

# NEW PERSPECTIVES ON POLITICAL ECONOMY

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# **NEW PERSPECTIVES ON POLITICAL ECONOMY**

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# The Importance of a Realistic Theory of Capital for Institutional Reform – The Case of Financial Accounting

Eduard Braun, Clausthal University of Technology

**A** severe problem arises when an economic theory, which is itself institution-free, is applied to the reform of institutions. There is the risk that economics compromises the institutions that it and our current economic order are based upon. If economists want to avoid counterproductive reforms of fundamental institutions, they must adopt a more realistic theory of capital that incorporates the institutional framework of capitalism. This point is exemplified by the recent harmful reform of financial accounting regulation – the substitution of historical-cost with fair-value accounting – which was justified within the framework provided by neoclassical economics.

## The institutional framework of capitalism

It would be helpful if the term “capitalism” were only the name for a positive economic order. Economists could then proceed to try their best in describing and analyzing it. Unfortunately, the term “capitalism” means much more than that, and, above all, it is not value-free. For some people capitalism is an ideal, a hypothetical economic order where pure private property and the non-aggression-principle have been implemented. For others, capitalism is rather the opposite. They link capitalism to the exploitation of men by men. For them, capitalism is evil.

In other words, the term “capitalism” is the focal point of two opposing ideologies. For many, among them many intellectuals, capitalism is not a positive economic order, but either a utopia or a dystopia. Therefore, the term seems to be very inapt for use in scientific inquiries. It is unlikely that any analysis of this term could be kept free of ideological influence.

Still, it would be a loss if the term “capitalism” were abandoned by economists. Its purpose is to remind us of a crucial feature of our present economic order – to remind us of “capital.” There is a good reason why Karl Marx and his followers used the term “capitalism” to describe

the economic order that is based on private property and the market. In this economic order, the production of goods and services is accomplished within enterprises, and the purpose of enterprises is to generate profit based on the capital that has been invested in them. Marx expressed this idea, the circulation of capital in the pursuit of profit, in his famous formula 'Money – Commodity – Money'. The valorization of capital, the making of money by investing money in business, is behind almost all goods and services that we consume, including our homes and cars, food and clothes, toys and tools, vacations and high-tech gadgets. All these goods and services are produced because enterprises try to employ their capital profitably. Capital is a necessary element of the economic order we live in, and it is more than justified to recognize this fact by calling this order "capitalism."

Given that capital is a central element in our economic order, one would expect that economists are highly interested in analyzing and debating this matter and that the role of capital in capitalism is the number one topic in economic science. But this is not the case at all. Already John Stuart Mill (1848: 89) famously cautioned economists against the alleged mistake of attending "only to the outward mechanism of paying and spending." They should instead focus on the "realities of the phenomena." That is, they should pay attention to the tangible elements of wealth production, particularly to the factors of production: land, labor, and the produced means of production. According to Mill, the mechanism of paying and spending blocks our view on the more relevant events and relationships.

To describe the nature and scope of the mechanism of paying and spending, however, is of course the central purpose of the formula 'Money – Commodity – Money'. This formula is not concerned with technical and tangible details of the production process, but with the organization of production in capitalism by means of the circulation of capital. What Mill did is to ask economists not to focus on capital.

Most economists follow Mill's advice to the present day. True, in the history of economic thought, capital has been at the core of three major debates. The first controversy took place in the last decade of the 19th and the first decade of the 20th century, the second one in the 1930s, and the last one in the 1950s and 1960s. But none of these debates revolved around the actual role of capital in the actual economic order of capitalism. All sides in these debates defended definitions of capital that fitted their respective economic models.

Economists of the Austrian School use the term "capital" in their analysis of a time-consuming production process. Therefore, they fought for a respective definition in the first two controversies.

They defined capital as a conglomerate of producer goods that, heterogeneous in principle, still have one thing in common, namely that they have a time dimension as they are all placed at different stages of the production process. Neoclassical economists – who participated in all three debates – treat capital as an easily measurable production factor in their equilibrium models. Therefore, they opted for a definition of capital as an aggregate of homogenous producer goods. The Neo-Ricardians, who participated only in the last controversy, deny the possibility to define capital in these two other ways. For them, there is no method to quantify capital at all. Their models focus on individual producer goods, not on the characteristics that these good have in common. They avoid the term “capital” as far as possible (e.g. Sraffa 1960: 9) and did not try to establish an alternative definition of capital in the controversy.

After the last debate, the question of capital was abandoned by almost all schools of economic thought. In other words, one of the most important issues of economics, the role of capital in capitalism, was covered only cursorily, if at all, in the three main capital controversies, and for the last 50 years there has not even been a basis for bringing it back on the agenda. Economists simply avoid the theory of capital. They do not define capital in any great detail, nor do they discuss the circulation of capital, described by the formula Money – Commodity – Money’, although it is central to our economic order.

It is important to emphasize one specific aspect of Mill’s advice for economists to stick to the realities of the phenomena. This amounts to the advice to ignore institutions. Institutions, of course, are not tangible realities like consumer goods, production factors, or people. They are, in the definition of Hodgson (2003: 163),

durable systems of established and embedded social rules and conventions that structure social interactions. Language, money, law, systems of weights and measures, table manners, firms (and other organizations) are all institutions.

Economists either take institutions for granted – as exogenous constraints that incentivize or even dictate certain courses of action for maximizing agents – or they explain them as the spontaneous and unintended outcomes of the separate actions of self-interested individuals (Lowenberg 1990: 629). However, the foundation of the market process itself, the institutional framework of capitalism, including money, capital-based enterprises, and financial accounting, is mostly ignored. Without these institutions, there would be no noteworthy market process in the first place, thereby making them essential prerequisites of economic analyses. They are (and must be) tacitly assumed as given, but as the theory of capital lies idle, there is no place for them in standard economics.

Below, this paper will illustrate this point and its implications with regard to financial accounting. It should be mentioned, however, that even money, one of the most important institutions of capitalism, does not play an important role in standard economics. Hahn (1971: 417), a famous contributor to general equilibrium models, admits that “money can play no essential role” in them.

Not all economists abide by Mill’s recommendation and ignore institutions, of course. For more than a century the old and new institutionalists have been fighting for a more important role of institutions in economic science. Yet, since the end of the last debate on capital, the institutions that allow for the circulation of capital are not at the center of their attention. Even Williamson (1985), who has done very important steps towards the integration of the institutions of capitalism into economic science, does not discuss the role of capital in capitalism at any length. He does not refer, in his analysis of capitalistic institutions, to their relationship with the circulation of capital. Yet capital is the element of capitalism that gives meaning, or at least a specific, capitalistic meaning, to many institutions in the first place.

As already mentioned, the institutions behind the formula Money – Commodity – Money’ are, in particular, money, (profit-oriented) enterprises, and financial accounting. It is only possible to understand their specific, capitalistic meaning if it is kept in mind that they bear a direct relationship to capital and its circulation.

It goes without saying that financial accounting is directly connected to the valorization of capital. Financial accounting accomplishes the calculatory separation of a firm’s capital from the rest of the wealth of its stakeholders. As Werner Sombart (1919: 119) explained, it is one of the main purposes of double-entry bookkeeping to create a separate fictional actor, i.e., the enterprise. Financial accounting determines the relationship between expenses and revenues of the accounting enterprise, or, in the terms of the Marxian formula, between Money and Money’. Without efficient accounting methods, there would hardly be a rational way to constitute enterprises as separate agents and to distinguish successful business actions from unsuccessful ones.

That there is a necessary relationship between capital and the enterprise has been emphasized by Max Weber. Weber (1922: 91) even defined the (profit-oriented) enterprise as being directly related to capital, and capital as being directly related to the enterprise. Capital, according to him, is “the money value of the means of profit-making available to the enterprise,” and the enterprise is “autonomous action capable of orientation to capital accounting.” Capital and the

enterprise belong together and cannot be separated. Capital grants enterprises the power to dispose over the production factors, and it is the purpose of enterprises to use them profitably.

A good case can be made for money as well. True, if there was no possibility for money to become capital in a business, money would still be a means of exchange. However, it would cease to pervade the whole production process because it would lose its central role in the organization of production within enterprises (Ritschl 1948: 123). It is in the form of capital that money is used to pay wages and rents to the production factors. Without capital, there would be no enterprise, and without enterprise, there would be hardly any free waged workers or hired land – except perhaps as personal servants and copious hunting grounds in noble or wealthy households. The relationship between those who direct the production process and those who execute it would be similar to the relationship between feudal lords and peasants throughout large parts of the middle-ages (Lütge 1966: 297).

Next to property rights and markets, these institutions, which are necessary to explain the formula Money – Commodity – Money', constitute what one may call the institutional framework of capitalism. They are behind the organization of the production process under capitalism. Therefore, they must be part of any theory of capital that claims to be realistic, i.e., that is oriented towards the reality of economic life.

In the remainder of the paper, I explain what I mean by a realistic theory of capital (section 2) and indicate, through the example of financial accounting regulation, the harmful consequences of institutional reforms based on institution-free economic theories (section 3).

## **The realistic notion of capital**

A realistic notion of capital has been endorsed by numerous German-speaking economists and social scientists since the 19th century. (For the Anglo-American tradition, see Hodgson 2014). Among them, I will only mention Richard Hildebrand, Carl Menger, Rudolf Stolzmann, Robert Liefmann, Max Weber, Werner Sombart, Joseph Schumpeter, Alfred Amonn, Wolfgang Heller, Richard Passow, Erich Preiser, Ludwig von Mises, Hans Ritschl, Otto von Zwiedineck-Südenhorst, and Wilhelm Andreae. In most of these cases, however, the endorsement of the realistic approach to capital was not systematic. It is for this reason that I consider it to be futile to provide an extensive literature overview. As a general remark, I would only like to mention that the realistic notion of capital goes by several different names in the history of economic thought. It has been called "business" capital because it is directly linked to enterprises and their business. It has been called, by others, "financial" capital because its fundamental form

is the money by which enterprises are financed. Last not least, some have called it “private” capital – as against “social” capital. “Social” capital is capital from the viewpoint of society, which includes, among other things, public utilities like streets, schools, universities, hospitals etc., even if those are not profit-oriented. “Private” capital, in contrast, only encompasses assets of private, profit-oriented enterprises. “Business capital,” “financial capital,” and “private capital” are all expressions that have been used to describe the realistic notion of capital in the past. In my work, I employ the term “business capital,” and as far as the other two are mentioned, they are used as synonyms.

Carl Menger, the founder of the Austrian School, is probably the most important economist who realized that it is necessary to have a look at the institutional framework of capitalism, and especially at the role of capital. As a young scholar, he defined capital, in his *Principles of Economics* (Menger 1871), in a way that fit best into his model of the time-consuming production process. In doing so, he did not pay attention to the role that capital actually played in everyday business life. Later on, however, he changed his view. In Menger (1888: 2), he called it “a mistake that cannot be disapproved of enough” when economists use words in a different sense than common parlance. Instead, if economists want to describe and analyze reality, they have to pay attention to the concepts that are used in everyday life. When it comes to capital, the important question is what business people and lawyers understand by the term. According to Menger (1888: 37 ff.), the realistic notion of capital comprises all assets of a business in so far as they constitute, in the calculations of the business, sums of money that are dedicated to the acquisition of income (Braun 2015; 2020b).

Capital, understood in this way, presupposes the existence of private property, money, enterprises, and the methods of monetary calculation. It is a term that is necessarily and directly connected to capitalism as an economic order where production is accomplished by private enterprise. It is a historically specific term that does not make sense in other economic orders where production is not organized to be profit-oriented – for example by a national planning board.

Although Carl Menger might be the most important economist in the history of economic thought who pleaded for a realistic definition of capital as an element of the institutional framework of capitalism, he was definitely not the first one – nor was he particularly influential when it came to spreading this idea. He wrote his 1888 essay defending the realistic capital concept, but did not make any further contributions to a corresponding, positive theory of capital.

In this lack to provide a positive approach, he was similar to the economists of the German Historical School of Economics and the old American Institutionalists. Those schools had stressed the realistic concept of capital long before Carl Menger and with much more vigor. However, like Menger, they were unable to elaborate on the realistic notion of capital so as to achieve a generally acceptable theory of capital that could enter economics textbooks. It was very difficult for them, so it seems, to conceptualize business capital in a way that made it fit into the normal models used by economists.

Still, these economists were able to improve our understanding of capitalism by analyzing its institutional framework. Bruno Hildebrand (1848) and especially Albert Schäffle (1870), for example, were able to clarify the essential role of capital and monetary calculation for the organization of the worldwide division of labor. Many decades before Mises (1920) and, even more remarkably, many years before there was any real-life experience with large-scale socialism, economists of the German Historical School demonstrated that socialistic regimes would have severe difficulties when it comes to allocate resources in the economy rationally. The only known method to do so, they argued, is the organization of production by capital-based and profit-oriented enterprises in a market economy (Hodgson 2010; Braun 2016).

Over the years, there have been several attempts to integrate the business capital concept into the system of economic theory. Two of the most elaborate ones were made by Robert Liefmann, in his *Grundsätze der Volkswirtschaftslehre* (Liefmann 1922/23), and Ludwig von Mises in his opus magnum *Human Action* (Mises 1949). After his death, Liefmann was soon forgotten, but Mises remains to be an important figure in economics.

Almost all other economists of the Austrian School thought and think that the object of capital theory is the roundabout, time-consuming production process. Wherever people produce goods – and be it Robinson Crusoe catching fish on his desert island – Austrian economists speak of capital-using or even capitalistic production. Mises clearly and explicitly rejected this approach, arguing that capital is a term that cannot be separated from the context of monetary calculation by enterprises in the market economy. However, Mises was not consistent in this rejection. He included a whole chapter in Mises (1949) where he stuck to the less realistic capital concept of his fellow-Austrian economists. His attempt to conceptualize capital as a necessary element of rational economic calculation under capitalism remained rather unnoticed despite his otherwise wide sphere of influence (Braun et al. 2016).

The current situation is the following. Economic theory, both mainstream and heterodox, ignores important elements of the institutional framework of capitalism, and particularly a realistic concept of capital. In so far as economists deal with business capital, it is not as part of any theory or system. Geoffrey Hodgson, for instance, covers many important aspects of the institutional framework of capitalism in Hodgson (2015). However, his goal is not to clarify the relationship between the capitalistic institutions and economic theory. The purpose of Hodgson and other institutionalist authors is rather to demonstrate to economists that there are important gaps in their theories and systems that should be covered up. There is no direct link between economic theory on the one hand and the discussion of historical institutions on the other.

In short, when it comes to capital, economics is divided. Theoretical economists make use of mainly mathematical tools in order to construct testable scientific models. They do not employ the term capital, or if they do, they mean something different by it than the capital concept of actual business life. Historical and institutionalist economists, in contrast, deny that it is possible to build generally applicable models. Therefore, they concentrate on the description of the institutions underlying capitalism, among them business capital. Between those two groups, there are not many connections that go beyond mutual criticism.

This gap in the literature has been noticed and addressed in recent years by Lewin and Cachanosky (2018; 2019), Braun (2017; 2020a) and Braun et al. (2016). They provide a link between economic theory and the institutional framework of capitalism. They demonstrate how far the organization of the production process depends on and presupposes the existence of capitalistic institutions.

Usually, the production process is conceptualized as a production function that associates production factors with production output. Building from Menger (1888) and Mises (1949), and with strong borrowings from the historical and institutionalist schools (especially Hodgson 2015), Braun (2017) links the production process with the institutions that actually organize production in capitalism. He fleshes out the Marxian formula Money – Commodity – Money’.

The graph that inspired Braun’s (2017) discussion of this relationship can be found in Zwiedineck-Südenhorst (1930) and is reproduced below (in English translation) as Figure 1. Otto von Zwiedineck-Südenhorst argued that the transformation of land, labor, and produced means of production into products via production is embedded in the circulation of capital. The reason why enterprises combine production factors at all is that they hope and plan that their money revenue surpasses their money expenses. They only spend money on land, labor, and produced

means of production because they expect that the production process will yield products that can be sold for profit.

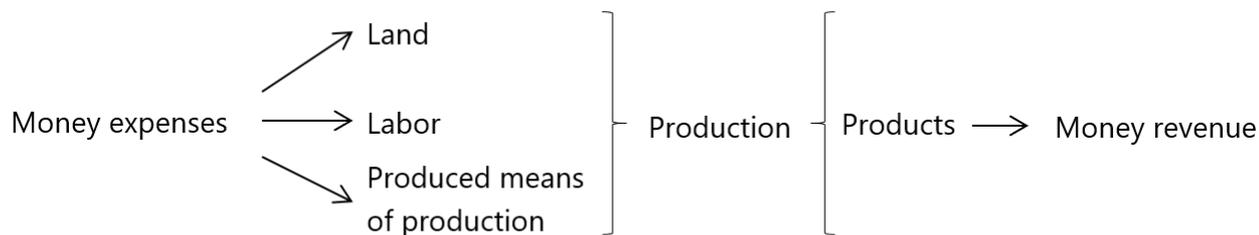


Figure 1: The circulation of capital according to Zwiedineck-Südenhorst (1930: 1069)

If we integrate the circulation of capital into the theory of capital, as was done by Braun (2017), it becomes apparent how capitalistic institutions constitute the market processes that create a tendency towards the equilibration of demand and supply. Money, enterprises, and financial accounting are all part of the story that is told in figure 1. Enterprises try to profit from the difference between monetary revenues and expenses and thus drive the market process; they employ financial accounting in order to determine their profits; obviously, all these processes and calculations are denominated in terms of money.

