

THE ECONOMIC POINT OF VIEW

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

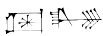
ISRAEL M. KIRZNER

The Economic Point of View

An Essay in the History of Economic Thought

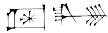
Edited and with an Introduction by

PETER J. BOETTKE and FRÉDÉRIC SAUTET



LIBERTY FUND Indianapolis

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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 second edition © 1976 by the Institute for Humane Studies, Inc., Menlo Park, California.

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Printed in the United States of America

C 10 9 8 7 6 5 4 3 2

P 10 9 8 7 6 5 4 3 2

Library of Congress Cataloging-in-Publication Data

Kirzner, Israel M.

The economic point of view: an essay in the history of economic thought / Israel M. Kirzner; edited, and with an introduction, by Peter J. Boettke and Frédéric Sautet.

p. cm. — (The collected works of Israel M. Kirzner; v. 1)

Originally published: [2nd ed.]. Kansas City, Kan.: Sheed and Ward, 1976, in series: Studies in economic theory.

Includes bibliographical references and index.

ISBN 978-0-86597-733-4 (hardcover: alk. paper) —

ISBN 978-0-86597-734-1 (pbk.: alk. paper)

I. Economics. 2. Economics—History. I. Boettke, Peter J. II. Sautet, Frédéric E. III. Title.

HB71 .K5 2009

330.09—DC22

2008038381

LIBERTY FUND, INC.

8335 Allison Pointe Trail, Suite 300

Indianapolis, Indiana 46250-1684

B'EZRAS HASHEM

To Our Parents

CONTENTS

Introduction to the Liberty Fund Edition *xi*

by Peter J. Boettke and Frédéric Sautet

Introduction to the Second Edition *xxi*

by Laurence S. Moss

Foreword *xxv*

by Ludwig von Mises

Author's Preface *xxvii*

Acknowledgments *xxix*

1. On Defining the Economic Point of View 1

The Economic Point of View and the Scope of Economics 3

The Multitude of Economic Points of View 5

The Controversy Over the Utility of Definition 6

An Interpretation of the Controversy 8

The Economists and Their Definitions:

 The Classical Economists 12

The Economic Point of View:

 The Background of the *Methodenstreit* 14

 Twentieth-Century Economic Points of View 17

2. The Science of Wealth and Welfare 20

The Emergence of Political Economy as the
 Science of Wealth 21

The Science of Material Wealth 28

The Science of Subsistence 33

The Science of Wealth Retained 39

Man Against Nature 43

From Wealth to Welfare 46

The Science of the Lower Side of Human Nature 52

3. The Science of Avarice; Getting the Most for the Least 55

The Science of Avarice 55

The Economic Principle 61

The “Economic Impulse” 65

Selfishness and “Non-Tuism” 69

Economics and Mechanics 71

4. Economics, the Market, and Society 76

- Economics and Catallactics 76
- Exchange and the Propensity to Truck 81
- Exchange and the Division of Labor 83
- The “Purely Formal” Concept of Exchange 85
- Exchange and the Economic System 87
- Economics, the Economy, and the *Volkswirtschaft* 90
- Economy and Society 93

5. Economic Affairs, Money, and Measurement 97

- Money, Wealth, and Exchanges 97
- Money as the Measuring Rod 101
- Money as a Universal Measuring Rod 104
- Measurement and Economics 104
- Money and Price-Economics 108
- Money as an Economic Institution 111

6. Economics and Economizing 114

- The Economics of Professor Robbins 115
- Scarcity and Economics 117
- Economizing and Maximization 121
- The Character of Robbins’s Definition 123
 - A. The “Breadth” of Robbins’s Definition 125
 - B. The “Formalism” of Robbins’s Definition 127
- The Nature of Ends and Means 130
- “Given” Ends and Means 134
- Single End and Multiple Ends 138
- Economics and Ethics: The Positive and the Normative 142
- The Nature of Economic Science and the Significance of Macroeconomics 147

7. Economics as a Science of Human Action 151

I

- The Sciences of Human Action 153
- The Emergence of the Praxeological View of Economics 156
- Max Weber and Human Action 161
- Acting Man and Economizing Man: Mises and Robbins 163

