism."⁹

TWO BASIC AUSTRIAN TENETS

I have asserted that two distinct strands of thought may be identified in the writings of Austrian economists with regard to the meaning and purpose of economic explanation. I would now like to distinguish two distinct insights about the economic world that receive varying emphasis and are not often adequately differentiated. First, there is the insight that *human action is purposeful*, and, second, there is the insight that *there is an indeterminacy and unpredictability inherent in human preferences, human expectations, and human knowledge*. Now these two insights are really quite distinct, because one does not encompass the other in any logical or epistemological sense. That human action is purposeful is an insight by itself, and that human knowledge and expectations are largely unpredictable is another. Nor is the truth of these two propositions equally obvious. The purposefulness of human action is something we arrive at by introspection. In this sense it is “obviously” true. On the other hand, the insight that men’s preferences are inherently unpredictable—that we cannot discover consistent patterns in what men prefer and that we cannot postulate that there are consistent patterns in what men know and expect to happen—cannot be arrived at by introspection. The truth claimed for this last insight depends on our observations of our fellow men, that we do as a matter of fact find them to be unpredictable in their actions and expectations about future states of the world.

To me, the different emphasis Austrian economists attach to these basic insights is largely responsible for their different attitudes regarding the purpose of economic explanation. The recognition of purposefulness is, of course, fundamental to our definition of economics as the logic of choice. We are able to use our logic to simulate the actions of other human beings only because we share the logic that other men’s purposes lead them to harness in their own interests. The recognition of purposefulness is essential to our positive conception of economics as the logic of choice and to our enterprise of studying the consequences of purposeful action. But if we consider those aspects of the Austrian approach that are used, not to derive economic laws, but to criticize other areas of contemporary economic thought, then the second of these basic tenets comes into prominence. Our dissatisfaction with empirical work and our suspicion of measurement rest on the conviction that empirical observations of past human choices will not yield any regularities or any consistent

pattern that may be safely extrapolated beyond the existing data at hand to yield scientific theorems of universal applicability.

THE SIGNIFICANCE OF PURPOSEFULNESS

Let us try to understand the role these basic tenets of Austrian economics play in the Lachmann-Hayek discussions concerning what economic explanation is all about. In 1938 T. W. Hutchison published *The Significance and Basic Postulates of Economic Theory*.¹⁰ The book received a blistering Austrian-like critique from the pen of Frank H. Knight, who was on most other issues, such as capital theory, not in sympathy with the Austrian school. In that article Knight conveyed some brilliant insights about the relationship of economics to the study of human action. Knight noted that “the whole subject of conduct—interests and motivation—constitutes a different realm of reality from the external world.” In addition to the external world, with which the natural sciences are conversant, there is a different realm of reality, a realm no less real than the external world, but nevertheless different from it. This other realm is that of human conduct, which Knight identified as interests, motivation, and purpose.

The first fact to be recorded is that this realm of reality exists or “is there.” This fact cannot be proved or argued or “tested.” If anyone denies that men have interests or that “we” have a considerable amount of valid knowledge about them, economics and all its works will simply be to such a person what the world of color is to the blind man. But there would still be one difference: a man who is physically, ocularly blind may still be rated of normal intelligence and in his right mind.¹¹

Here, surely, we have the first of the basic tenets of Austrian theory, that there is a realm of reality constituted of human motives, interests, and purposes, and that, although purposes cannot be seen or touched, they are nonetheless “there.”

When Lachmann called upon economists to make the world intelligible in terms of human decisions and purposes, I take it that he was telling us the following: *It is the task of science to describe and explain reality. If reality consists of more than the external world, then a science that is confined to the facts of the external world is simply incomplete. It does not account for everything that is there.* The Austrian approach insists that there is something besides the facts of the external world and the relationships that

may be postulated between these bare facts. What is that something else? It is the realm of reality that Knight pointed to, the realm of purposes. And even if one were able to explain the facts of the external world in terms of similar facts, without regard to the human purposes underlying these facts, one would not have explained everything there is to be explained, not have set forth everything there is to set forth. One would have failed to make the world intelligible in terms of human action, that is, in terms of human purposes. Thus, even if the second Austrian tenet (that there are no constants in human behavior) were false, even if one were able to postulate consistent chains of cause and effect that depend only on externally observable phenomena, still one has failed to fulfill one's scientific obligation. There is a realm of reality called purposes. It is there, and if we fail to point it out, then we fail in the task of making the world intelligible in terms of human action.

Let us consider a simple example. Suppose a man from Mars is doing research for his doctorate and, after focusing his telescope on a particular location on Earth, discovers a certain regularity. Through his telescope he observes a set of boxes lined up in a row. He further discovers that a smaller box moves past these boxes every day at 7:30 A.M., comes to a stop at one of the boxes, and then, after a short stay, moves on. Moreover the investigator discovers something else; out of one of these boxes a body emerges every morning, and when the moving box makes its daily stop, the body is swallowed up by the moving box. Discovering this regularity, the researcher postulates a definite law, the law of moving boxes and bodies. As he goes on with the research, however, he discovers that sometimes the box moves away before the body has entered it, leaving the body behind altogether; while sometimes the body moves at an unusually rapid speed, arriving at the daily moving-box stop just in time to be swallowed up before the box moves on. Now this Martian researcher may be able to predict just when the person is going to miss the box and when he is going to catch it. He may even be able to explain the movements of the body and the box entirely without reference to the fact that someone is trying to catch the bus because he wants to get to work on time. But if he does so, he has not told us everything there is to be learned about this situation. A theory of moving bodies and boxes that does not draw attention to the dimension of purpose gives a truncated picture of the real world. *This is what economics, in the Austrian view, is all about.* Economics has to make the world intelligible in terms of human motives. It is

more than simply moving boxes or changing economic quantities. This is the task to which Lachmann drew our attention when he insisted that we must make the world intelligible in terms of human purpose.

A memorable passage in Hayek's *Counter-Revolution* is the one in which he explained that objects useful to human beings are simply not objective facts.

In fact most of the objects of social or human action are not "objective facts" in the special narrow sense in which this term is used by the [natural] Sciences . . . they cannot be defined in physical terms. . . . Take the concept of a "tool" or "instrument," or of any particular tool such as a hammer or a barometer. It is easily seen that these concepts cannot be interpreted to refer to "objective facts," i.e. to things irrespective of what people think about them.¹²

Pursuing this point Hayek asserted (in a footnote reference to the work of Ludwig von Mises) that every important advance in economic theory in the preceding century had been a result of the consistent application of subjectivism.¹³ Lachmann's advice to economists paralleled Hayek's. According to Hayek, when we deal with artifacts—with tools and instruments or other products of human beings—we have not exhausted the description of what it is that we are describing if we stubbornly confine ourselves to their physical entities. We have not described a hammer until we have drawn attention to its purpose. Lachmann, similarly, instructed us that when we deal with broader questions, with institutions and regularities in economic affairs, we have not completed our task if we have not called attention to the purposes and motives and interests that underlie these phenomena. A hammer is more than a handle with a metal head; so is a price more than a number, milk consumption more than a number of gallons, and its relationship to price more than a simple functional relationship. A whole world of interests and motives is "there," is real, and it is surely our responsibility as scientists to make it clear.

Critics of Austrian methodology often argue that since praxeology deals with unobservables, it is inherently incapable of telling us anything scientific about observables. The latest (and perhaps the clearest and most sympathetic) statement of this argument was by James Buchanan, in his contribution to the Hayek *Festschrift*,¹⁴ when he drew attention to the distinction between (1) the logic of choice (what he called the abstract science of economic behavior) and (2) the predictive science