## **Reform of capitalistic institutions without a theory of capital – The case of financial accounting**

What are the implications of the present state of affairs where capital theory is neglected? It is well known that the economics profession at large did not see the financial crisis coming that we witnessed a decade ago. This crisis is called a “financial” crisis because it broke out in the financial sphere. It started with banks going bankrupt and the stock market collapsing. But later on the real economy was affected as well. Investment declined and unemployment rates in the U.S. and Europe soared. The financial crisis became an economic crisis.

In order to understand the emergence of economic crises, it is necessary to clarify the relationship between the financial sphere and the real economy. A realistic concept of the circulation of capital would help immensely in this regard. After all, each enterprise of the real economy is part of this circulation. Capital is usually provided to them by the capital market, that is, by banks, the securities market, or both, and the enterprises try to produce profit in order to satisfy investors. Enterprises depend on the capital market for finance, and the capital market depends on enterprises and the real economy for profitable investment outlets. Capital, in other words,

connects the financial sphere to the real economy. In some way, therefore, it must be at the core of what happened during the financial crisis and the following recession. It must be a part of any attempt to explain how the financial sphere and the real economy intertwine in good days and how a crisis spreads from one sphere to the other in bad days.

Yet, since the theory of capital has been lying idle for half a century, there are hardly any tools in economics that would help us to explain how the capital market and the real economy interact. The real economy is supposed to stand on its own. Have a look at standard microeconomics textbooks. Microeconomics is supposed to explain how the market economy works, i.e., how the price system organizes the production process in order to satisfy consumer demand. If microeconomics were really to describe how production is organized in the market economy, capital and the enterprise would be the first and most important terms in those textbooks. Instead, however, if capital is mentioned at all, it is in subsidiary chapters. You sometimes find sections where the price of assets is explained as the capital value of future cash-flows. More often, intertemporal choices are covered at some length, with consumers either saving or borrowing on the capital market at the market interest rate. Mainly, however, capital is treated as a production factor that plays a similar role in the production process as labor. It is not a constituting element of enterprises, but one factor among several in the production function where each can be handled with the standard optimization tools.

In macroeconomics, the place of capital seems to be a little bit more central. As Braun and Erlei (2014: 157-159) show, the Keynesian short-term solution for economic crises clearly accepts the central role of enterprises for the economy. If enterprises do not earn profit on their capital, they stop producing commodities and employing workers. It is for this reason that low interest rates and government investments are propagated as stabilization policy. They are supposed to maintain or boost enterprise profits. These tools aim directly at the core of capitalism, that is, at the profit considerations of capital-based enterprises.

Capital itself, however, is not analyzed in short-term macroeconomics. The interest rate is supposed to influence the amount of aggregate investment in the economy, but the institutional foundations of the way capital-based enterprises organize the production process is hardly mentioned.

When it comes to long-term macroeconomics, the term "capital" plays a rather prominent role. Yet, like in microeconomics, capital is treated as one production factor among several, neither

more nor less important, in general, than labor or land. That capital defines the way capitalistic production is organized in the first place, does not enter the analysis.

In both micro- and macroeconomics as it is taught to economics students, capital is more or less only a production factor. There is no adequate allowance in standard economics for the fact that the term "capital" originated from business practice, or that it stems from the economic calculations of capital-based enterprises. Economists assume that the problems that are dealt with in actual business life by "capital accounting" (Weber 1922) have been solved already. They tacitly assume that the institutional framework of capitalism guides the market process well enough so that they can focus on the equilibrium relationships between the more tangible items, like consumer goods, producer goods, and production factors.

What I have said in the last paragraphs must not be misunderstood as a fundamental criticism of standard micro and macro theory. There are good arguments for ignoring the institutional framework of market processes and focusing on equilibria instead. The tools of comparative statics are very helpful when it comes to analyzing the impact of certain changes and shocks on the economy – for instance, how an increase of the income tax rate influences wages and employment. So far as these tools go, it would only complicate the analysis if they were undergirded by reflections on money, capital, and monetary calculation.

A major problem arises, however, when the tools and methods of standard economics are applied to a reform of the institutions that they themselves tacitly assume as given. In these cases, it must be feared that the reforms destroy the institutional foundations of the economic order that they are meant to improve. It is important to point out that this is not only a hypothetical problem. In the area of capital and its circulation, such reforms have actually been implemented before the outbreak of the financial crisis.

One important example is the recent reform of financial accounting regulation. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have replaced the traditional, historically evolved accounting principles by new ones, and in doing so, they leaned onto what is usually called neoclassical economics (Bromwich et al. 2010; Braun 2019).

Now, heterodox economists are inclined to scapegoat neoclassical economics for numerous things that go wrong in economic policy-making. This is not my intention. Still, it is hard to deny that neoclassical economics, however defined, does not focus on the analysis of the institutions that make the working of the market possible in the first place. By implementing new accounting

principles, especially the fair-value principle, the standard boards have relied on the assumption that market processes work well under any circumstances and did not realize therefore that they interfered strongly with the institutions that guarantee the working of the market process in the first place.

According to the traditional historical-cost principle, financial accounting is supposed to inform the stakeholders of an enterprise on its financial performance. Its purpose is to provide new and necessary information to the stakeholders and the market on the expenses and the revenues of the respective enterprise. Net income determined according to this approach is able to inform the market on where there are gaps in the price structure. Figure 1 also shows that money revenue and money expenses are directly linked to the combination of production factors. Net income appears where the combination of the production factors is consistent with the demands originating from consumers or other customers. As long as financial accounting focuses on the actual expenses and revenues of the accounting entities, it is a necessary condition for the market process to work.

According to the fair-value approach endorsed by the standard setters, however, the market does not need to be informed. Even to the contrary, the market is to inform the enterprise, not the other way around. The "fair value" of assets and liabilities is basically their current market price (Laux and Leutz 2009: 827). But if the market provides the necessary price information to financial accounting, then financial accounting cannot be regarded as a precondition of the market process. The market is supposed to work perfectly already (Braun forthcoming).

Standard setters came up with their reform because they followed neoclassical economics in ignoring the role of institutions. As a consequence, they implemented the fair-value principle that is often recognized as having accelerated the boom phase and exacerbated the bust of the recent financial crisis (Schildbach 2015). Ironically enough, the standard setters had to suspend the fair-value principle during the crisis when they realized that it jeopardizes the equity base of banks.

In the area of financial accounting, the shortcomings of an economic theory that ignores important elements of the institutional framework of capitalism is particularly obvious. There is a strong need in economic policy for an alternative approach based on a realistic notion of capital. Otherwise, institutional reforms will continue to be based on theories that ignore the preconditions of their own *raison d'être*: the institutions behind the market processes and equilibrating forces characteristic of our economic order.

## Concluding remarks

Economists of almost all schools of thought ignore institutions when it comes to capital. The present paper makes clear the relevance of a realistic theory of capital that gives attention to the actual institutions of capitalistic societies. Any institutional reform that is not based on such a theory, but instead makes use of the institution-free models of neoclassical economics, is in danger of destroying the institutions that are the tacit preconditions of capitalistic societies themselves and the theories that the reforms are based upon.

The counterproductive replacement of historical-cost-accounting with fair-value accounting in recent years exemplifies this problem. However, financial accounting is, of course, only one example of the many institutions that are ignored by economists although they make the market process possible. Other parts of the institutional framework of capitalism, such as money and enterprises, are likewise treated as orphans, at least when it comes to the roles they play in the circulation of capital. If we want to understand capitalism, these institutions must be analyzed not as choice constraints or unintended outcomes of human action but as the foundation of economic analysis in the first place. Without them, there would be no large-scale market process, and therefore, there would be no neoclassical economics. In this paper, I have pointed to what happens if the institution of financial accounting is reformed on the basis of a theory that does not really include financial accounting. The same remains to be done for money and enterprises.

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## **Bio**

### **Eduard Braun**

Institute of Management and Economics  
Clausthal University of Technology  
Julius-Albert Straße 2  
38678 Clausthal-Zellerfeld  
Germany  
Tel.: +49 5323 72 – 7636  
Fax: +49 5323 72 - 7639  
eduard.braun@tu-clausthal.de

# The Problem of Indifference and Choice. Answer to Nozick's Challenge to Austrians

Matúš Pošovanc, F.A. Hayek Foundation Bratislava

**T**he aim of this paper is to link the Austrian School's approach to indifference with the mainstream approach. The paper looks critically at an interesting ongoing discussion about the problem of indifference and choice within the Austrian School. The discussion was conducted in response to Nozick (1977) address to representatives of the Austrian school on the problem of indifference, implying the invalidity of the law of diminishing marginal utility in the absence of a presupposition of indifference. This paper briefly introduces the discussion and its main problems. Stated reservations will be replaced by suggested solutions based on the minor modification of the theory of subjective value and on the premise that needs are satisfied by a portfolio of goods over time. The discussion will allow the preservation of elements of Indifference analysis as interpreted by the neoclassical mainstream. However, it will also allow interpretation of the problem of choice based on *strict preferences* and creates room for Indifference, also from the point of view of the Austrian School of Economics. This is quite a controversial conclusion, but it is a logical consequence of the proposed minor modification in the theory of subjective value.

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## Introduction

Although the primary audience for this paper are representatives of the Austrian school, it is likely that it could be of methodological interest to representatives of mainstream who already work extensively with the concept of indifference. The aim of the paper is two-fold: To show that the Austrian skepticism about the problem of indifference is important for the very concept of indifference and, at first glance, to attempt the impossible—to link the Austrian's approach to indifference with the mainstream approach.

The concept of indifference and indifference curves was criticized by Rothbard (1956, 1997). In principle, the representatives of the Austrian School accepted the solution he proposed. Indifference cannot be identified in the choice as indifference is not part of the choice. On the contrary, the choice is necessarily based on strict preference and there is nothing about which to be indifferent in terms of choice or action (within praxeology); indifference can only be a psychological concept when we consider whether a person is indifferent to something in terms of his/her preferences. The primary discussion within circles of the Austrian school<sup>1</sup> was initiated by Nozick (1977, pp. 370-371, taken from Block 1980), who identified the following problem in the methodology of the Austrian school:

“Austrian theorists need the notion of indifference to explain and mark off the notion of a commodity, and of a unit of a commodity. . . .Without the notion of indifference, and, hence, of an equivalence class of things, we cannot have the notion of a commodity, or of a unit of a commodity; without the notion of a unit (“an interchangeable unit”) of a commodity, we have no way to state the law of (diminishing) marginal utility.”

Block (1980, p. 423) considers this kind of criticism to be one of the most brilliant and most creative ways to criticize the methodology of the Austrian school. Nozick has identified contradictory statements in two arguments of the Austrian School. If Austrians reject the concept of indifference associated with making decisions and making choices, then it is necessary to reject the law of diminishing marginal utility and vice versa.

In principle, the problem we face is a homogeneous assessment of economic goods. According to Nozick, logically, homogeneity is necessary for the validity of the law of diminishing marginal utility when an additional unit of economic good necessarily satisfies our needs less than the previous one<sup>2</sup>. However, homogeneity collides with the logical conclusions of the subjective theory of value and the associated problem of choice. Choice implies that a preference exists for one economic good (e.g., good A) over another (even physically the same economic good A, or different, economic good B). It should be pointed out here that it is completely irrelevant if a “chosen A” is physically identical to other physically identical A<sup>3</sup>;

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1 The whole genesis of the Austrian discussion on the topic can be seen at the beginning of Block (2012).

2 The law is inevitably practiced in time. Therefore, the aim of our work is focused on this time-context.

3 Wysocki and Block (2018a) argue that any good A differs from the other good A at least in terms of its location in the space. It follows logically, according to them, that the selection of a particular good A is always a unique choice in this respect. Wysocki and Block’s argument (2018a) implies that there is (in principle) no identical economic good, given the fact that each economic good has its unique position in space. It is true that the item/good indeed has a particular location in the space, but the choice is primarily about the value determination from an economic point of view and not about the location

what matters is the value determination. This means that if I choose A, then that particular A is for me subjectively more significant in terms of value over (although physically the same) another A, or as (a physically different) B. However, this means that the selected good (A) cannot be considered as having the *same value* as any physically identical A or any other B. However, if choice causes value heterogeneity related to the good it contradicts the possibility of applying the law of diminishing marginal utility. We have nothing to apply it to (no similar or homogenous good). The choice causes that there is no second or third unit of the good to be more preferred over the first. We have only discontinuous value perceived goods over time.

The theory of indifference states that there is no such strictly preferential character of our valuation of goods. According to this theory, we are in an optimal position when we are indifferent between goods A and B. In that case, we should actually perceive in value terms that the economic good A as well as B satisfies our needs *identically*; therefore, we are able to recognize the given goods as value homogeneous. According to Nozick, the concept of indifference implies that we can identify the same class of goods. However, this contradicts the fact that we make a particular choice and select a very specific good (*the A*), which is therefore considered heterogeneous. We must prefer it based on certain criteria and, therefore, we choose it. The proof is that we did. The choice is the very basis of this action that Rothbard (1956, 1997) defines as the concept of so-called demonstrated preferences. Nozick claims, however, that without the assumption of indifference, the law of diminishing marginal utility does not apply. And he's right. So, we are facing an interesting logical paradox where both sides of the debate seem to be correct.

The following procedure is required to show the possibility of linking the two approaches to the problem. First, I will present a more detailed approach of Austrians to Nozick's challenge; it will be necessary to make some methodological comments on the Austrian approach. This will make it possible to identify the root problem of the Austrian's approach. The awareness of the problem always leads to a hunt for a solution. I will, therefore, present the basic argument which enables us to satisfy the legitimate claims of Nozick to value homogeneity while maintaining a logically consistent view of the Austrians' approach to the problem of choice. The solution lies in a slight modification of the theory of subjective value. The value

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of items/goods in the space. We see different valuations of economic goods because of the agent, not because of the location of items /goods. Theoretically speaking, if there is any possibility to have two items/goods at the exact and same location in the space, there is still room for the agent to choose one particular item and make it the specific economic good to meet his/her needs.

causality between needs and goods is not applied to the dichotomous relationship of the *need-good* which must necessarily cause value heterogeneity over time due to the different value context. The value causality is presented at the teleological level of thinking, whereas the dichotomy is applied to the conceptual level of thinking in the form of a *combination of the sum of needs*, which is satisfied by a *combination of goods (a portfolio)*. This makes it possible to identify a value-homogeneous concept or a mental construct, which can be applied over time. The form of the value causality is presented in the form of "*the combination of needs is satisfied by a portfolio of goods*". Since the portfolio is always a structure composed of specific parts, it is not a problem to maintain the desired homogeneity on the level of a portfolio and, at the same time, to preserve the diction of a strict choice. This will allow us to formulate a consistent response to Nozick's challenge. The answer has several implications; some of them, given the scope of the paper, will be introduced at the end of the paper. The implications will already be directed to the connection of both seemingly logically contradictory approaches to the problem of indifference - Austrians and mainstream. We will shortly conclude.

## Reactions to Nozick

Block (1980) has tried to solve the problem. He is trying to preserve the valid parts of the concept of demonstrated preferences<sup>4</sup> based on strict preference promoted by Rothbard (1956, 1997) and to respond to Nozick at the same time. Block must show that choice is actually made on the basis that "I want *this* good A!", so, I don't decide that I want both A and B because I know that both A and B will meet my needs in the same way but eventually, I opt for A (weak preference). At the same time, he must maintain the law of diminishing marginal utility, which implies homogeneity of goods. Block (1980) comes up with a fresh solution where he explains the homogeneity of the good on the thymological level - outside of the action. He claims that the person making the choice related to a unit of good A (using the example of an ounce of butter) must, by definition, decide based on the evaluation of a *particular* unit of an economic good. Until then, he perceived it as a part of a homogeneously assessed stock of the economic good (100 ounces of butter). He gives an example of a butter vendor who perceives 100 ounces of butter as a homogeneous good, to which he is indifferent (outside of action and choice; he judges butter from a psychological - historical

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4 It should be noted that Rothbard's definition of the demonstrated preferences is not very happily named. The very concept of demonstrating a preference implies that economic science is able to identify, along with the demonstrated preference, some non-demonstrated preferences. However, economic science obviously doesn't know what is not demonstrated. The only point it can say about the situation is that choice has been made, and that someone preferred good A over other good at that time; but which ones, or any indication of "lack of preference" remains only as a secret on an individual level of the acting individual. See also Stroukal (2014).

perspective - thymologically). However, if he/she sells the x-th (e.g. 72<sup>nd</sup>) ounce of butter to his customer, he perceives it specifically as an independent economic good, for which he receives a *specifically* perceived sum of one dollar from the customer while continuing to perceive homogeneity of the good in the form of 99 ounces of butter. In this case, this specifically perceived 72<sup>nd</sup> ounce of butter (as good A) is less preferred than 99 ounces of butter (good B) for obtained good – one dollar. In other words, Block claims that we are indifferent to 100 ounces of butter until we decide otherwise. As he later remarks (Block 2009) he leaves the indifference at the level of thymology; in the absence of action, i.e. in the psychological-historical motives of why we make decisions. In doing so, it is intended to ensure that the law of diminishing marginal utility is maintained with regard to its applicability to the butter supply, while at the same time maintaining the strict choice on the basis of preference and not indifference<sup>5</sup>.