II

- Praxeology and Purpose 166
- Praxeology and Rationality 170

The Assumption of Constant Wants—
 The Praxeological Context 176
 Praxeology, Apriorism, and Operationalism 181
 The Economic Point of View and Praxeology 185

Becker-Kirzner Debate

Irrational Behavior and Economic Theory
by Gary S. Becker 193

Rational Action and Economic Theory
by Israel M. Kirzner 211

Rational Action and Economic Theory:
 A Reply to I. Kirzner
by Gary S. Becker 221

Rational Action and Economic Theory:
 Rejoinder
by Israel M. Kirzner 225

Index 229

INTRODUCTION TO THE LIBERTY FUND EDITION

The Economic Point of View: An Essay in the History of Economic Thought was Professor Israel M. Kirzner's first book. Kirzner published the first edition in 1960 with Van Nostrand Press. The second edition was published in 1976 as part of the Institute for Humane Studies series Studies in Economic Theory. We are using the second edition for this first volume of the Collected Works of Israel Kirzner being published by Liberty Fund. The series comprising the Collected Works of Israel Kirzner consists of ten volumes involving all major monographs, scholarly papers, and books that Kirzner wrote over a period of five decades starting from 1960.

Israel Kirzner is one of the most important figures in Austrian economics in the second part of the twentieth century. After a career of almost fifty years, he retired in 2001 from his position as professor of economics at New York University. At that point, he had written eleven books, authored over a hundred scholarly articles (many of which were published as books), and edited five volumes dedicated to the advancement of Austrian economics. As he retired, Israel Kirzner was the leading economist in the field of entrepreneurship and market process theory. He contributed immensely to the resurgence of the Austrian school of economics and the demise of Keynesianism, notably with the graduate program in Austrian economics at New York University that he started in the mid-1970s.

With the growth of the field of entrepreneurial studies since the 1980s, theoreticians in business schools and scholars who study business start-ups and other entrepreneurial phenomena have come to discover Kirzner's work. Kirzner has achieved recognition in these sister disciplines but not in the mainstream of his own profession, which has remained somewhat unreceptive to the idea of entrepreneurship and the discovery process—ideas that Israel Kirzner developed throughout his career.

Nonetheless, Israel Kirzner's influence in economics is likely to continue to grow in the future. Indeed, a good portion of the research in economics has moved away from the dry and overly mathematical approach of general equilibrium that was popular in the 1960s at the time when Professor Kirzner started thinking about ways to explain economic change.

Another reason Israel Kirzner's influence will continue to grow is the greater attention paid to innovation and knowledge in the field of economics and its related disciplines. Kirzner's theory presents a truly endogenous approach to economic change, providing an explanation for the generation of knowledge and its link to innovation in markets. The fundamental issue of the dispersion and generation of knowledge that Friedrich Hayek identified many decades ago found a solution in the work of Professor Kirzner. Knowledge, innovation, and the role of the entrepreneur are now more widely seen as cornerstones of the theoretical understanding of development and economic growth. There are good reasons to believe that someday many economists will turn to the Kirznerian theory of entrepreneurship to understand social change.

It is in this context that the present series, which includes the books and most of the scholarly papers that Kirzner has written in his career, has been organized. The stand-alone books are being published in chronological order, while those volumes consisting of previously published articles are arranged thematically. To these republished articles, we have added some hard-to-find articles and monographs that have not appeared since their first printing. (Some of these articles and others will be published in the same volumes as the stand-alone books for thematic reasons.) We hope that such an arrangement will demonstrate for the reader the full extent of Kirzner's influence, showing the evolution of his thought and his contributions to the economics of entrepreneurship, market process theory, capital theory, and other fields.¹

The first four volumes are stand-alone books and include, in addition to this volume, *Market Theory and the Price System* (Kirzner's only textbook); *Essays on Capital and Interest*; and his most famous book, *Competition and Entrepreneurship*.

The next three volumes present a thematic arrangement of Kirzner's scholarly papers. *Austrian Subjectivism and the Emergence of Entrepreneurship Theory* contains Kirzner's most representative articles on these subjects (including his seminal paper on entrepreneurship that he presented in 1967 at the Mont Pelerin Society meeting in Vichy, France). *The Essence of Entrepreneurship and the Nature and Significance of Market*

1. Note to the reader: All the typographical errors that were discovered in the original papers and books Israel Kirzner published have been corrected. We believe this improves the readability of the texts.