The topic has been discussed by several authors. However, it is Hoppe (2005) who criticizes Block (1980) in the context of Austrian discourse. He points out that the concept of indifference is an epistemological category that is indispensable for the classification of objects of reality. We must be aware that classification is also necessary for the conduct of the action; at least to be able to distinguish one good from another or for identification of resemblance. He accuses Block of a vague and psychological interpretation of the character of indifference. Hoppe points out to Mises, who explains that: *“Quantity and quality, are categories of the external world. Only indirectly do they acquire importance and meaning for the action. Because everything can only produce a limited effect, some things are considered scarce and treated as means. Because the effects which things are able to produce are different, acting man distinguishes various classes of things. Because means of the same quantity and quality are apt always to produce the same quantity of an effect of the same quality, action does not differentiate between concrete definite quantities of homogeneous means.”* (Mises 1998, p. 119)<sup>6</sup>. Accordingly, Hoppe further points out that the heterogeneous nature of the good (butter) cannot arise by any division of a given group of objects of reality, i.e., 99 ounces of butter and 1 ounce of butter. It can only arise if exactly the 72<sup>nd</sup> ounce of butter (exactly that one and no other) is attributed by some separate character. Only then can we speak of

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5 As the reader will see below, Block (1980) is very close to the solution proposed here. A small modification of a given example from 100 ounces of butter to a portfolio (stock of any) goods owned by an individual will allow us to anchor the concept in a time continuum.

6 For the sake of completeness, here is the full quotation from Mises (1998, p. 119), where Mises adds: „But this does not imply that it attaches the same value to the various portions of a supply of homogeneous means. Each portion is valued separately. To each portion, its own rank in the scale of value is assigned. But these orders of rank can be ad libitum interchanged among the various portions of the same magnitude. “

a heterogeneous (other) good that is different from any ounce of butter. Hoppe goes on to say that the problem of indifference is more in the description of our actions. If we imply in the description of an action that I am indifferent to the blue and green sweater, and finally I choose one of the sweaters, it only means that we are mistaken in the description of the choice, where my choice was simply focused on the sweater itself (not green or blue) while I chose a sweater instead of a T-shirt (or anything else).

There was another discussion between Block with Barnett (2010), and Hoppe (2009). Their interchange is characterized by Wysocki (2017) as a discussion of the dual nature of what the term "choice" means for both authors. Hoppe perceives choice in the context of strictly given preferences of classificatory different goods, while not denying the existence of indifference as a psychological relationship between equally assessed options. However, at the same time, he claims that if one perceives this psychological character of indifference (blue-green sweater), then our description of action and choice must be different. Choosing sweaters must be based on another categorization of action: I prefer a sweater over any T-shirt. According to Wysocki (2017), Block is attached to specific circumstances, which lead a person to choose a *particular* good. It is a necessary praxeological explanation of what happens when we choose, leaving the concept of indifference in the thymological field of analysis as a necessary psychological-historical explanation of the law of diminishing marginal utility.

At this point, it is appropriate to identify some of the problems facing both Block and Hoppe. Block's relatively elegant solution implies that the law of diminishing marginal utility has a one-off nature in the context of action. Based on his explanation, the law would always be applicable only to particular temporal circumstances. In other words, it is applied to good A (100 ounces of butter), then comes action and choice at a given point in time. We exchange one ounce of butter for a dollar—and we are done. Consequently, the law must be applied to another good B (99 ounces of butter) given the fact that the choice of replacing a particular ounce of butter for a dollar should have caused the butter owner to perceive the butter as two goods, the specific ounce of butter (good A), which he has exchanged, and the remaining 99 ounces of butter (good B). Block's solution, therefore, lacks a wider application in the time continuum.

Hoppe is unaware of the implicit value aspect of Block's reasoning; his remark on the classification of objects of reality is inaccurate. It is clear that Mises (Hoppe) considers only

the physical properties of goods<sup>7</sup>. We have no reason to claim that means (goods) of the same quantity and quality are apt *always* to produce the same quantity of an effect of the same quality *in terms of value*, which is *attributed* to goods<sup>8</sup>. Logically speaking, an economic good of the same kind and quality may not exist at all if we look at the good from the point of view of valuation. This is because the value context in which given (otherwise physically identical) goods are evaluated necessarily changes. For example, buying a fireplace, sofa, dog, or relaxing music; their physical properties imply their use, but in value terms, their use may be perceived as different since they satisfy different needs over time. The objects may all bring relaxation as in the form of sitting in front of the fireplace associated with stroking the dog and listening to music, but later can be used to maximally engage the female attention for sex, and a day later the fireplace can be used in the context of heating and the dog used for hunting. Value effects are simply different and are constantly adapted to fit new plans that the-owner of the objects of reality may have. Hoppe's (Mises) arguments in this section lack the value context that Block (1980) implicitly assumes. As we will see in a moment, the value context is explicitly brought to the discussion by Machaj (2007). In other words, Hoppe, in an epistemological sense, omits to explain the *value-perceived homogeneity* of the good. It is precisely the value homogeneity that we should apply to the law of diminishing marginal utility; otherwise, we would have to assume the existence of some *objective utility of goods*, which must always be perceived in the same way.

Wysocki (2017) draws attention to the ambiguous perception of choice by both authors. In the context of our approach, it is necessary to add that both authors lack the temporal, continuous aspect of choice. The choice is not inevitably focused on a particular moment when it is made, but it is focused on the future. This is "required" by Shackle (implicitly also

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7 It must be stressed, based on footnote 5 where I left the remaining part of Mises's citation, that Mises value approach in the citation has a different character as we ask for. He is focused on the different valuation of different parts of the supply of economic goods. We are focused on the value causality between needs and means.

8 The primary problem is that Mises' (Hoppe) interpretation implies the immutability of valuation. Once recognized, causality related to the need-to-good relationship must be "always" the same. There is strict causality of satisfying needs with the same good at the physical level of course. Water satisfies thirst. Sofa satisfies the need for sitting or lying. However, the value context by which we attribute value to economic good necessarily changes over time. And it is the question of value, not physical properties, which count in economics. Let's take the example of a sofa. The sofa serves the same person who bought it for sitting or lying, but also for sitting/lying while relaxing, watching TV, relaxing in front of the fireplace, or maybe for working ... and also, if I know that it is made from wood, it could have a heating effect if I decompose it, etc., etc., ... Purchased water can be used for drinking; but also for bathing, or as garden irrigation. The value context in which a person uses physically the same economic good can be very variable. At the value level in terms of physically similar goods, there is not always the same effect of satisfying needs. However, Mises (Hoppe) writes: „means of the same quantity and quality are apt always to produce the same quantity of an effect of the same quality, the action does not differentiate between concrete definite quantities of homogeneous means.“

by Mises<sup>9</sup>). In other words, the choice is merely the implementation of a plan to remove the perceived state of uneasiness towards the future. It is in this value context (the context of needs and the plan for their satisfaction) that it is necessary to explain both the realization of the choice, and at the same time, our ability to apply the law of diminishing marginal utility. It is precisely from the satisfaction of needs that the value characteristics of goods and their epistemic economic classification should be derived. However, there must also be a value-classification character, not only a physical-classification character.

It is Machaj (2007) who draws attention to the necessity of the value-based character of goods derived from how we subjectively perceive that some goods meet subjectively perceived needs. Machaj gives an example of a physically identical wedding ring which would have a different meaning for a fiancée if she gets it from her fiancé than if she got it from a complete stranger. In other words, *it is not* (only) the physical characteristics of the goods on which the homogeneous perception of the goods is dependent on the context of action and evaluation. Machaj then defines value homogeneity as follows:

“...two objects are homogenous if they both can serve the same end. If so, it follows these are two units of the same supply, because they are capable of satisfying the particular need. From the point of view of an actor’s particular need, they are homogeneous and interchangeable or equally serviceable. It does not have anything to do with psychological considerations or psychical characteristics, but rather with the possibilities of action. Now, this point cannot be demonstrated through action, and cannot be observed in action. But as we emphasized before, economics is not only about actions, but also about different possibilities of acting toward the satisfaction of human needs”..

Machaj is followed by O’Neill (2010); In the discussion following Machaj, O’Neill brings interesting observations which are based on the concept of so-called weak preference. O’Neill, as well as Machaj, point out that our primary interest should be in need assessment, claiming that:

“...we are indifferent between two actions when we judge that there is no difference in the magnitude of the satisfactions of needs obtained from those actions (the actual needs may be different, but the magnitude of the satisfactions from these needs must be equal). Similarly, we are indifferent between two goods when we

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9 Unfortunately, Mises’ requirement to focus on the analysis of economic phenomena in the future has a dichotomous character. Mises derives much of his analysis of economic phenomena from the past. Shackle is much more consistent in this respect. See, for example, the criticism of Mises’ procedure of analysis and methodology in Pošvanc (2019b).

judge that there is no difference in the magnitude of the satisfactions of needs that depend on our command of those goods." (O'Neill 2010, p. 72)

O'Neill is aware that, according to Machaj, we do not evaluate goods. He claims that we evaluate our needs, which we satisfy with goods. Only in this way can goods have some value; on this basis, he brings the element "*no worse than*" into the analysis. Since it is primarily through an assessment of identified needs that we seek appropriate action, some of our actions may be assessed as 'not worse than' some other results, but since they remain counter-factual, we ultimately reject them. The so-called strict preference concept is then a subset of this modus-operandi, where sometimes the outcome of the action is necessarily assessed as "*better than*". Machaj (2007) was criticized in Block (2009) and O'Neill (2010) was criticized in Block (2012). Machaj and O'Neill were also criticized in Wysocki (2016). In principle, criticism is fixed to one issue. Both Machaj and O'Neill imply decisions based on indifference between goods. This is because two, even physically heterogeneous, goods can satisfy the same need. It depends on the subjective judgment of the person in question. Subjective judgment indeed counts, but at the same time, it is correct and logical that once someone chooses the good A that satisfies the need, it must at the same time be true that he prefers it over something else. We still face the same paradox: If there are strict preferences related to the choice, how do we explain the validity of the law of diminishing marginal utility?

Although Machaj and O'Neill are criticized, in my opinion, their contribution to the debate is very important. Machaj and O'Neill bring a much-needed subjective value aspect to the discussion. According to them, the perception of subjective value is derived from the perception of human needs; it is the point that needs are prioritized, which consequently brings value to economic goods. The action is aimed at the elimination of perceived uneasiness. The perception of priorities of needs implies the preference of one good over another; that ascribes the value. Only this relationship can then be imputed into some good(s) that already satisfy the perceived need(s).

Wysocki (2016) enters the discussion with this very important question: Under what condition does the law of diminishing marginal utility apply? He states that since the law is conditional, it necessarily implies the prerequisite of having the same good concept. What does the concept of the same good mean? Wysocki and Block (2018a) define, first of all, the difference between, goods and economic goods. They write that the difference between things and

goods has already been identified by Menger who has made a condition of existence for economic good as follows:

- a) existence of need
- b) existence of causality between a given need and a thing that is, a causality we know that this item satisfies that need
- c) the ability to control those things.

According to them, the *good* exists if there is at least one person who identifies causality between one's own need that is met by the identified object/part of reality. According to them, an *economic good* exists if the above-mentioned conditions occurs for the existence of the good (meaning man, need, and knowledge about causal relationship "need – good"), *and at the same time it applies*<sup>10</sup>:

(economic good exists if) its marginal utility is greater than zero. This means that the good is able to satisfy some other human need or satisfy more completely the need previously attended to. (Wysocki and Block, 2018a, p. 134)

Based on these clearly defined and classified phenomena, they come up with the following statement, which I will quote in its entirety:

The concept of homogeneity (or, equivalently, the same good) must be prior to the law of diminishing marginal utility because this law assumes it. That is, this law applies only when it considers homogeneous units of the same good. What is more, the relation between human action and homogeneity is very complex indeed. This is because of the fact that a person treating homogenous units of a given commodity as the same good cannot ever demonstrate this in action.

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<sup>10</sup> I am not sure whether Wysocki and Block (2018a) realize that in their elegant and absolutely clear interpretation of the distinction between items, goods, and economic goods, they explain that scarcity is not a necessary condition for action. On the contrary, based on their interpretation, the concept of scarcity must be inferred from the action. This is a premise that is wrongly interpreted within the Austrian school. It is interpreted in the form that scarcity is a necessary condition for action, i.e., that without the world being scarce, we would not act.

Cf. with a very gritty and not quite obvious explanation of this statement in Pošvanc (2019a, p.18), where Pošvanc explains the connection between action and grasping of reality. At the time of writing Pošvanc (2019a), in which, inter alia, author claim that scarcity is not a necessary condition for action, the author was not aware of this much more elegant explanation by Wysocki and Block (2018a).

the same good is a concept which is clearly prior to any action. Therefore, it belongs in the category of transcendental concepts– it provides us with a way of construing human agency, and it cannot by any means be inferred from the data of particular human acts. In other words, the notion of the same good gives us *Bedingung der Möglichkeit* for formulating the law of diminishing marginal utility. It is due to the concept of the same good (not being manifested in action itself) that we can better make sense of human action. The same is true about the concept of human purpose. After all, human purpose does not manifest itself in human action. The former is rather assumed a priori to make sense of the latter.” (Wysocki and Block, 2018a, pp. 135-136).

Wysocki and Block (2018a) point out that by definition, a choice must always be based on a good that we prefer, at least from the point of view of the location of the good, since physical and homogeneous things cannot be in the same place at the same time. Subsequently, they approach the definition of the same good, whereby they still remember that the action *per se* does not enable us to identify whether one has economically used consecutive or different units of a given commodity.

For them, physical equality is *only a sufficient condition* for defining the same good. They consider Machaj’s value condition (*the same end is served by the same good*) to be too roughly defined depending on how the need is defined. Machaj’s value condition would mean that once we define the need as “*to satisfy any need*”, it would actually be true that everything is the same good because everything that is identified as a good satisfies a need. Going to the other extreme two physically heterogeneous goods, although they can satisfy the same need, they are nevertheless physically different. This factor makes it quite tricky to describe the goods as the same. There is one more problem they face - it could be that an additional unit of some goods, e.g., a second beer relative to the first, can satisfy the given need more than only one beer. What this implies is that in the context of equality of assessment of goods, we must also take into account that physically divisible goods must sometimes be perceived as a single good. For example, one good = 2 beers, which is preferred to another good = 1 beer. Rothbard (1956, 1997) argues similarly.

Of course, Wysocki and Block (2018a) still realize that they must inevitably respond to this ingenious point, the challenge that Nozick (1977) puts forward most aptly, in the footnote 30 of his work. They quote Nozick, (Wysocki and Block, 2018a, pp 138-139):

“However, on p.122 he [Mises] says, “All parts – units – of the available stock are considered as equally useful and valuable if the problem of giving up one of them is raised.” Here, then, we do have indifference. Yet a choice will be made, perhaps at random. One particular object will be given up. Yet, the person does not prefer giving up this one to giving up another one. Therefore, choice entails (at best) weak preference; it does not entail strong preference.”

It is clear that, on the one hand, they must explain a strict preference, but with a homogeneous good, which necessarily implies an identical possibility of satisfying the perceived need. They present the following solution (Wysocki and Block, 2018a, p. 140, use the example of the ring since they respond to the example given by Machaj; bold mine):

*Homogeneity is defined as a physical identity but the equal serviceability of the units of the same good cannot be demonstrated in action. It is necessarily true that only one particular ring [good] will be eventually picked up, thus showing the actor's strict preference for the chosen unit. So, no contradiction arises. **Those weddings rings [goods] are equally serviceable prior to the act of choice and this is what makes them a supply of the same good before an actual choice is made.***

Wysocki and Block (2018a) complement this explanation in Wysocki and Block (2018b), which takes on even clearer contours. It is in this work that they focus on how their concept is related to the formulation of needs (ends). It is the specificity of definition of the needs, which creates the list of these needs in question. It is evident that a need, which is too specifically defined, would identify any good as heterogeneous, and a too generally defined need would make any good homogeneous. They write (Wysocki and Block 2018b, p. 404):

„First of all, we posit that whether two items represent the same economic good always depends on how a given economic actor envisages his ends. This, in turn, implies that there can be no inter-subjectively correct answer to the question of whether two physical goods can be subsumed under the category of the same good. For the answer thereto is always contingent upon the way of referring to an actor's ends.”

The argument is probably best explained by their example stating that the difference is when we define the end (need) in the form: “*going to the cinema with a woman*” and in the form, “*going to the cinema C, with a woman W, by route R*”. The first example implies that we can satisfy the end in any cinema, with any woman, and we can get there by any route, i.e., the

means of *fulfilling the end* may be more variable. However, the second example of the end implies a more specific form of the good - namely *the* cinema C, *the* woman W and *the* route R. This implies a very important finding (Wysocki and Block 2018b, p. 406; bold, author's):

...., whether any given pair of goods are in the same supply depends on how a given economic actor frames his ends. A pair of items would thus constitute the same economic good **relative** to one way of describing ends but not from the other."

Thus, Wysocki and Block (2018b) finally give a more complete picture of what the same good means<sup>11</sup> and leave it in the thymological area. In my opinion, it is a pity that Wysocki and Block (2018a, 2018b) do not use their knowledge of relativism associated with the economic perception of satisfaction of needs with goods over time. They would avoid the criticism presented here. So, what, in my opinion, are the problems of their approach? They can be summarized as follows:

1. The concept of an economic good based on a premise of marginal utility higher than zero implies a cardinal perception of utility; that concept implies that the good has utility *per se*.
2. Goods, economic or otherwise, are not useful *per se*. The usefulness is attributed to goods - it is not given. It is, therefore, always derived from the valuation of an agent. Without the agent's valuation, the goods would be regular items. Valuation, as Čuhel-Mises (Mises 1998) rightly shows, is only possible in the more-less relation; and as Rothbard (1962) notes and Biřo (2004) stressed, this is possible at the level of needs, which are then imputed into goods.
3. This implies: any value concretization of the good that occurs over time will cause that the good *per se* to be of non-homogeneous in value terms. I think that we must simply accept this. It can't be bypassed. Evaluation in time continuity necessarily implies the possibility of changing the value perspective of *particular goods per se*.
4. The law of diminishing marginal utility is the law of logic and mind. It must be the part of the actor's modus operandi. The presupposition of the existence of a homogeneous good as a prerequisite for a given law, when the law is applied to the concept of an economic

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11 We can also say that they come with relativism. Wysocki and Block (2019b) use subjective relativism related to the definition of goods, which is very similar to modus operandi in explaining some economic phenomena over time in Pořvanc (2019a, 2020a).

good is a circular argument (*pettito principi error*). This is more explicit when Wysocki and Block (2018a) define an economic good on the basis that it has a marginal utility higher than zero, while at the same time assuming the existence of that good as a condition of the existence of the law of diminishing marginal utility.

5. The law of diminishing marginal utility is not based on the assessment of goods but on the assessment of needs. It is a variety of composed and mutually ordered needs that imply its validity. The satisfaction of one need and the gradual transition to another need causes that the additional unit of the good that satisfies the need in question satisfies it less. The law must therefore be interpreted in this context as part of the action, i.e. a part of a purposeful change in meeting needs.
6. By my last reservation, I am not quite sure because Wysocki and Block (2018a, p. 136) are unclear. They claim that *“physical sameness is a sufficient condition for two economic goods to be the same economic goods because physically identical economic goods necessarily serve the same list of (correctly perceived) ends.”* This is similar and already criticized Mises’s assumption, (see above), that *“means of the same quantity and quality are apt always to produce the same quantity of an effect of the same quality, the action does not differentiate between concrete definite quantities of homogeneous means.”* (Mises 1966, p. 119). However, in the footnote, Wysocki and Block (2018a, p. 136, footnote 14) write that: *“We hesitate to say that, but it can be the case that this “correctly perceived” scenario is not necessary at all”*. As we have explained above, Mises’ premise is not correct, and their hesitation, in my opinion, is therefore not appropriate. In other words, they should stop hesitating and reject Menger-Mises’s interpretation of economic causality. Menger-Mises’s premise implies only a physical connection between needs and goods, but this is inevitably contrary to the fact that in economics we “engage” in valuation. Nozick’s challenge must, therefore, be explained on the value principle, namely, on the value homogeneity of the perception of something, as we will see, not of the concept of the same good. In other words, we need the causality *need - means* relate to a different concept of the mind so that it is also valid over time.

Based on the above, I consider that Wysocki and Block (2018a, 2018b) still have not responded to Nozick’s (1977) expressed a position on the problem of Indifference. Their proposed solution has logical inconsistencies. It is necessary to eliminate all reservations and prove that both strict preference and the validity of the law of diminishing marginal utility are part of the solution.

## Solution – proposal

It is evident that Wysocki and Block's (2018a) approach to the argument in explaining the law of diminishing marginal utility is circular. As Pavlík (2004, 2006) shows, the circular nature of the argument implies that the concept to which the argument relates must be explained differently – in a more abstract way, by a Hegelian crossing of the circle or changing the paradigm of its perception. And since the law is valid, and it is equally correct that choice causes a preference to be expressed, *it is necessary to abandon the assumption that the law is based on the assessment of the homogenous good per se*. Abandoning this assumption is also related to the fact that for any particular value-based character of a good that is derived from human valuation, we must simply assume the possibility of changing the value-perception of the good over time. We cannot avoid different valuation over time. The proposed solution presented here will be based on the already presented modified theory of subjective value as described in Pošvanc (2019a)

The theory briefly says that man always satisfies some perceived factual and expected counter-factual sum of needs, i.e., there is *always a combination of needs*. The needs are met through the second mind concept - a portfolio (of goods). At the same time, the mental concept of the portfolio has an overlap with reality in the form of a real accumulation of goods. The actually perceived combination of needs is always satisfied by action, such as acquiring goods that compose the portfolio; man utilize these goods to meet current needs and potential counterfactual future needs. The more urgent and complex combination of needs that can be simultaneously satisfied by the good<sup>12</sup> the more preferable the economic good is in terms of being included in the portfolio.

The value perception depends on the content of the need. The content of the need is always a combination of some perceived needs<sup>13</sup>. If the need is perceived *"to relax on the sofa while listening to music"*, the need will be met if the person has in his possession *"a sofa, music carrier with music and music player"*. From a physical point of view a sofa has a positive effect

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<sup>12</sup> It is also a combination of features of the economic good.

<sup>13</sup> Reservation of one anonymous review to this approach was given by the statement that it is possible to define a solely non-combining need and a corresponding good. I am not so sure about this reservation. I believe that we are only able to define either very abstract need which implies a combination of other needs or we can define only a very particular combination of some needs. Let's consider these two examples: a) abstract need as "to live happy life" implies endless combinations of needs over time which could be met by any combination of goods and b) to define some particular need per se we need to show some combination of description, e.g., as "eliminating thirst to stay alive and continue reading". This implies some specific good which has some combination of specific features, e.g., water which must be safe to drink, clean, fresh etc. I think that the reason lays simply in the fact that a man is holistically grasping himself over time as a conscious being who can define chain of reasons why he needs this or that.

on the need, i.e., relaxation; and still has the same effect in this physical sense (one can lie on it and relax) but, without the other goods, the combined defined need is not met. The economic *value causality* between needs and means is, therefore, a more complex perceived phenomenon.

The value scale is simple; two-levels: one, factual (sphere of a present urgent combination of needs which were defined sometime in the past) and, two, counterfactual (sphere of the possible and impossible combination of needs). What is perceived as a most urgent combination of needs takes priority over other perceived complex of needs and plans. At the same time, the combination of needs allows us to identify, in principle, any extensive and complicated plan. There can be a few moments plans such as eating chocolate so no one can see me; hour plan (practice); a daily plan (working during the day and going to the cinema in the evening); annual plans (engaging in business) or, a lifelong plan (being a good person). The perceived factual combination of needs is, at the same time, satisfied by the current action<sup>14</sup>.

The action is focused on activity that, on the one hand, impoverishes our portfolio of goods (costs), but when we act, we assume that the outcome of the activity will complement the portfolio, which will be better suited to meet our future needs (gain). At the same time, one

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14 Chroustal (2019) pointed out here, that it is necessary to explain here the use of terms: the factual and counterfactual character of the value scale. Hülsmann (2003) e.g. uses these ideas in terms of "choice" and "any alternative to the choice which may have been the actual choice but this does not happen for some reason". The use of the term "factual" and "counterfactual" is exclusionary. What happened, happened, and everything else was left behind on a counter-factual level.

The passing of time, the impossibility of repeating a given moment, and thus the impossibility of repeating the choice in question in the classical interpretation of the theory of subjective value and displaying the value scale implies the absolute and unrepeatable character of our choice. Strictly speaking, given the particular temporal nature of choice, each choice is utterly unique. A strict position related to the unique character of the choice can be found in Shackle (1992) or Lachmann (2005).

However, the relativization of needs and the relativization of the portfolio of goods within the framework of the presented modified subjective theory of value allow us to use terms "factual" and "counter-factual" in a slightly different and not so absolute form. While "factual" is meant here in terms of "currently selected, elected, manifested in the action", so as in the traditional way, the term "counter-factual" does not have an absolute exclusionary character. It is still very true that choice, its related circumstances, and the perception of needs will never have the same and uniquely identical character, but the relativization of a combination of needs (and the relativization of their satisfaction with goods in possession) makes it possible, later in time, to make a very similar choice or to have for once realized choice persisting character in time (you can use good in many different ways to meet the different combination of needs). The newly constructed combination of needs implies the possibility of repeating some unrealized needs in a different economic context. At the same time, building a portfolio allows us to explain the process continuously. Lego-type relative character of needs and position of goods within the portfolio enable us to satisfy also counterfactually perceived needs later in time from the point of view of present action and choice. It is not an exclusionary mode. Relativization of needs and relativization of the position of goods within the portfolio enables us to adapt to the uncertain future.

prefers the resulting composition of the portfolio, which one is convinced will satisfy actual and expected counterfactual future needs more than the previous portfolio (subjective gain). Acting in this sense does not have to be explained in the form of identifying every second of our life, e.g., *"I will take this strawberry, put it in my mouth, I will five times masticate to satisfy 1/20 of my hunger"*. It happens as a complex phenomenon. Some actions are more complex and general in nature, while some are very particular. The level of detail again depends on the degree of what combination of needs the action in question requires. This means that sometimes it is sufficient to carry out an activity in the sense of *"I am working all day which will allow me to support my family"* and sometimes if I am a biochemist, the activity must be more detailed as in, *"I have to connect this particular cell very precisely with that one"* The detail of the plan and our actions depend on a subjective assessment of the complex of needs.

The concept allows us to explain how we grasp and estimate the uncertain future; this concept is presented in more detail in Pošvanc (2020b). Basically, our grasp of the future is based on the principle that we relativize our needs and the means of satisfying them in the future. That is, the greater diversity of the portfolio of goods (if this is our goal) enables us to be better prepared for the satisfaction of needs, which we expect or not expect to be perceived later in the future. In other words, we prepare for the future by acquiring a higher variability of accumulated goods that we can later use or exchange. So, though we are not estimating our future per se, or its specific character, we relativize its precise occurrence and concrete importance. We prepare ourselves for more eventual futures<sup>15</sup>.

The concept enables the solution of the problem of value imputation by the mentally structured concept of a *sum complex combination of needs* that are met by the mentally structured concept of a *portfolio*. Thus, the imputation of value takes place at the mental level, therefore it does not interfere with reality. In reality, it is reflected only subsequently by the fact that the portfolio corresponds to some real accumulation of real aspects of reality we call economic goods. It is necessary to stress that needs as well the concept of a portfolio is a mental construct. It is composed of parts (goods); however, as a mental structure, it is possible to construct it in many ways and combine its parts in endless possibilities. Therefore,

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15 This is also the reason why we have invented the concept of exchange and money. Both concepts enable us to the higher relativization of the specific character of the future. What I do not have, I can later exchange for something I want to put into the portfolio. And the concept of money is another more abstract thought layer of the principle of diversification of the portfolio in the time continuum; the vast diversification of portfolio is a substitute for a simpler concept - money. See in more detail (Pošvanc 2019a, Pošvanc 2020a).

it is possible to claim that we have only one portfolio although its structure is changed by different combinations of goods and its relative representation within it, which, though it seems to be a different portfolio, it is still the only portfolio we have. Though we can imagine another structure of the portfolio to see possible changes within the portfolio, it is still the same homogenous concept. The concept is comparable over time; the perceived sum of goods is a time-invariant (mathematical, structural) concept. The portfolio concept today is the same as it was yesterday and as it will be tomorrow. The concept is *comparable among humans*. Formally it can be recorded as  $\Sigma \text{ Ends is satisfied by } \Sigma \text{ Means}$ . Thus, over time, through the relative composition of the goods within the portfolio, we can choose a subjectively preferred structure of the portfolio over another structure<sup>16</sup>. Economic causality is applied to a complex of needs satisfied by a complex of means, which entitles us to claim that economic (value) causality is applicable overtime. Meaning there is a causal diction that A always causes B, i.e. portfolio (A) always causes needs to be met (B) over time.

How, then, is it possible to formulate the answer to Nozick (1977) on these presuppositions? And how to satisfy the logical inconsistencies set out above in the context of the whole discussion of the problem of indifference and choice?<sup>17</sup> All the above arguments and briefly introduced modification of the theory of subjective value leads us to apply the law of diminishing marginal utility, not to the concept of the homogenous good, but the portfolio and its marginal changes. The portfolio is the desired homogeneous concept. Thus, homogeneity is “ensured” on another layer of grasped reality—the mental concept of the portfolio. This allows us to use the law continuously over time and it is possible to solve the problem of a one-time application of the law as Block’s (1980) proposal implies. The law, which is based on the prioritization of a combination of needs, is like the mental law applied to another mental concept of the portfolio. Čuhel-Mises “more/less dictum” is assessed in terms of higher/lower satisfaction of needs by the portfolio, which consists of goods. Therefore, we can have a strict preference for goods as well as portfolios. It means that in terms of goods

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16 According to the author, the concept is also realistic. The traditional theory of subjective value based on the implication of the existence of complicated lists of differently categorized needs that are satisfied by a complicated potential list of goods is practically inapplicable. As Hayek (1952) shows in his *Sensory Order*, our minds “intentionally” simplify our perception of reality. The concept of portfolio is simpler and very adaptive when we are thinking about the changing needs over time.

17 Let’s reiterate our reservations. Given the above-identified argument in the circle (law of diminishing marginal utility based on the same good concept), it should be pointed out once again that the law of diminishing marginal utility must be applied to something other than to an economic homogenous good. As we also mentioned above, inferring valuation of a good from a person necessarily implies that the actual value context of a particular good, defined in any way, makes the law of diminishing marginal utility not applicable to goods at all and it is impossible to be applied in time. The concept must be equally realistic. That means it is not possible for a person to consider a conceptual list of defined goods and to associate them with a precise and particular combination of needs that can even change constantly. Not to forget, the law is our *modus operandi* and must be easy to use.

*per se*, we continue to apply a strict preference. Additionally, the choice is always associated with the strict preference of a portfolio as well. However, the statement does not affect the validity of the law. We can perceive at the same time that the marginal change of the portfolio due to the withdrawal/incorporation of economic goods from/to the portfolio will occur. The law is also our *modus operandi* in the continuum of time. As follows: Enriching a portfolio with a particular good is preferred until we perceive the satisfaction of a perceived (even in the context of expected counter-factually perceived) combination of needs; on the contrary, the portfolio is deprived of a particular good until the satisfaction of the factually perceived (even in the context of a counter-perceived) combination of needs is jeopardized.

## Implications

In principle, the concept relates to the valid parts of Wysocki and Block (2018a, 2018b). As these authors rightly point out while assessing the physical identical characteristics of a good, the homogenous value perception of the good in the context of demand and supply is possible on the basis of the relativization of needs. However, we have abandoned the application of the law of diminishing marginal utility to the economic good. Relativization allows us to identify, over time, a homogeneous value concept, i.e., a portfolio where the problem of applying the law of diminishing marginal utility no longer exists.

In my opinion, the definition of an economic good given by Wysocki and Block (2018a, 2018b) needs to be modified and extended. It is possible to do so by the realization that we examine the good through several, like mental-like layers of perception of the world around us. In other words, Menger's definition of good conditions must be enriched with other conditions, mainly from the teleological and normative field of mental perception. What does this mean? We could use Engliš's terminology to explain. Engliš (1930) claims that we are perceiving the world through a causal (Kantian "as is") and teleological and normative system of thinking (Kantian "as it should be"), over which the formal-logical system operates<sup>18</sup>. If we apply this distinction to the perception of economic goods, then three different views are needed to define the economic goods.

We perceive goods at the level of the *causal layer* of thought in terms of their physical properties, which creates one content for the idea of the causal relationship of satisfaction of

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<sup>18</sup> The author does not fully support the views of Engliš in the field of theory of knowledge but rather advocates Hayek-Pavlík's theory of evolutionary apriorism in the field of theory of knowledge. See e.g., in Pavlík (2004). Engliš's classification, however, allows the reader a better understanding of the explanation of different classification views of the good and it is, therefore, used here.

needs. It is necessary to agree with Wysocki and Block (2018a) that this kind of categorization is a sufficient condition for identifying the same kind of good. It is at this level that we can imply the validity of Menger-Mises' (used by Hoppe 2005) dictum that goods of the same kind and quality will always satisfy the identified needs with the same intensity. And to this level, the Menger conditions for the definition of a good can be fully applied in the form of:

- a) the existence of a need
- b) the existence of causality between the need and the thing, i.e., the causality we know that this item satisfies that need
- c) the ability to control the thing.