Process comprises a selection of articles on market process theory; and *Competition, Economic Planning, and the Knowledge Problem* focuses on the “knowledge problem”—a Hayekian concept that Professor Kirzner developed and applied to various issues such as that of central planning.

The last three volumes in the series begin with *Discovery, Capitalism, and Distributive Justice*, a stand-alone volume that includes additional articles on the same theme. *Reflections on Ethics, Freedom, Welfare Economics, Policy, and the Legacy of Austrian Economics* includes two interviews with Kirzner that have already been published, as well as a more recent interview we conducted in July 2006. The last volume of the series, *Ludwig von Mises: The Man and His Economics*, presents Kirzner’s study of Mises, who was his dissertation adviser, as well as other articles on Mises. An observer will have noticed the centrality of Mises in Kirzner’s work: the series starts with a book inspired by Mises and ends with a book about Mises.

Israel Kirzner was born in London on February 13, 1930. He spent his early years in England and lived in South Africa between the ages of ten and eighteen. He was educated at the University of Cape Town (1947–1948), the University of London (1950–1951), and then Brooklyn College (1952–1954). After graduating from Brooklyn College summa cum laude in 1954, Kirzner attended New York University (NYU), earning an MBA in accounting in 1955. While at NYU, Kirzner enrolled in Ludwig von Mises’s class on economic theory.

In searching for classes to fulfill his course requirements for the MBA, Kirzner examined the university catalogue and the publication list of the faculty. He enrolled in Mises’s class for the simple reason that Mises had the longest list of publications among the faculty at the NYU School of Commerce. When Kirzner registered for the class, he was told by administrators and fellow students that Mises was an old man out of touch with the modern world. These comments didn’t deter Kirzner. From the start, Mises’s analysis of the market economy intrigued Kirzner, and sparked his interest in the discipline of economics. In 1996, Kirzner told the story of his first day at Mises’s seminar:

That occasion was . . . my first meeting with Ludwig von Mises, and it is etched deeply in my memory. . . . His very opening substantive sentence that evening [was], “The market,” Mises began, “is a process.”

Coming as I did from a rather spotty undergraduate training in economics (and mainly along Keynesian lines) Mises' statement, I recall, left me completely puzzled. I had thought of the market as a place, an arena for exchanges, as an abstract idea referring to voluntary exchange transactions. I could not fathom what on earth could be meant by the observation that the market is a process. I now, in retrospect, consider that all my subsequent training and research in economics, both before and after obtaining my doctorate under Mises, has consisted in learning to appreciate what it was that Mises meant by this assertion.²

After completing his MBA, Kirzner made the decision to study economics in more depth. Mises had advised him to study for his PhD at Johns Hopkins University under the guidance of Fritz Machlup, Mises's former student in Vienna. Mises even offered to arrange a fellowship for Kirzner to study with Machlup as he thought that would be the best path for this promising young scholar of economics. Mises's reasoning was straightforward—Machlup was younger, a renowned and talented teacher, and possessed great professional connections in the world of academics. Machlup would make the path to professional success much easier than it would be studying with Mises. Kirzner decided he would rather stay at NYU and study firsthand with Mises. It is under the influence of Mises that Kirzner came to write on the topic of the definition of economics, as Mises suggested that he explore the various definitions that have been accepted throughout the history of the discipline. *The Economic Point of View* was the result of his doctoral dissertation work done under the auspices of Mises, who had become Kirzner's mentor and supervisor. Kirzner graduated in 1957 from NYU with a PhD in economics. After earning his PhD, Kirzner joined the faculty at NYU, where he taught throughout his career.

Two other background issues are important to stress with regard to Kirzner's career in economics. At the time he entered the profession of academic economics, the discipline had been transforming in ways that would come to adversely affect Kirzner's influence.

2. Quoted in Richard Ebeling, "Israel M. Kirzner and the Austrian Theory of Competition and Entrepreneurship," August 2001, *Freedom Daily*, <http://www.fff.org/freedom/0801b.asp>.