The second view of the notion of needs-goods relationship is made at the teleological level. It is necessary to enrich the Menger conditions based on the new knowledge of how we value goods. In principle, it is a more detailed description of the above-mentioned condition c). The economic value-causality has the character of a relationship where  $\Sigma$  *Ends are satisfied by  $\Sigma$  Means*. From an economic point of view, we can then create a distinction between an economic good and other goods as follows. Meeting the needs is possible with goods and economic goods. There must be some knowledge about the good and the economic good, meaning that it satisfies a complex of needs in terms of the physical-causal character of the relationship. A good becomes an economic good if one wants to include it in their portfolio. Otherwise, it is what Mises (1998, p. 90) calls *the general conditions of human welfare*. It is the intention of a person to include a good into the portfolio (economize the good). This implies that a portfolio enriched by good is preferred more than a portfolio without good. At the same time, the assessment of the portfolio is influenced by the law of diminishing marginal utility. This means that the portfolio will be enriched by the given parts of goods as long as there is a perception of both actual and expected counterfactual needs that can be satisfied in the continuity over time with the new portfolio composition. And, of course, vice versa. The portfolio will be deprived of some selected goods until the satisfaction of a person's needs is at risk from the point of view of the person. In other words, the needs at risk would become factual if a marginal change in the portfolio cause such a change that would make the satisfaction of needs impossible.

The third kind of insight is created based on normative rules that imply different forms of standardization and possibilities for the mutual understanding and comparison of subjectively perceived content from other layers of thinking. At this point, we must disagree with Wysocki

and Block (2018a, p. 404), who claim that there is no possibility of inter-subjective comparison of goods. They write “... *we posit that whether two items represent the same economic good always depends on how a given economic actor envisages his ends. This, in turn, implies that there can be no inter-subjectively correct answer to the question of whether two physical goods can be subsumed under the category of the same good.*” I believe it is the other way around. Whether a good can be categorized intersubjectively as the same good is recognized by the agreement of at least two people<sup>19</sup>. This also implies an intersubjective categorization option. At the social level, even a wider version of this standardization in the form of money or standards of trading of goods exists<sup>20</sup>. At the same time, this normative standardization does not imply that we cannot (like Lachman) interpret an economic perception of goods ultra-subjectively (Lachman 2005). The agreement (standard) *only allows* the mutual understanding of what does or does not constitute the same good. For example, having a standardized ounce of gold, we understand what an ounce of gold means, what it looks like, what we do when we trade it, how we use it in debt relations, what its purchasing power is, and so on. We know all of this regardless of the possibility for ultra-subjective interpretation of enrichment/depletion of a portfolio by an ounce of gold.

This triple-division also meets the epistemic demands of Hoppe, where differentiation, respectively categorization is based on:

- a) physical characteristics (causal field of classification)
- b) economic perception of a good and its composition into a portfolio (teleological field of classification)
- c) normative rules, i.e., intersubjective social standards (normative field of classification).

We also avoid circular arguments related to the Law of diminishing marginal utility. This is because the sequence of interpretation is as follows: firstly, the perception of the complex of needs, from which the law of diminishing marginal utility is derived. The complex of perceived factual and counterfactual needs that are satisfied by a portfolio of goods (sum of goods)

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19 As is shown in Pošvanc (2020b) we, as individuals, have created some economic and normative standards. The above-mentioned relativism we use to mitigate the uncertain future and our very subjective view of the world is thus open for this coordination and understanding of each other. They enable us economic coordination and economic understanding of each other. These normative concepts eliminate the trap of subjective relativism.

20 Clearly not only market and voluntary relationships and agreements among people (e.g., some stock exchange rules) affect the normative determination of the definition of good, but also politically initiated regulations or politically normative rules.

implies that one can differentiate between an item (object of reality), a good (object of reality that could satisfy some complex of needs), and an economic good as an object of reality to be used economically to satisfy some complex of needs. The differentiation is possible along these lines.

The object of reality is a part of reality (an item) or a part of the general welfare (good) when the complex of needs does not imply its inclusion into the portfolio of goods. Concerning items and goods, there may or may not necessarily be the knowledge that something satisfies a need. In the case of some items, we do not know that this object could possibly satisfy some needs; e.g., uranium two centuries ago. In the case of goods, we need not intentionally think about the need-good relationship because we have an abundance of supply of a particular good; however, we know that this object could possibly satisfy some needs. It, therefore, means that the good is not subject to any intentional perception of the change of satisfaction over dissatisfaction of needs, it is merely good in the form of a *general condition of human welfare* (such as water in an area where there are abundant freshwater supplies and a person drinks when he/she needs, or goods such as air or sunshine are in abundance). Although goods like sunshine or air are used by people, the needs satisfied by these freely available goods are met automatically without the need to prioritize them.

However, everything changes depending on the person's reason for including goods into a portfolio. It is precisely through the inclusion of good into the portfolio that we can assume that the good is perceived as an *economic good*<sup>21</sup>. The good ceases to be part of the general

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21 There is also an interesting question about how our predecessors started to differentiate among items, goods, and economic goods. It is impossible to reconstruct or describe this process empirically. At this point, we have at hand only the method of logical historical reconstruction (sometimes called theoretical conjectural history); see method description e.g., in Pavlík (2004) or a brief outline in Pošvanc (2020b). If we imagine our predecessors as pre-humans with a lower level of awareness (e.g., intellectually being on a level of children aged 2-3 years), we can imply the existence of some quasi-needs. I use the term "quasi-needs" because if they were not fully aware themselves, it was not possible for them to become intentionally aware of what the needs are and what are explicitly goods that meet those needs. The need implies the intentionality of thinking. Rather, there had to be some instinctive (naturally controlled) processes where the quasi-needs were met automatically, and the surrounding objects of reality were not perceived as some economic goods, but either as the general condition of human misery-welfare or ignored objects of reality. It can be assumed that our predecessors did not fully realize what scarcity means; even to perceive scarcity we need to assume the intentionality of mind. Thus, they could have felt only physiologically (not consciously) their dissatisfaction connected with some vaguely perceived quasi-need; we see this today when we observe very young children – they feel either misery or welfare. However, the physical durability of objects of reality also allowed accumulation and hoarding. Hoarding is not strange or some rare activity; we see it in nature as well. So, it is possible to presuppose some kind of instinctive activity. The accumulation could have been focused on any object of reality; not only useful. Meaning anything that causes attention or interest in the personality of "post-animal-pre-human" being. These individuals could have also accumulated things that were not necessarily limited (i.e., they were the general condition of human welfare). However, they probably accumulated also physically limited objects of reality (they could not be fully aware of scarcity). Instinctive hoarding is, therefore, the way as they could have created incentives for the emerging Ego to differentiate between the objects of reality and economic goods. The incentive to differentiate here may have been not only the subjective perception of the necessity of goods, but also the perceived usability of goods from other members of the group, or when

condition of human welfare and becomes an economic good. The differentiation (mental as well as logical) enables the concept of a portfolio. And this is because the law of diminishing marginal utility is applied to the portfolio, not to the good *per se*. If an economic good is included in or withdrawn from the portfolio, it implies that the action connected with the good in question changes the perception of the marginal utility of the portfolio. Thus, the concept of an economic good is the result of an action, not a presupposition of the law of diminishing marginal utility.

The portfolio of goods conceptually allows the mind to differentiate between an economic good, a good in terms of a general condition of human welfare, and what is an unusable object of reality – an item. The differentiation between an economic good and a good in terms of a general condition of human welfare depends on whether the good is intentionally included in the portfolio or not. This is the only way we actually can distinguish one from the other. The differentiation between a general condition of human welfare and an inapplicable object of reality - an item - is also done through a definition in terms of whether a person assigns them to his/her portfolio. We are fully ignorant of many items. These are objects of reality which brings us nothing (e.g., one particular insect or bacteria or some unnoticed star in the Andromeda Galaxy). They are not, however, general conditions of welfare. The general conditions of welfare are used by us; however, we need not incorporate them into the portfolio. But we are aware, a good in terms of the general condition of human welfare can become an economic good by changing the combination of needs (from time to time). It is because we can know explicitly that it satisfies some of our needs, e.g., water in the desert if we have moved there from the rainforest, or fruits from the rain-forest trees when we move to savanna, or the air under the water, or sunshine in a cave, and so on. The difference is, therefore, based on the intentionality to put something into the portfolio (while portfolio implies that we meet some combination of needs by portfolio). The human mind can differentiate all these options based on the portfolio concept, which satisfies the sum (combination) of needs. The attentive reader observes that the concept of portfolio coincides with the private property concept. And it is no coincidence. As Engliš (1930) states teleological

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they had to face any change in the combination of needs caused by environmental change or some elementary economic social activities within the group (e.g., exchange, or liability repayment). To admit some possible attacks to this argumentation, it has to be stressed that the assumption here is some kind of instinctive activity in the form of hoarding of objects of reality.

I also wonder how our economic concepts (need-means, the law of diminishing marginal utility, costs, revenues, time preference, etc.), which we use to grasp our economic reality and which have conscious mind character, develop in children's, not fully conscious, mind. This could be an interesting stimulus for some further research.

and normative order of thinking is the decomposition of the Kantian “as it should be” (it is the sphere where we see the intentionality of the mind). It is also no coincidence that the definition of good presented here is the decomposition of Menger’s condition to have the ability to control the item. The attentive reader would also recognize that a precondition to all of this is human intention.

### **Implications within the Austrian School’s view of the problem of indifference**

We can solve several of the problems mentioned above based on the proposal presented. First, I think it is a relevant response to Nozick (1977). We have maintained the law of diminishing marginal utility and the concept of strict preference. The law is applied to the concept of the sum of needs satisfied with the sum of goods (portfolio). The strict preference is applied around goods.

There is no problem explaining why 2 beers over 1 are sometimes preferred (example of Wysocki and Block 2018a) or 4 eggs over 3 (example of Rothbard 1956). This is due to the different perceived combination of needs and goods to be included in the portfolio in terms of the combinations of needs. A combination of 2 beers or 4 eggs that a person may want to include into the portfolio is preferred because of a combination of needs to be satisfied (e.g., to get drunk faster or more intensely, or the preference for a sweet cake over an omelet satisfaction of needs – Rothbard example). Whereas the law of diminishing marginal utility is applied to a marginal change of the portfolio thus created. Using these examples, it is also possible to explain the economization of some non-economic free goods that are included in the portfolio if they satisfy a special complex of needs (e.g., the air enabling us to survive underwater), and we remove these goods from the portfolio as soon as the actual complex of perceived needs changes (e.g., we will stop diving).

We can better express ourselves using a moral (not economic) example given in Hoppe (2005) about a mother who had two sons, Peter and Paul, whom she loves equally. When they are drowning, and she can save only one of them. According to Wysocki (2017), saving Peter only implies that it happened that way, and that, for whatever reason, the mother prefers the world with Peter and not with Paul. According to Wysocki, we know nothing else from the praxeological point of view. From our theory’s point of view, we know that “whatever reason” is not enough. We know that it is always a combination of needs and a combination of means and circumstances that made the mother to choose Peter and not Paul. From a moral, legal, and praxeological point of view, this knowledge about the combination of needs and

means gives us a point of reference to assess what the mother has done. Whether she will be a heroine or a murderer, whether we will sympathize with her, or not, or whether we say that she did the best she could or not, and so on.

The proposed solution also shows that Machaj (2007) is correct with his focus. He is focusing on the evaluation as the main way of explaining the problem. In my opinion, what is interesting is that this way, it is also possible to explain the neoclassical claims about indifference. A person can actually be indifferent to the good A vs. good B, or any multi-dimensional model of goods (an example of multi-dimensionality is used in Wysocki 2016) because the case of indifference implies no change of portfolio, i.e., a person prefers to have the present time portfolio in a time continuum, which they composed in the past and which currently suits them (present time) best (focused on future elimination of uneasiness)<sup>22</sup>. O'Neill's (2010) remarks that needs should be assessed in the context of '*no worse than*' changes the meaning within the context of here presented solution; meaning the complex of needs can be met by different combinations of the goods within the portfolio. This does not imply a weak indifference among particular goods, it implies a *relative* grouping of goods in the portfolio that enable the satisfaction of *relative* combination of needs.

The neo-classical mainstream must acknowledge that during the moment when a person is indifferent to good A and B, the person is actually in optimal position; he/she is in his/her kind of equilibrium. Indeed, being indifferent to both A and B implies that the person is satisfied with what he/she has - some portfolio of goods that he/she anticipates will best respond to what the future will bring. For Austrians, it is possible to realize that the invariance of the portfolio is not necessarily an intentional choice for a person at any time-point in their life; e.g., while sleeping or doing nothing economically, or just performing certain actions automatically without the need to interact economically. It does not mean that he/she does not act. It means that a person does not act economically in the sense of a purposeful change of portfolio by which he/she satisfies his/her needs. This is understandable because a person can be ignorant of slight changes in his/her portfolio. This is because it is possible to meet a combination of needs by portfolio over time. Only a significant marginal change of the portfolio or a different combination of needs causes a feeling of uneasiness after which an intentional action is taken to re-arrange the indifferent state of affairs – asked portfolio.

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22 This knowledge has implications for the problem of equilibrium, the process of equilibrium, or the definition of the state of equilibrium at the individual level of an individual, but we will deal with it in another, independent, work.

Similarly, we can now see the freshness and relevance of the solution presented in Block (1980), where he shifted the state of indifference *per se* into the thymological field. Although it was necessary to make several adjustments to this assertion, in the thymological field the indifference remains. However, and this is a controversial piece of a consequence the argumentation presented also found in the action. Indifference is not only a psychological-historical conception, but it is also a conception of our actual actions, i.e., it is an action-thymological concept<sup>23</sup>. At this point, it can be argued that the decision for no change to the portfolio still means strict preference (action). In my opinion, this is a thymological state of the matter because the portfolio was compiled sometime in the past. This ambiguity exists because we deal with Nozick's objection as another layer of thinking (the sum of needs is satisfied by the portfolio) in the future. Therefore, to me, it seems relevant to mention that the concept of indifference is precisely *action-thymological* in nature. This allows the Austrian School thinkers to understand what the neoclassic mainstream refers to when they talk about optimality in making decisions based on indifference.

### **Implications within the mainstream view of the problem of indifference**

The solution as presented, also has some implications for the mainstream approach. As we have shown - indifference is a state that is *the result* of some intentional economic activity (action). We do not make decisions based on indifference but in the context of indifference (as our benchmark). We decide, act, and we try to achieve the given state of affairs (indifference). The emphasis on describing the decision-making process is the point of the Austrian School. The choice and decision must always be specific. We cannot make decisions based on indifference. However, as we have shown, the choice and decision lead to some state of indifference. Let us illustrate from the point of view of this paper how it is possible to look at this methodological twist. This description can be achieved by answering the following question<sup>24</sup>: "*Is the glass I have in the kitchen and glass I have in my hand the same good? Is there an indifference?*"

There is no indifference at the level of choice associated with choosing some economic good. The indifference is only at the level of the overall situation. The overall situation is the satisfaction of some combination of needs by some combination of goods (portfolio) that I have while I do not need to change this combination. The given overall situation is,

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23 We will see how Block or Wysocki, whose opinion is that indifference is purely subject to thymology (the area of psychological-historical reasons for action), will potentially respond to this statement.

24 I had received the question from an unknown reviewer. I think that it goes directly to the point, so I will use it to demonstrate the methodological point.

of course, composed of some parts, but the combination of the given parts also creates an ontologically independent structure of its perception (Lawson 2012). We can perceive only heterogeneous choice at the level of specific goods. However, we can also perceive the homogeneous structure of some state of overall affairs at the level of the overall situation. By combining and creating relationships between individual parts, we strive for a given overall situation. Let us examine this closely.

Let's say I'm sitting in the living room watching TV and, on the table, next to me I have a glass of water<sup>25</sup>; I am thirsty. However, go to the kitchen to get a glass of water from there and drink from it. Obviously, I have demonstrated that the glass of water in the kitchen is *the* good I chose. I was not indifferent to the glass next to me or the glass in the kitchen, a few meters from me. Why? Maybe because the combination of my needs implies going to the kitchen for a glass of water. The combination of needs can be such that when I drink water, I don't want to cut my lips and the cup next to me seems to be dangerous (maybe it's a little cracked, or I only think it is cracked). Or it may be that I need the exercise, and some steps to the kitchen and back are a suitable way to fulfill a given combination of needs—my exercise. The choice and subsequent action is always particular and depends on the combination of needs that I want to satisfy. The choice is not about meeting needs that I have already satisfied. It could still be that I will not drink at all no matter how thirsty I am. Let's say that I keep watching the TV and I'm in a situation where I have been 30 minutes or maybe an hour before. *This* is the description of the indifferent thymological-praxeological state of affairs. No matter how thirsty I feel I won't make a choice yet; the given perception of the overall situation is not sufficiently significant for me to make a choice. Only a marginal significant change in the perception of this whole state can cause me to decide to drink from the glass next to me or from the glass in the kitchen, depending on the current combination of needs.