First, the discipline had moved from a “book culture” to a “journal culture,” as scientific contributions were not communicated through books but through journal articles. Kirzner was a book writer, and what he set out to do once he joined the faculty at NYU was to revise his dissertation into a book, and then to write two other books during the 1960s—*Market Theory and the Price System* and *An Essay on Capital*. While Kirzner wrote journal articles, it was not his primary scholarly activity.

Second, the discipline of economics was moving in a direction that increasingly marginalized works in the intellectual history of economics and works that sought to address the fundamental philosophical issues of the discipline, which were the domains of Kirzner’s main contributions. These two issues fit together—contributions to the history of economics and to the philosophy of economics are best communicated in book form rather than through the normal science discussions that take place in the journals of the discipline.

It is within this changing context of economic scholarship that Kirzner entered the profession and offered *The Economic Point of View*. Kirzner argues that economics begins with a recognition and then a puzzle. The recognition is that there are systemic forces at work in the market economy that produce social order. This is the “Paris gets fed” idea that Frédéric Bastiat promoted with vigor when explaining what economics is about. The puzzle is how precisely the market economy achieves this degree of social order in the absence of centralized control. The recognition and the puzzle help define the object and subject of the study of economics. As Mises explains in his foreword to the book, “Economics shows that there prevails in the succession and interdependence of the market phenomena an inescapable regularity that man must take into full account if he wants to attain ends aimed at.”³ This fundamental position is at the center of Kirzner’s book, in which he carefully explains its emergence and how it came to be accepted. In his first book, Kirzner provides a historical account of the evolution of the debate and establishes the path that led economics to become the science of human action.

The Economic Point of View was published during a period when the object and subject of economics had been totally transformed by the Keynesian revolution. Keynesian macro-theories dominated the mainstream of economic education and economic research by 1960. In that context, Kirzner published a book on the microfoundations of the discipline.

3. See below in Mises’s foreword to *The Economic Point of View*.

Kirzner argues for a particular form of the microfoundations of the discipline—a consistent and persistent subjectivism. It is only by pursuing the subjectivist position, he argues, that we can aspire to have an objective science of economics. In this sense, he finds himself in the company of Carl Menger, Eugen von Böhm-Bawerk, Knut Wicksell, and Philip Wicksteed in the late nineteenth century, of Mises and Hayek in the mid-twentieth century, and to some extent James Buchanan in the later half of the twentieth century of economic thinking. In the process, Kirzner would eventually seek to establish economic science as occupying the middle ground position between the equilibrium economics of Gary Becker and the indeterminacy of the radical subjectivism of G. L. S. Shackle.⁴

The book reveals many of the themes that Kirzner would come to develop later on in his career, especially the nature and role of entrepreneurial activity. We see the essential elements of Kirzner's theory of the entrepreneurial nature of human action that drives the market process in his discussion of catallactics and later praxeology.

Finally, and as Mises explains in his foreword, Kirzner's work enables us "to re-examine the present state of economic theory in the light of all attempts earlier generations made for their solution. In comparing our point of view with past achievements and errors we may either detect flaws in our own theories or find new and better reasons for their confirmation."⁵ This is especially relevant with regard to the development of behavioral economics (including behavioral finance) in recent years. It is also pertinent to the emergence of neuroeconomics and other related disciplines currently influencing the foundational choice theory that contemporary economists work with. The work of Kirzner allows us to reaffirm the foundations of economic science and its relevance to explaining the inescapable regularities of market phenomena. Economics has been under attack from within since the Pigovian and Keynesian revolutions. It has also been under attack from without since the *Methodenstreit* at the end of the nineteenth century. The praxeological approach developed

4. This last discussion of situating economics as appropriately occupying the middle ground becomes a major theme of Kirzner's work from the mid-1970s onward. As one can see in his critique of plutology and the development of praxeology, the basic pieces of his argument are already present in *The Economic Point of View*.

5. See below in Mises's foreword to *The Economic Point of View*.

by Mises and Kirzner provides the best tools to detect the flaws in new internal or external competing views.