This example shows the process of transition between choice, action, and indifference. The choice is an intentional decision and is made on the basis of an assessment of costs and expected revenue. Each action is associated with some cost and expected achievement of a situation or the removal of some uneasiness connected with a situation that would be worse if I did not act. In other words, the expected achievement of some returns (which ex-post can be assessed as a loss). This is also the reason for the bid-ask exchange phenomenon on the

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25 I would like to slightly change the example in the question above; this is only a minor change from the original question, but it demonstrates the situation in a better way. However, if the cup is in hand, the same reasoning applies, in principle

market, which indicates that I have to get rid of something to acquire something else. In a non-monetary economy, it shows what I offer from my portfolio to someone else's portfolio, and what I expect to gain from the other person's portfolio. The same is true at the level of the individual. When choosing (alone; not in exchange), I consider the cost (Is it worth getting up from the couch and going for a glass of water in the kitchen?) and what I get (subjective gain as training, quenching thirst), while it is still true that I can stay in an indifferent position (I continue watching the TV) without changing the overall state of my own affairs. If I remain in the unchanged state of affairs, this is not a third option or choice - nothing happens. I am merely sitting and watching TV; the decision was made an hour ago. This is even though I feel thirsty and that I also know that I have to walk to achieve fitness. It is a condition that has a thymological-praxeological character. Why is this so? The marginal change that is of course happening, i.e., the body is gradually increasing its state of thirst so I only slowly realize that I have been sitting too long and should start walking, is not significant enough for me to move out of this balanced state. Only a significant marginal change causes intentional choice. The significance of the change is related to either a change within the portfolio (I consume goods which I have so I have to act again) or a change in the perception of the combination of needs. Only this raises a reason to re-assess the situation, consider the costs and gains, conduct action, and potentially move towards a new state of indifference.

This means that a person judges what he/she spends and what he/she gets in the context of how the overall state of the portfolio changes. This way the person can assess the ex-post economic error as well. It may well be that I find out that that it was not particularly wise of me to get a glass of water from the kitchen when I went for a glass in the kitchen since I had one next to me and did not notice. In other words, I could have been in an equilibristic position, which I left by my ignorance of the state of affairs, and later I regretted the action of going to the kitchen. The countermeasure may be that, in the future, I will buy multi-colored cups to be more attentive or binoculars because I discover that my vision had deteriorated. And the good (binoculars or multi-colored cups) will once again begin to contribute to the puzzle-mosaic of the whole state of affairs for which I am striving.

This description indicates *what is* the indifference or the definition of indifference. We know that the theory presented here implies the existence of a mental concept in the form of a combination of needs and a combination of goods (portfolio). We also know that the utility of goods is attributed to goods. The usefulness of goods is therefore derived from us; it is not an intrinsic given part of the goods. At the same time, choice directs us from one state of

the portfolio structure (when we have to give up something) to another state of the portfolio structure (when we get something), while the overall combination of a given state implies the optimality of the achieved state of affairs. So, what is indifference, apart from the fact that it is a situation that there is no choice and consumers have no preference?

The indifference state between A-good and B-good describes an *ideal idea of a part of the portfolio structure, which is connected with A and B-goods*. Until a person reaches some local state of indifference between A and B, they try to add A and B to the structure of the portfolio that completes the ideal structural state of the portfolio. This way, a person maximizes their intended utility at the overall level and once it is achieved, no additional combination of goods in question is needed. *The state of indifference* is thus some *intended idea of the structure of the portfolio* first. Through action, we fulfill the idea. If the given structure is achieved, we maximize our intended utility of the overall state of affairs, which we transpose into realistically owned goods, combinations of real things that we actually own.

This interpretation implies that the current graphical representation of the indifference problem should be moved to 3D space graphs leaving the classical representation in 2D space<sup>26</sup>. This is not entirely new knowledge; it is Aguirre Sotelo and Block (2014, pp. 8-11) who show this kind of attempt to sketch curves in a multi-spatial way and also show the development in plotting indifferent curves through different economic literature. Aguirre Sotelo and Block (2014, diagram no. 32 - 34, pp. 36-38) conclude that sketches used by Vickery, or Boulding, or McClosky have the character of various land-scape sketches that most faithfully depict the situation related to indifference analysis. The topological description of the problem should enable us to describe the process between choice and indifference as intended as well as the consequently achieved state of affairs. That is when the indifference (e.g., between goods A and B) is at the beginning of the process of achieving some intentional part of the structure of the portfolio we would like to achieve, based on some existing portfolio restrictions (or budget restrictions when we move into the monetary economy).

## Conclusion

The aim of this paper was to anchor the problem of indifference and choice in the time continuum. It seems to me that Nozick (1977) can be meaningfully answered through this solution. Similarly, the proposed solution allows us to link the Austrian School and neoclassical approach to the

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<sup>26</sup> The author is unable to describe the mathematical notation of a situation, given the fact that he is not trained in this area.

problem of indifference and choice. Some other implications arise from the presented theory, especially in the fields of economic success/error dichotomy, economic learning, and the theory of equilibration and ordering. However, these implications need deeper examination and are beyond the scope of this paper.

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## **Bio**

### **Matúš Pošvanc**

F.A. Hayek Foundation Bratislava

Jašíkova 6, 821 03 Bratislava

Slovakia, Europe

E-mail: [matus.posvanc@gmail.com](mailto:matus.posvanc@gmail.com)

Mobile: 00421905962667

# In Defense of Normative Value of the Spontaneous-Planned Dichotomy

Piotr Szafruga, Jagiellonian University

**T**he notion of spontaneous order helps to understand how social institutions emerge. However, ambiguity of classification of orders as spontaneous or planned raises concerns of how such a dichotomy corresponds with the complex realm of social interactions. Critics state that it is impossible to distinguish between these categories, as they rest entirely on the observer's subjective frame of reference. Similar animadversion stems from the notion of evolutionary and endless character of social planning. The article argues that this criticism is misplaced, and it contends that categorization of orders as spontaneous or planned reflects perception of the phenomenon of deliberative formation of political order and therefore perception of the limits of reason. As a result, this approach helps recognizing normative value of the spontaneous-planned dichotomy. It also leads to rejection of the criticism according to which Hayek's appreciation of spontaneous order is inconsistent with his advocacy for liberal reform of constitutional order.

## Introduction

Distinction between spontaneous and planned order has become a subject of a number of studies, providing understanding of how social institutions emerge (e.g.: Hunt and McNamara 2007; Meseguer 2012; Dale 2018). However, it also has raised concerns about ambiguity of such classification. Although criticism of this classification can be perceived as referring to the problem of precision of definitions, it also leads to a question about the adequacy of binary characterization of orders as spontaneous or planned. Introduction of only two categories of order implies concerns about how such a dichotomy corresponds with the complex character of social interactions. This, in turn, leads to more general question of usefulness of such categorizations. Simultaneously, however, precision of used terms should not be perceived as an end in itself. Terms should rather be adequate to a situation or a problem with which they correspond. According to Karl Popper (2002) terms serves as a mean, not a goal, in scientific investigation and an increase in their precision and exactness should not exceed of what this situation demands. In this sense, the value of used conceptions and definitions depends on the

extent at which they are useful in solving a particular problem or identifying a new one. Therefore, to consider both descriptive and normative value of the spontaneous-planned dichotomy it is necessary to recognize what problem situation this dichotomy reflects. Following this idea, the article argues that normative value of the categorization of order as spontaneous and planned stems from the issue of the limits of reason.

Second section of this article briefly presents the idea of spontaneous order. Third section provides reflection regarding the problem of identification of spontaneous order phenomenon. It identifies the source of difficulties in distinguishing between planned and spontaneous order, thus providing the ground for considerations regarding normative aspect of the categorization of order. Fourth section studies conception of spontaneous order within context of the problem situation of bounded character of human cognitive processes. This perspective allows rejection of the criticism of the spontaneous-planned dichotomy as misplaced and supports recognition of normative value of such classification of orders. Final section presents concluding remarks.

## **Idea of Spontaneous Order**

Although the idea of spontaneous order has been studied by various thinkers through the history, it is mainly associated with the Austrian School of Economics. The Austrian School approach to study of social phenomena is formed around recognition of human cognitive limitations and dispersed and subjective character of knowledge. This perspective implies existence of limitations in ability of any central body to coordinate interactions between individuals. As a result, highly complex forms of social structures cannot be deliberately created. This is because dynamic character of social interactions and cognitive limitation makes it impossible to aggregate all the necessary information. According to representatives of the Austrian School various structures of the social order emerge spontaneously without any design. These structures are an effect of interactions between individual people pursuing their own goals. As a result, agents are able to utilize knowledge of others and therefore mutually coordinate their activities without establishing any commonly shared purpose. This in turn allows emergence of social institutions of complexity far exceeding cognitive abilities of a single man.

Fact that the emergence of order does not imply the existence of a common intention leads to the recognition of two categories of order according to their genesis – planned and spontaneous. Planned order (taxis) is an order which is a result of deliberate design. The second category refers to structures which are an effect of unplanned processes. Such structures are known as spontaneous order (cosmos).

The problem of emergence and functioning of spontaneous institutions is crucial for understanding social processes. According to Friedrich Hayek (1948, 7) the aim of social sciences "is to explain the *unintended* or *undesigned results* of the actions of many men."<sup>1</sup> Due to the dispersed character of knowledge and the limits of human mind, only relatively simple and small institutions can be deliberately planned. It is beyond the capacity of humans to design complex structures. In contrast, interactions between individuals within spontaneous order allow them to utilize dispersed information possessed by many actors and which no central body is able to collect. This allows formation of social structures of a complexity far exceeding the capacity of any human design. Notably, society in its widest meaning, which Hayek calls "the extended order of human interaction" (1991, 14) is not a planned organization, but the effect of spontaneous and dynamic processes. This allowed Austrian scholar to formulate criticism of the rational constructivism, which he described as an approach according to which social order is, or should be, an effect of deliberate plan.

The conception of spontaneous order provides an insight into processes of formation and change of social institutions. It also seems to be convergent with intuitive understanding of this term as something that emerges unintendedly. However, common use of the concept of spontaneous order in analysis of social processes does not mean that it is an unambiguous term. As Ulrich Witt notices, "spontaneous order in the interactions of the members of society is something to which everyone contributes, from which everyone benefits, which everyone normally takes for granted, but which individuals rarely understand" (1994, 179). Moreover, recognition of only two forms of order rises concerns about how this dichotomy corresponds with wide spectrum of social interactions of various levels of complexity. Is it possible to unequivocally differentiate between spontaneous and planned?

According to Timothy Sandefur (2009, 5), the above issue stems from the fact that identification of form of order depends only on observer's frame of reference. Because of human intentionality action various actions forming a given order can be interpreted both as an attempt to purposefully influence this order and as a single experiment in spontaneous process. Therefore, any universal distinction seems useless as "we have no principled way to categorize the choice that a person might make as either an element of 'rational constructivism' or an element of 'spontaneous order'" (Sandefur 2009, 7). Any such distinction seems to be inconclusive. Stefano Flori (2006)

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1 Carl Menger presents a similar point of view: "It is here that we meet a noteworthy, perhaps the most noteworthy, problem of the social sciences: How can it be that institutions which serve the common welfare and are extremely significant for its development come into being without a common will directed toward establishing them?"(1985, 146).

presents similar concerns. Following Hebert Simon's (1996) approach he describes interactions between agents as an evolutionary process. In this process people interact with each other as a result of their pursuit of their own, individual aims. Together with bounded rationality of every decision-maker this implies that people affect each other plans, which forces them to "alter their own behavior to achieve their goals in the changed environment" (Simon 1996, 153). Due to constant interactions, agents adapt resulting changes by adjusting their plans. This refers also to plans of purposeful change of social order. According to Flori any plan "exerts a limited, direct, influence on specific domains, but it also stimulates a number of changes in other (social) spheres which are beyond its control" (2006, 51). Therefore, social planning can be seen as an evolutionary process without any final goals, where unintended consequences are always present in spite of the planner's intentions. Additionally, order's design is not formed ex nihilo. It is based on the knowledge and experience of its creators, who themselves are embedded in some cultural and social environment. As a result, newly created rules are linked with previously existing rule, upon which they have been formed and therefore present some similarities. This rises to question of whether introduced changes are sufficient to recognize them as a new order, different from already existing structures.

The above issues can be interpreted as indicating the necessity of providing precise enough definitions. Simultaneously, at a more general level, recognition of only two categories raises concerns of whether such dichotomous perspective corresponds with the complex character of social reality, leading to the more general question of the usefulness of such categorizations.

## **Ambiguity of the Spontaneous-Planned Dichotomy**

Spontaneous order is an order which is not made purposefully, but which emerges as a result of actions not intended to create this order. In other words, it is an order which is "the product of the action of many men but not the result of human design" (Hayek 1973, 37).<sup>2</sup> What characterizes this description is that its relation to the conception of purpose. Not being the result of conscious design, spontaneous order as such does not have any purpose. Only purposes which can be recognized are those of actions of individuals within this order. It also seems coherent with common understanding of spontaneous order as something unintended. What more it defines order by referring to its origin. This in turn allows identifying two aspects of identification of

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<sup>2</sup> This terse phrase was adopted by Hayek from Adam Ferguson, who in his *Essay on the History of Civil Society* writes: "Every step and every movement of the multitude, even in what are termed enlightened ages, are made with equal blindness to the future; and nations stumble upon establishments, which are indeed the result of human action, but not the execution of any human design" (Ferguson 1978, 122). Thanks to Hayek this phrase has been reintroduced to common awareness.

spontaneous order. The first aspect is recognition of whether this phenomenon constitutes an order as such and the second refers to recognition of whether this order is purposeful or not. This means that the issue of ambiguity of the spontaneous-planned classification can result from ambiguity of any of these two aspects.

Order can be described as "a state of affairs in which a multiplicity of elements of various kinds are so related to each other that we may learn from our acquaintance with some spatial or temporal part of the whole to form correct expectations concerning the rest, or at least expectations which have a good chance of proving correct" (Hayek 1973, 36). It represents patterns and regularities of human actions. This means that criterion for order identification is presence of regularities which are seen as defining this order. At the same time distinction between orders is based on recognition of different set of regularities representing these orders. This means that identification of an order depends on what changes are considered sufficient to distinguish this order.

Similar ambiguity is present in the case of an attempt to categorize order as spontaneous or planned. As mentioned, this can be seen as an issue of purpose. On the one hand, if there is a purpose that can be identified as a cause of regularities, an order these regularities form is a planned order. On the other hand, spontaneous order does not present any purpose. In this case ambiguity results from mutual dependency between people and fact that any individual is able to act along his own aims. This limits ability to assign single main cause to a complex network of human interactions forming given order. This issue can be illustrated by the examples of language and legislation. It is commonly attributed to Thomas Edison to introduce the word "hello" as a term used to begin a telephone conversation. Regardless of whether such a change in a language forms a new order, let us consider whether this change can be described as planned or spontaneous. On the one hand this new term is a form of purposeful modification of language, or at least this was the intention of its creator. Introduction of a word and an attempt to provide this word with a meaning is a form of purposeful action. On the other hand, natural languages are considered one of the most accepted examples of spontaneous institutions. This situation is not universal and changes depending on considered institutions. For instance, legislation can also be presented as result of analogical series of purposeful modifications. However, in this case resulting institution seems to present itself more as a planned form of order.

An aspect that seems to differentiate between these two examples is the extent to which a creator of a given modification is able to influence an acceptance of this modification in the society. In

the case of language this acceptance is independent from initiator's will, whereas changes in law form an obligation toward citizens to obey new legal norms. As a result, activity of a legislator can be seen as having more "causality power" than Edison's innovation and therefore presenting purpose of the legislator as more influential and easier to associate with a resulting order. However, at the same time we cannot disregard situation in which impact of particular actors on formation of these orders differs from the one suggested above. Legislation may have little ground in norms and culture of a given society, limiting its influence. Simultaneously, a verbal expression or an innovation may quickly spread in society and have significant impact on its culture. All this illustrates strongly qualitative character of order identification and therefore difficulties in distinguishing various forms of order.

It is worth to notice an additional challenge regarding classification of orders, which is lack of distinction between issue of identification of order and issue of its purposefulness. This situation can cause confusion the subject of the study. An example of such situation is the discussion between Richard Posner (2005) and Donald Boudreaux (2006) regarding the Constitution of the United States of America. For Posner this document is an example of rational design, which therefore can be described as an expression of "rational constructivism". He argues that this shows inconsistency in Hayek's considerations regarding the human ability to construct order. As Posner notices, the Austrian's "disapproval of law founded on 'constructivist rationalism' rather than on custom is in considerable disagreement with his great admiration for the Constitution of the United States" (Posner 2005, 151). Boudreaux, for whom the Constitution does not form any new order, objects to Posner's opinion. He argues that the authors of the document "did not seek to create all or even most law de novo" (Boudreaux 2006, 163), but based it on already existing system of common law. What is more, the same common law "rooted in English experience and modified by the more recent experience in the colonies, remained the law of the land" (Boudreaux 2006, 163) and the Constitution influenced common law only to a modest extent.

What distinguishes the two authors in their opinion regarding the role of Constitution of United States in formation of legal order are different criteria for the classification of this order. Although the Constitution is based on common law, for Posner the fact that the rules have been written purposefully is sufficient to consider this order of law as planned one. Boudreaux, in turn, argues that the scale of planned changes introduced by the Constitution together with the retained law of the land does not permit such conclusions.<sup>3</sup> Although the two scholars discuss whether

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3 Although Boudreaux considers the Constitution to not be a sufficient condition for creating planned order,

the Constitution is an example of rational design, they use different frame of reference. As a result, they are both correct in their opinions. This is because answer to the question of whether the Constitution can or cannot form a rationally designed order depends on frame of reference, that is of what we consider as an order. Simultaneously, this means that the whole discussion is pointless as each author refers to different order. One considers the structure which formed together with introduction of the Constitution. The second identifies order with general tradition of the common law system, in which the Constitution was formed and part of which it has become.

The above observations illustrate that the problem of distinguishing between spontaneous and planned order does not stem from a simple observation that any order is formed from intentional activities of various actors. This observation means only that, like the Constitution being a part of the common law system, planned orders may form parts of cosmos. In this sense, presence of purposeful activities within spontaneous order does not make this order a taxis. This, however, does not resolve the issue which seems to stand behind the criticism of the spontaneous-planned dichotomy. Actions influence order in various ways. This leaves us with the question about influence particular actions have on formation of a given order. To what extent architect designing sidewalks in the quad influences the paths students choose when walking between buildings? Does the Edison's language novelty create a new order in English language? Have creation of the Constitution of the United States reformulated common law?

The above observation helps to clarify the problem of the spontaneous-planned dichotomy and identifies the source of this issue, providing a starting point for considerations regarding normative aspect of the categorization of orders as spontaneous and planned.

## **The Problem Situation**

The above considerations show various difficulties hampering ability to provide a clear-cut distinction between cosmos and taxis and casting doubt on the adequacy and value of the spontaneous-planned classification. This however does not necessarily negate value of this classification. Simultaneously, it neither implies necessity of introducing more precise definitions or different categorization of orders. On the one hand precision of used terms is always bounded by a given language. On the other hand, as long as precision of used terms is a crucial aspect of any scientific research, considerations regarding these terms should not be an end in itself. As Karl Popper (2002) argues the need for accuracy depends on the problem situation in which it

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he does not explicitly state whether it is sufficient for emergence of order in general.

is used. In other words, the problem of whether alternative definitions or categories are desirable is a problem of finding definitions suitable for a given situation. This is because growth of human knowledge starts with identification of problems, followed by attempts to solve them. Therefore, terms are merely a means in our study of a given problem and an increase of their precision and exactness should not exceed of what this situation demands. According to Popper progress proceeds not from precision, but from "seeing new problems where none have been seen before, and of finding new ways of solving them" (2002, 23). Considerations regarding words and their meaning that exceed beyond this purpose, which he describes as "verbalism", cause a loss of clarity and waste of time "on preliminaries which often turn out to be useless" (Popper 2002, 22).

In the case of the spontaneous-planned dichotomy the problem situation pertains to human constraints in deliberate shaping of social reality. Not all institutions can be planned. In turn, these constraints have their source in human cognitive limitations. People are not omniscient and thus are unable to gain knowledge sufficient to deliberately create complex structures of social order. Humans are able to construct only simple orders, as only then it is possible to grasp all information necessary to design them. Contrarily, highly complex order cannot be deliberately created, but emerges spontaneously. Its formation is possible only through a dispersed process of interactions between individuals, which allows agents to utilize knowledge of others and establish mutual coordination of activities. In this sense human cognitive constraints are a necessary condition of existence of spontaneous forms of order, and therefore the central element constituting the dichotomy of cosmos and taxis. Without them differentiation of orders would be irrelevant, as knowledge necessary for formation of even the most complex order would be accessible to a designer.

The above considerations show that the categorization of orders as spontaneous and planned reflects the constrained character of the human mind. However, it does not identify where the boundary of human cognitive abilities lies. This means that recognition of both categories of order is not a problem per se, but it rather stems from a more general issue of the limits of knowledge. These limits determine human abilities to create social order. In other words, it is the problem of knowledge that is the problem embedded in the spontaneous-planned dichotomy. In this sense the categorization of orders as spontaneous and planned fulfills its role as it allows recognition of the problem situation of human cognitive limitations. Simultaneously it implies that attempts to define conditions which would allow more precise identification of orders existing in the complex realm of social interactions is a form of verbalism, which makes any

discussion regarding the considered issue pointless (e.g.: Sandefur 2009; 2010; DiZerega 2010). What is important is a study of constraints in deliberate formation of social order as well as limits of spontaneous human cooperation (e.g. Boettke 2005; Leeson 2008; Koyama 2014).

A discussion regarding the categorization of orders without recognizing the problem situation can be seen in the case of the mentioned debate between Posner and Boudreaux. Presented arguments for a given classification of the constitutional order focus only on definitional aspect and do not help answering the question of human limits in rational design of constitution or legal system in general. Therefore, they do not provide better understanding of the considered phenomena.

## **Normativity**

The problem of limitations of knowledge provides also some insight into normative aspects of the conception of spontaneous order. As such, the categorization of orders as cosmos and taxis reflects the fact that not all regularities are purposefully created. In this sense distinction between planned and spontaneous carries no normative implications. However, this distinction based on the assumption of human cognitive limitations. This means that the spontaneous-planned dichotomy reflects our knowledge about constraints of reason and therefore about our abilities to deliberately shape social order. As a result, knowledge of these limits provides a normative guideline of human actions. It implies what cannot be planned and thus should not be pursued. Therefore, foundation for normative critique of constructivism does not stem from a categorization of orders, but from the limits of reason upon which this categorization is based. This means that Sandefur's argument that distinction between cosmos and taxis does not present a normative guideline seems misplaced. Although normative values do not stem from distinction between spontaneous and planned, they are connected with it as the categorization of orders reflects our knowledge about the limits of reason. It is knowledge of these limits that provides normative guidelines.

The fundamental role of cognitive limitations is visible in discussions regarding normative dimension of the spontaneous-planned dichotomy present in Hayek's (1960, 1978) conception of constitutional order. Considering individual freedom as a necessary condition for coordinate activity of individual agents, Hayek argues that maximization of this freedom requires formation of a legal system based on general and impersonal laws. Only a constitutional structure based on such universal rules guarantees coercion to be "reduced as much as possible in society" (Hayek 1960, 11). It is only "when we obey laws, in the sense of general abstract rules laid down

irrespective of their application to us, we are not subject to another man's will and therefore free" (Hayek 1960, 153). This places Hayek in favor of institutional changes which would lead to emergence of such legal structure. However, according to some scholars (e.g.: Kukathas 1989; Barry 1994; Samuels 1999; Muller 2007) this approach is inconsistent with Hayek's criticism of rationalist constructivism.<sup>4</sup> According to the Austrian scholar limitations of individual's knowledge forbid rational design of complex institutions. As Buchanan notices, Hayek's argumentation results from the ascertainment that structure of rules "emerges only through a lengthy process of evolutionary change, and that efforts at explicit reform in this structure are misguided" (2008, 172). This however stays in opposition to Hayek's suggestion for "a radical departure from established tradition" (1973, 4) as well as re-examination of current beliefs and conceptions to redesign constitutional system. This has led Chandran Kukathas to conclusion that there are "two incompatible philosophical attitudes" (1989, 206) in Hayek's thought.

Proponents of constitutional design (e.g.: Vanberg 1994; Steele 2002; Servant 2013) refute the above criticism. They argue that processes of forming the extended order of human interactions does not take place in a social vacuum but is always embedded in cultural and social structures. In the same way as market competition is based on the institution of private property, also competition in the sphere of political activity should be placed within certain institutional constrains. Therefore, in principle, it does not exclude formation of designed institutions in this process. Although evolutionary character of social changes implies fallibility of human design, "[t]o advocate the utilization of competitive evolutionary processes as a critical check on our institutional constructions is not the same as to claim that we could get along without any rational institutional design" (Vanberg 1994, 194). This design does not form the extended order itself but helps establishing foundations for this order. In this sense, constitution forms a framework in which community can spontaneously develop its rules of conduct.

According to previous considerations regarding the problem situation of Hayekian project of constitutional design rise question that is fundamental for functioning of social order. It is the question about the limits of human reason. This is because these limits determine to what extent legal system can be deliberately formed without falling into a trap of the fatal conceit (Hayek 1991). In this sense discussion regarding apparent contradiction between this vision and Hayek's admiration to spontaneous formation of order is of little cognitive value. It is the knowledge of

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4 Rationalist constructivism Hayek (1969) equates with naive rationalism. Epistemologically it refers to Cartesian understanding of reason as a capacity of deductive reasoning from undoubtable premises. On the level of ethics, Hayek links it with Bentham's utilitarianism and Hobbesian social contract.

the limits that should be the focal point of research regarding proposed constitutional vision. As Posner writes, "the disagreement (...) is about the degree to which purposeful regulation is doomed to failure because of inability to obtain the information necessary for ascertaining value" (2006, 268-269). Although he wrote these words to address the discussion between Austrians and neoclassical economists, it can be generalized beyond scope of economics. Mere use of reason, even in case of forming rules of order, does not place proponents of such process in opposition to the idea of spontaneous processes. Use of reason leads to rejection of spontaneous formation of order when it tends to achieve what goes beyond the limits of this reason and falls into the error of fatal conceit (Hayek 1988). Therefore, discussion of whether there is a "tension in Hayek's thought, between the rationalist advocacy of liberal reform and the anti-rationalist critique of all social reconstruction" (Kukathas 1989, 215) translates into the question about an extent to which human pursuit of rational reforms does not cross the line of the pretense of knowledge (Hayek 1989). In this sense it is not identification of a system of rules with a particular category of order that should be the purpose of scientific study. It is rather research of effects which the functioning of this system can lead to.

## **Conclusions**

The idea of spontaneous order underlines the crucial role of knowledge in formation of the complex realm of social interaction. Presented controversies regarding adequacy of the spontaneous-planned dichotomy and non-instantiation of used terms, does not necessarily negate value of this dichotomy, nor justifies constructing more precise definitions. Firstly, precision of both orders' definitions is necessarily always restricted by used language. However, what more important, description of used terms should not be an end in itself. It should be adequate to the problem situation of the limits of reason. Existence of these limits is the necessary condition of phenomenon of spontaneous order, and therefore the central element constituting dichotomy of cosmos and taxis. Therefore, to omit verbalism, consideration regarding the spontaneous-planned dichotomy should be placed in the context of the issue of human cognitive limitations. Identification of orders as spontaneous or planned is not the problem per se, but a reflection on constrained character of human cognitive processes.

Existence of the limits of reason means that knowledge about these limits is a source of normative implications. This is because these limits reflect our abilities to deliberately shape social order. In this sense, the argument that identification of cosmos and taxis does not present normative value is misplaced. The spontaneous-planned dichotomy reflects perception of the limits of

reason in reference to formation of regularities in human actions. Therefore, normative values, although do not stem from the categories of cosmos and taxis, are correlated with them.

Recognition of the problem situation provides a new insight into the discussion regarding Hayek's vision of constitutional order, making the limits of reason the main aspect of this discussion. This is because to recognize a constitutional design as an extension of the fatal conceit it is necessary to know whether planned formation of a corresponding order exceeds the limits of reason. In this sense the discussion regarding apparent contradiction between this vision and Hayek's admiration to spontaneous formation of order is of little cognitive value. Instead, it is research of the results of functioning of a given constitutional order that should be the main point of interest.

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## **Bio**

**Piotr Szafruga, Ph.D.**

Institute of Political Science and International Relations, Jagiellonian University

# Spontaneous Order Approach in Political Science

Piotr Szafruga, Jagiellonian University

**T**he theory of spontaneous order conceptualizes and explains institutions and social phenomena which are not deliberately created, but rather emerged as an unintended effect of grassroots activity of individuals following their own aims. Moreover, it argues that complex social structures cannot be formed deliberately. Due to human cognitive limitations these structures emerge only in unplanned manner. However, this approach is not widely recognised in social sciences, especially in political science. Addressing this situation the article implies that theory of spontaneous order can find application in explaining political phenomena. It presents an overview of some of possible areas within the scope of political science where theory of spontaneous order may provide valuable insight into studied phenomena. The proposed approach helps understanding the coordinative character of spontaneous processes and introduces new arguments to the discussions about conceptions and theories already present in political science, like the theory of public choice or the conception of veil of ignorance.

## Role of Theory of Spontaneous Order in Political Science

One of the most concise but also insightful description of the conception of spontaneous order can be attributed to Adam Ferguson who defined it as “the result of human action, but not the execution of any human design” (1966, 122). Emerging from this idea theory of spontaneous order concentrates on social phenomena which emerge as an unplanned outcome of interactions between people pursuing their own aims. It helps to conceptualise and explain a number of institutions and social phenomena which are not an intended effect of either individual decisions or collective consensus. Simultaneously, it implies presence of limitations in the sphere of purposive creation of social structures.

The conception of spontaneous order can be traced back to works of ancient Roman jurists as well as reflections of medieval scholastics. However, the most significant contribution to the development of this idea can be attributed to economics. Self-organizing nature of the market

and the way price systems are formed have been intriguing thinkers for centuries: How do such spontaneously formed structures manage to coordinate economic activity of various people and increase their wealth? In this aspect, one should mention the central role of the Austrian School of Economics in reflection regarding spontaneous processes. Representatives of this school not only extensively studied this issue. The conception of human action and recognition of constrained nature of human cognition allowed Austrians to fully embrace the conception of unplanned, spontaneous emergence of institutions and order in the sphere of economy. This, in turn, has led to formation of the theory of spontaneous order which is embedded in methodological perspective of the Austrian School.

Perspective of theory of spontaneous order results from recognition of dispersion and uncertainty of information available to human beings, which in turn has its source in limitations of human cognitive capabilities. Rather than being given, information is formed using human cognitive abilities. This means that while negating availability of perfect knowledge theory of spontaneous order simultaneously recognises the phenomenon of human creativity and ability to discover and create new information allowing recognition of new aims and means. Additionally, interactions between agents allows them to transmit information and making it available to others. As a result ability to act upon their will and to pursue their subjective aims means that in their actions individuals not only transmit information about their preferences, but what more important allows others to use this knowledge to modify their own activity accordingly. This allows mutual coordination and cooperation between people and thus emergence of social structures which has not been purposefully created, but emerged through dynamic continuous process of mutual adjustment. Therefore, many institutions, that appear to be a product of some design, are an effect of unintended actions of individuals.

The lack of perfect knowledge not only establishes necessary condition for emergence of phenomenon of spontaneous order, but also implies that in many cases social order cannot be planned. This translates into rejection of the approach, according to which society forming institutions are or should be a product of deliberate planning. In fact highly complex social structures cannot be planned. Due to human cognitive limitations and dynamic character of social processes it is impossible to aggregate all necessary information to deliberately create them. Instead, these structures emerge spontaneously as a result of human interactions causing creation and transmission of information. This allows individuals to utilise knowledge and actions of others for their own purposes, leading to coordination of human activity and emergence of social structures of complexity far exceeding cognitive abilities of a single man.

Universal presence of uncertainty and unintended effects of human activity presents the theory of spontaneous order with potentially wide range of areas of research. Despite that, the theory is not widely recognised in social sciences. It is used mainly in economics. To a lesser extent similar reflection is present in jurisprudence, where the idea of spontaneous formation of legal system has been discussed since ancient times. In contrast, reflection on spontaneous order is virtually almost non-existent in political science. It appears in works regarding political philosophy (Hayek 1960; 1973; Vanberg 1994) and in relation to the public choice analysis (Ikeda 2003; Tarko 2015; Herbert 2018). However, to the best of author's knowledge, currently there is a lack of publications which would present comprehensive and systematic approach to use of the conception spontaneous formation of order in political science.

Trying to respond to the above situation the article presents an overview of the possible implementation of the theory of spontaneous order in some areas within political science – public choice theory, fragile states and the veil of ignorance. In this sense, rather than providing in depth analysis of considered issues, its goal is to highlight advantages of the theory in the study of political phenomena and suggest possible directions of further research. The choice of topics is based on a premise that it should reflect the diversity of possible research areas in political science, including political economy and political philosophy. Furthermore, to better illustrate the new approach of the theory and emphasise its distinctive aspects, research conducted within selected topics often feature little recognition of spontaneous processes or, more importantly, the conception of human cognitive constrains as a limit factor in achieving political goals and deliberate shaping social order.

## **Public Choice Theory**

Public choice theory can be described as "the use of economic tools to deal with the traditional problems of political science" (Tullock 2008, 723) or as the application of the methodology of economics to the study of politics (Mueller 2003, 1). Although both theory of spontaneous order and theory of public choice present economical provenance, they differ significantly. This is due to neoclassical perspective of the public choice approach, while theory of spontaneous order is based on methodological perspective of the Austrian School of Economics. As a result theory of spontaneous order introduce perspective which helps identifying issues public choice theory faces and providing new approach for solving them.

The central point of difference between the two mentioned theories is the conception of rationality. In analogy to market processes public choice theory perceives political phenomena

as a form of exchange. It describes politics using models of market behavior based on the conception of rational agents. However, the adopted conception of rationality has significant limitations. It states that actors do not make mistakes, which leads to obvious inconsistencies with empirical observations. Responding to this issue public choice approach introduced conceptions of rational ignorance and rational irrationality, which tend to reconcile neoclassical rationality with observable mistakes people constantly make.