An example of the use of the praxeological approach, which is also a direct application of the lessons of *The Economic Point of View*, can be found in the debate between Israel Kirzner and Gary Becker on rationality in economics. Becker argued that even if one were to assume rationality away, market results would still be rational. In other words, even if some individuals are assumed not to react to price changes the way rational beings would, they are forced by the nature of the opportunity sets they face (after a relative price change) to alter their behavior. In what became an important debate, Kirzner, applying the insights of praxeology, replied that Becker implicitly assumed that individuals pursue objectives and thus are rational. Indeed, what Becker described as an alteration of behavior is really the market process at work.⁶ Because of the importance of this debate, we republish at the end of this volume the four articles of the Becker-Kirzner debate.⁷

Most dissertations published as books never change the face of economics.⁸ Some commentators have seen Kirzner's first book as part of this endless supply of dissertations-turned-into-books which don't address essential problems and don't make much difference to the state of economics.⁹ It is true that Kirzner's book is concerned with a problem which generally does not attract much attention: the definition of eco-

6. In February 1962, Becker published "Irrational Behavior and Economic Theory" in the *Journal of Political Economy*. In August of the same year and in the same journal, Kirzner published a critique of Becker's paper: "Rational Action and Economic Theory." Becker's reply was published in February 1963 along with Kirzner's rejoinder.

7. Note to the reader: We have made the changes to the texts that Gary Becker suggested in the first footnote in his reply to Israel Kirzner. These changes do not affect the meaning of the texts but improve their readability. We have also corrected a few typographical errors that were present in the original publication of these articles.

8. Notable exceptions would include Frank Knight's *Risk, Uncertainty and Profit* (1921), Abba Lerner's *The Economics of Control* (1944), Paul Samuelson's *Foundations of Economic Analysis* (1947), Kenneth Arrow's *Social Choice and Individual Values* (1951), Gary Becker's *The Economics of Discrimination* (1957), and Mancur Olson's *The Logic of Collective Action* (1965).

9. See for instance Kurt Klappholz's review of *The Economic Point of View* in *Economica* 30, no. 117 (February 1963): pp. 89–90.

nomics. How economists define and see their own discipline is a subject that is rarely part of the training that young economists receive. This was already an issue at the time Kirzner studied; it is even more acute today with the quasi-disappearance of the history of economic thought as a subject taught at the PhD level. However, almost fifty years after the publication of Kirzner's book, many economists still define the discipline of economics as being about large scale phenomena such as inflation and unemployment.¹⁰

It would be wrong to consider Kirzner's book as just a book on the definition of economics. Indeed, in trying to provide a definition of economic science, he offers a history of the development of economic thinking. This development takes us from the birth of economics as concerned with the accumulation of wealth to economics as the science of economizing behavior. Understanding this development helps us realize the importance of economics in the social sciences. By understanding the development of economic thinking through the search for the ultimate object of economic science, one comes to see the great accomplishments of early economists. In this sense, the book is more than a definition of economics, it is a voice in the most important contemporary debates about the nature and achievements of economic science.

Kirzner's achievement in *The Economic Point of View* is to illuminate how the praxeological position emerged in the slow but continuous development of economic science since the end of the eighteenth century. Purposefulness (teleology), subjectivism, and rationality (economizing) are the three pillars of the praxeological approach. Kirzner's historical account of the evolution of economic science sheds light both on the nature of economic science and on its object.

In retrospect, Kirzner's first book foreshadows the great economist he came to be. The book introduces the reader to a subtle and committed scholar who is essentialist in explanation and clear and precise in his writing style. It also establishes the foundations of his future work on the

10. For instance, David Romer, in his *Advanced Macroeconomics* textbook (New York: McGraw-Hill, 1996), defines macroeconomics as "the study not just of aggregate fluctuations but of other features of the economy as a whole" (p. 1). Edwin Mansfield's *Microeconomics* (New York: W. W. Norton, 8th ed.) states that "microeconomics deals with the economic behavior of individual units such as consumers, firms, and resource owners; macroeconomics deals with the behavior of economic aggregates such as gross domestic product and the level of employment" (p. 1).

role of the entrepreneurial function, the theory of the market process, and the role of capital.

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.

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 possible this project. 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 Rosemarie Fike for her invaluable help in the preparation of the volumes.

Peter J. Boettke
Frédéric Sautet