According to the idea of rational ignorance the human errors occurs when costs of obtaining knowledge necessary to avoid these errors are higher than resulting profits (Wittman 1989). Rational irrationality in turn is formed around distinction between epistemic and instrumental rationality. The first of the two means forming true beliefs and avoiding false ones, while instrumental rationality refers to situation when a person selects means to achieve a chosen aim according to his convictions. Recognition of the difference between epistemic and instrumental rationality implies that human can possess erroneous beliefs, or in other words he can be epistemically irrational, as long as the need to hold to these beliefs exceed the related costs (Caplan 2001).

Theory of spontaneous order rejects conception of rational ignorance as well as of rational irrationality, as both do not fully recognise the issue of human cognitive limitations. In fact, they assume that agents possess objective knowledge about profits and costs resulting from embracing particular convictions. Accessibility of such a knowledge means that the erroneousness of human action is an effect of calculation and not of ignorance. Contrarily to this approach, the theory of spontaneous order takes a position of radical ignorance, according to which ignorance is not a result of calculation, but of genuine uncertainty.<sup>1</sup> Therefore, agent's choices and any future actions are not determined, but rather conditioned by context of time and space. This implies that the main problem regarding coordination of human action is not transaction costs, but rather human ignorance.

Another aspect in which theory of spontaneous order differs from public choice theory is their comprehension of competition. According to public choice approach competition in the sphere of politics can be modeled similarly to competition present on the free market. However, for theory of spontaneous order such an analogy is unjustified. The coordination abilities of a market-based system does not stem from competition itself. It is the ability of such a system

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<sup>1</sup> The word "radical" is not intended to indicate any extreme form of ignorance, but to distinguish ignorance resulting from uncertainty from rational ignorance (Ikeda 2003, 67).

to create and transmit information which allows agents to respond and adjust to actions of other actors. In turn, the extent to which people are able to create and share information depends on a specific institutional framework in which those people act. In this sense, although competition is a mechanism allowing propagation of information, it should be seen as an output of a particular institutional arrangement. This means that implementation of various institutions can lead to different forms of competition, causing political processes to differ from market processes. In particular, economic calculation is defined by the presence of institution of private property (Mises 1990). This however is not the case when considering the sphere of political activity. The level at which politics is similar to market is the realm of human interactions. As Richard Wagner argues, politics is a “peculiar form of business practice” (2016), which should not be treated as a market process, but rather as a process entangled with economy.

The central role of information also means that the mere presence of many competing agents within governing structures does not guarantee coordination effects similar to these seen in the market. Therefore, coordinating capacity of a polycentric systems does not extrapolate easily beyond the area of interactions based on private property. This however, does not imply the necessity of central coordinating body, but rather emphasises the key role of the ability to discover new information and of institutional arrangement, which would support transmission and use of this information among agents. As a result theory of spontaneous order questions arguments formed by public choice approach in favour of the decentralization of state structures. According to public choice perspective structural solutions such as federalisation or overlapping jurisdictions introduce a competition among political structures. However, according to the theory of spontaneous order this does not solve problem of the disruptive impact of governmental activity, as local governments still remains governments (Boettke et al. 2011), with all their inability to gather all the necessary information. Comparing the free-market process of setting prices with planned economy provides illustration of the above issue. Fact that prices in planned economy can be established by mutually competing institutions responsible for managing different branches of economy does not mean that the results will be even remotely similar to these of free-market system.

The importance of the problem of knowledge emphasises the role of ideas and beliefs which helps agents to make decisions in the conditions of constant uncertainty. Convictions held by people formulate mental structures, which they use to interpret new information they receive. However, as beliefs help dealing with lack of knowledge, they simultaneously simplify perceived world. This simplicity is necessary for formation of any meaningful causal perception of external

world. It is also helpful in constructing a coherent perception of the social environment in which agent lives. Simultaneously, it means that in situation, where complexity of processes makes it difficult to identify causal relations within these processes, there is a limited ability to accurately identify these relations. This, in turn, may lead agents to attribute of what they experience to inadequate causes. As a result people are less likely to follow actions which benefit them the most, according to their own preferences. This refers especially to the sphere of politics, where particular decisions are intended to influence the whole realm of social interactions. Lack of an adequate knowledge means that in face of such decisions people often tend to invoke, to a large extent, to social heuristics and extrapolations of their moral beliefs (Cosmides and Tooby 1994; Dennett 1996, 494–510).

## **Fragile States**

Fragile state can be described as a state which is unable to realise functions, which are typically assigned to it.<sup>2</sup> This conception emerged in early 1990s in response to erosion and weakening of states structures after the end of the Cold War (Jackson 1990; Helman and Ratner 1992; Zartman 1995). Because being a fragile state is correlated with presence of internal instability and conflicts, from the beginning this conception had visible normative flavour. It is also often seen as a thread to international security (Rotberg 2002).

Considering crucial role of information in coordination of human activity, theory of spontaneous order perceives fragile state as phenomenon characterised by lack of access to information necessary to coordinate social processes, thus hampering state's ability to realise functions assigned to it. Lack of information together with recognition of human cognitive limitations allows theory of spontaneous order to emphasize the role of local knowledge in coordination processes. This type of knowledge consists of skills, beliefs, customs and practices embedded in social structures of various groups or communities (Coyne and Boettke 2006; Pojevich 2003; Boettke et al. 2008). Creation and transmission of this knowledge takes place within local social structures.

As local knowledge is created and carried by local structures relations between formal institutions, especially state apparatus, and endogenous institutions form the focal point for studies of phenomenon of fragile states. This means that ability of planned structures to follow purposes for which they are formed requires compatibility with often informal norms and practices present within a given community or society. Lack of embeddedness in local

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<sup>2</sup> Other terms used for this phenomenon are, among others, "failed state", "collapsed state" or "weak state".

knowledge limits ability of state structures to function according to roles assigned to them. Therefore, recognition of a coordinating role of endogenous local structures provides a tool for analysing changes introduced in socio-political structures. In particular, it helps explaining successes and failures of postwar reconstruction processes and differences in transition efforts between former communist countries (Boettke et al. 2008).

Recognising the role of endogenous institutions theory of spontaneous order stays in opposition to the state-centric approach to fragile states, which considers the state as the main and necessary factor in forming and maintaining social order. The state-centric approach inflicts perspective according to which solving problems posed by fragile states should be based on strengthening power and authority of state structures. This however undermines the role of local structures and ignores a problem of always incomplete knowledge, which precludes planned creation of social structures in general. According to theory of spontaneous order strengthening state institutions, understood as a process of centralization of power, hampers processes of creation and transmission of information in society, obstruct endogenous platforms fostering coordination between agents. This in turn limits access of governing body to local knowledge (Huerta de Soto 2010, 52–62). Additionally, disruptive impact on local institutions and mechanisms of transmission of information causes increase of uncertainty, thus fostering non-cooperative behavior. This means that, although the intention behind this process is to enhance cooperative tendencies in society, in the end it may lead to opposite effect.

Examples of negative impact of centralisation of power on coordination processes are noticeable especially in societies strongly relying on endogenous institutions, like clans, tribal structures and customary law (see: Blewett 1995; Little 2003; Powell et al. 2008). In such cases not only the state does not necessarily have dominant position, but stays in opposition to order based on kinship and customary law. The state is characterised by consolidation of power in centralised and hierarchical structure. This creates an incentive to gain control over its state structures while undermining the political role of local clan structures and limiting their independence. What important, the perception of the state is also affected by a cultural background and social relations of kinship system introducing clan identity as an important variable. From this perspective centralisation can be seen as a threat to political position of local structures. This limits trust between various clans and increases uncertainty as well as actors desire for secure their possessions. As a result relations between local structures tend to shift from the sphere of voluntary cooperation into compulsory competition.

The incompatibility between state structures and endogenous institutions hampers coordination processes in society, thus leading to conflicts and inability of the state to perform its role. In extreme cases governing structures may continue to last in a reduced form of so called “predatory” or “vampire state”, where state apparatus is used to provide benefits to groups with political power (Ayittey 1999; Clapham 1996). Simultaneously, this incompatibility translates into a tendency to reduce state’s reliance of its existence on local institutions. As a result many fragile states tend to shift their financing from sources highly interrelated with local economy to more standalone sources of income, like foreign aid and natural resources. In particular, this indicate possible causes of the negative impact of foreign aid on the condition of democratic institutions (Coyne 2007; Djankov et al. 2008). It also provides an explanation of the prevalence in some countries of “the source curse” (Sachs, Warner 2001). This expression refers to the phenomenon of slower economic development in states abundant in natural resources comparing to countries where these resources are scarce. According to the presented approach, these resources allows state authorities to stay in power even in case of strong incoherence with endogenous institutions and the wealth of the society, when comparing with countries not possessing natural resources.

Theory of spontaneous order also provides an alternative to the state-centric approach which recognises the political role of endogenous institutions (Lund, 2006; Merkhaus, 2007; Malejacq, 2016). The latter find reflection in the conception of hybrid political orders, which links the instability of fragile states with situation where various institution, like clans, possess relatively strong position comparing to the state (Boege et al. 2009).<sup>3</sup> The hybrid approach recognises the crucial role of local structures in providing public goods. It argues that political and social stability can be achieved by joining the Western liberal model of statehood with traditional forms of government typical for a given place - hence hybrid order (Clements et al. 2007, 48).

Although the conception of hybrid order incorporates local institutions into equation, it is still based on the state-centric perspective and assumes the necessity of the state for coordination and ensuring social and political order. This means that it perceives local institutions as a mean to consolidate decision-making process and improve effectiveness of the state. There is however no reflection regarding why such consolidation should take place in the first place. Instead, the hybrid perspective assumes fundamental role of the state in establishing social and political order. This stays in contrast with the approach of theory of spontaneous order which stresses the role of information in dynamic social processes. This means that the importance of the endogenous institutions steams from their role as the medium of transmission of local knowledge.

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<sup>3</sup> For the sake of simplicity phases ‘hybrid political order’ and ‘hybrid’ are used interchangeably.

These institutions mitigate the problem of scarcity of information, thus facilitating coordinative processes within society. This however does not mean that incorporation of endogenous institutions into centralised system like the state have a similar effect. This is because centralised system of decision-making limits accessibility and hinders creation of information in society (Huerta de Soto 2010, 52–62), thus counteracting coordinative features of local institutions. Additionally, such incorporation may have negative effect on both local institutions and central structures. On the one hand it may allow local communities to pursue their particular goals using the state apparatus thus extending the phenomena of rent-seeking. On the other hand incorporation of endogenous institutions into more hierarchical structure may corrupt their main role as a coordinative platform of local communities, as central governing body entails an interference with informal network of social relations.

The attempt to build a hybrid political order in Somaliland provides an example of some negative effects of interactions between the state and local structures (Hoehne 2013; Renders and Terlinden 2014). It led to growth of the role of the central government over decentralised forms of political activity based on clan structures. What more incorporation of local institutions into state structures allowed representatives of these clans to gain political influence much greater than possible at the level of internal affairs of their own clans. This caused these representatives to be more prone to corruption and alienated them group they represented. This in turn weakened the role of kinship-based structures as political entity. What more, while this process strengthened power of state apparatus, at the same time it eroded its legitimacy and stopped democratisation processes (Bradbury 2008). Similar effects can be observed also in other countries where endogenous institutions are used to reinforce state apparatus (Podder, 2014; Simangan, 2018).

Rejecting state-centric perspective allows theory of spontaneous order to introduce more broad perspective to the issue of fragile states. This shifts the focal point beyond the question about incorporation of local institutions into state structures. Instead of focusing on the issue of effectiveness of state structures and decision-making processes, it indicates the more broad problem of validity of consolidation of decision-making processes as such. This in turn allows recognising the possibility that lack of the state may serve social order and cooperation better than ineffective state structures hampering local institutions.

## **The Veil of Ignorance**

Theory of spontaneous order can also be used in political philosophy. Due to its reference to the issue of limitations of deliberate formation of social order this theory seems to provide insight into conception of the veil of ignorance. Conception of the veil of ignorance is formed around an idea of excluding or reducing the influence of personal interest and agenda of individual decision maker upon decision-making process. It is based on mental experiment of assuming that decision makers lack information regarding their identity of their own position in society, which makes them unable to predict an impact of decisions they make upon their own individual situation. As a result the veil of ignorance can be used to establish norms and rules which would not favor individuals due to their role in formulation of these rules.

Author who greatly contributed to the popularization of the conception of the veil of ignorance in contemporary political philosophy is John Rawls (1971). He considered situation in which no one knows his or her position in society neither abilities nor skills. According to Rawls this allows formulation of rules of justice and thus normative foundations of social structures. The veil of ignorance is also used in political economy to explain choice of constitutional rules (Buchanan and Tullock, 1962). In this sense, the idea of counteracting individual interests in decision-making processes forms one of key mechanisms preventing the abuse of power.

Implementation of theory of spontaneous order and therefore introduction of the idea of radical ignorance leads to issues when considering the conception of the veil of ignorance. In its attempt to mitigate the role of personal interest the veil of ignorance focuses on the motivation of decision makers. The ignorance it considers refers not to knowledge about effects of undertaken decisions, but to the part of knowledge regarding position of particular agents in society and therefore how implemented solution would influence their personal situation. In this sense conception of the veil of ignorance ignores the issue of radical ignorance and resulting state of uncertainty involved in any human activity. According to theory of spontaneous order this radical ignorance implies that the problem in formulating an order according to particular agenda is permanently linked with lack of sufficient information necessary for designing such an order. As a result there is a discrepancy between intended and actual results. Resulting lack of knowledge about effects of a given decision means that it is impossible to identify what benefits this decision would bring to a particular individual. This in turn undermines the mechanism of the veil of ignorance, as it makes the purpose of this mechanism irrelevant.

While considering the limitations in deliberate formation of social order, theory of spontaneous order also stresses the role of entrepreneurship and human ability to discover new information.

It points out that while constrained in his cognitive abilities agents are able to discover new aims and means to achieve them. This allows to form an argument against Rawls conception of justice, in which he uses the veil of ignorance to provide fair distribution of benefits within society. However, Rawls's approach is based on the assumption that knowledge about both aims and resources is given, which stays in opposition to radical ignorance and negates role of human creativity.

The above considerations allows to recognise the normative aspect of human creativity and implications this brings into the sphere of ethics and political philosophy (Huerta de Soto, 2010, 20). This suggests that when considering issues related to establishing of social norms, instead of focusing on how to use of what is assumed as given, we should also take into account human entrepreneurship and ask how to foster it to discover of what we want to use or achieve. Lack of such attempts may lead to the pretense of knowledge and thus to a belief that it is not knowledge but conflicts of interest which causes human abilities to shape social reality.

## **Summary**

Theory of spontaneous order provides a new approach which can be used to describe and explain political phenomena. However, it is worth to notice that politics reflects in actions and decisions aimed at active and purposeful change of social order. This refers especially to narrow understanding of politics concentrating on government and activity of state institutions. This teleological character of politics means that explanation of spontaneous phenomena does not have significant application in study of politics. Instead, it is reflection on limits in planned formation of social structures that allows theory of spontaneous order to introduce useful mean in research of political phenomena.

Implementation of theory of spontaneous order seems especially useful with regard to issues studied by public choice theory. It allows formulating arguments against conceptions of rational ignorance and rational irrationality. Instead, theory of spontaneous order argues in favour of the conception of radical ignorance, which does not require assumption about omniscience or irrationality of human being. As a result it tends to focus on human creativity and transmission of information rather than on competition. This leads to rejection of public choice understanding of competition among governing agencies as an analogy to market competition. Embracing human genuine ignorance also leads to recognition of the role of beliefs and ideas in interpretation on experienced reality. Therefore convictions, often representing social heuristics and extrapolation of moral beliefs, form a foundation of decision-making processes.

Another possible area of implementation of theory of spontaneous order are studies regarding fragile states. Thanks to recognition of the role of informal institutions and dynamic character of social processes theory of spontaneous order can be used in the analysis of institutional changes in areas lacking stable political and legal system. Rejecting the state-centric approach the theory contest perception of the state as a necessary condition for existence of a stable social or political order. Instead, it indicates that centralised governing structures obstruct transmission of information and local coordination processes. This helps understanding predatory nature of many regimes in fragile states and thus providing explanation to the phenomenon of the source curse. Additionally, it allows identifying problems present in the conception of hybrid political orders.

Recognising the problem of decision-making in the situation of permanent uncertainty and cognitive constraints, theory of spontaneous order shifts the focal point of the fragile state issue beyond the problem of effectiveness of state structures. It questions the validity of consolidation of decision-making process and asks to what extent such process is necessary.

Reflection about spontaneous forms of order finds application also in political philosophy. By incorporating the conception of radical ignorance theory of spontaneous order emphasises the issue of discrepancy between planned and actual results of decision-making. Therefore, it helps identifying the problem of normative implications of human radical ignorance and creativity. Among others this allows formulating arguments against using the mechanism of the veil of ignorance for establishing general norms of social order and helps recognising the risk of falling into an error of the pretense of knowledge.

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## **Bio**

### **Piotr Szafruga, Ph.D.**

Institute of Political Science and International Relations, Jagiellonian University