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THE “OTHER” LUDWIG VON MISES: ECONOMIC POLICY ADVOCATE IN AN INTERVENTIONIST WORLD

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ABSTRACT

Ludwig von Mises was most likely the most uncompromising advocate of free market liberalism in the 20th century. But while he is most famous for his theoretical treatises on various aspects of economic theory and political economy, he made his living in the Austria of the interwar period as a senior economic analyst for the Vienna Chamber of Commerce. In this capacity, Mises attempted to construct economic policy proposals that accepted the political constraints of the time, while moving monetary, fiscal, and regulatory policies in a direction more consistent with the classical liberal ideal of a free society.

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1. INTRODUCTION

Ludwig von Mises was quite possibly the most uncompromising, consistent, and principled defender of classical liberalism and the free-market economy in the 20th century.

It is not surprising, therefore, that Mises was one of the founding members of the Mont Pelerin Society at its first meeting in Switzerland in April 1947. Nor is it surprising that nine years earlier in August of 1938 he had participated in the Colloquium Walter Lippmann in Paris that was hoped by the organizers to serve as a catalyst for a “renewal of liberalism,” but which was cut short by the European war that broke out the following year.2

Long before that first Mont Pelerin Society meeting, Mises had established an international reputation as one of the leading economic theorists in the Europe of his time. His major works up to that time – The Theory of Money and Credit (1912); Socialism: An Economic and Sociological Analysis (1922); Liberalism (1927); Monetary Stabilization and Cyclical Policy (1928); Critique of Interventionism (1929); Epistemological Problems of Economics (1933); Nationalökonomie (1940), the German-language forerunner of Human Action that would appear in English in 1949 – marked him off as a unique, grand theorist dealing with the sweeping issues and problems of the human condition: the general logic and structure of human action and choice; the nature of different economic institutional orders – capitalism, socialism, and interventionism; the workings of the competitive market process and the role of the entrepreneur; the importance of the monetary order for economic calculation and market coordination; and the interconnections between time, money, production, and the occurrence of the business cycle.3

This is certainly the side of Mises’s thought and writings that often carries a timeless quality with continuing relevance and application, because it deals with the general and universal aspects of man, mind, markets, and society. It is this Mises about whom F. A. Hayek referred when in his review of Nationalökonomie, shortly after its publication in the midst of the Second World War, he said:

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2 See, Compte-Rendu des Séances du Colloque Walter Lippmann, 26-30 Aout 1938, Travaux Centre International D’Estudes Pour La Renovation du Liberalisme, Cahier No. 1 [Report of the Sessions of the Walter Lippmann Colloquium, August 26–20, 1938, Studies of the International Research Center for the Renewal of Liberalism, Vol. 1] (Paris: Libraire de Medicis, 1938). One of the “curiosities” of this volume is that both Mises and Wilhelm Roepke, not wanting to be associated in any way with the Nazi regime that controlled their native countries (Austria and Germany, respectively) both declared on the participants’ page that their “nationality” was the “Austrian School.”


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There appears to be a width of view and intellectual spaciousness about the whole book which is much more like that of an eighteenth century philosopher than that of a modern specialist. And, yet, or perhaps because of this, one feels throughout much nearer reality, and is constantly recalled from the discussion of technicalities to the consideration of the great problems of our time.  

2. MISES’S “LOST PAPERS” AS A KEY TO HIS LIFE IN EUROPE AS ACTIVE POLICY ANALYST

But we should also remember that Ludwig von Mises did not make his living as a grand economic theorist or social philosopher for most of the years before he came to the United States as a refugee from war-ravaged Europe in 1940. His only academic association was as a privatedozent (an unsalaried lecturer) at the University of Vienna with the honorific title of “Professor Extraordinary,” which allowed him to teach a seminar each academic term and supervise dissertations. (Fritz Machlup, another founding member of the Mont Pelerin Society, wrote his dissertation on The Gold-Exchange Standard at the University of Vienna under Mises’s supervision.)

For almost a quarter of a century, from 1909 to 1934 (except during the First World War when he served in the Austrian Army), Mises worked as an economic-policy analyst and advisor to the Vienna Chamber of Commerce. From the time he was 28 years old until he was 53 (when he moved to Geneva, Switzerland to accept his first full-time academic position, at the Graduate Institute of International Studies) he spent his working day as a “policy wonk.” He immersed himself in the factual details and economic policy specifics of, first, the old Austro-Hungarian Empire and, then, the Austrian Republic between the two World Wars. His statistical knowledge of “the facts” relating to Austrian fiscal policy, regulatory legislation, and monetary institutions and policy was precise and minute.

This became very clear to me while I was working through those “lost papers” of Ludwig von Mises that were recovered by my wife and myself from a formerly secret KGB archive in Moscow in 1996. Indeed, it helped me to better understand that much of Mises’s conception of the general economic order, its workings and requirements, and the institutional and policy “rules” that would help establish and maintain freedom and prosperity did not arise simply from a pure, a priori, deductive spinning out of implications from the “action axiom.”


They are, in many cases, the general theoretical insights and conclusions, and the social-institutional and economic-policy “wisdoms” derived from living through, acting within, and the lessons learned from those momentous and often catastrophic events that shook Europe in the first half of the 20th century. And they were amplified due to the particular everyday reality of Austrian political and economic life that Mises experienced and worked within during this time.

An appreciation of this aspect of Ludwig von Mises’s life and thinking comes out most clearly when reading through Mises’s policy writings from this period. Liberty Fund of Indianapolis has published a three-volume series under the general title, *Selected Writings of Ludwig von Mises*, for which I have served as the editor. The volumes contain many of Mises’s articles, essays, and Vienna-chamber memoranda and speeches on these themes from this time. The three volumes, together, offer nearly 1,000 printed pages of additional writings by Ludwig von Mises, many never previously published, and most all of them certainly never before available in English.

Volume 1 deals with *Monetary, Fiscal and Economic Policy Problems Before, During, and After the Great War* (2012), and includes many of Mises’s earliest writings as an economist. Here Mises analyzes issues surrounding the politics of establishing the gold standard in Austria-Hungary in the early 1890s; legal gold redemption by the Austro-Hungarian Bank in the decade before the First World War; the growing fiscal imbalances developing in the old Habsburg Empire due to the patterns of government spending and taxing policies in the first decade of the 20th century; and the reasons behind an economic crisis that hit Austria-Hungary in the years immediately before the start of the Great War.

Here, too, we see Mises analyzing during the war the motives behind German and Austro-Hungarian trade policy; the impact and significance of emigration from the Austrian Empire; the effects from the monetary inflation used to fund the government’s war expenditures; and the pros and cons of financing those war expenditures through taxation versus borrowing by the issuance of war bonds.

After the war, Mises explained the distorting effects from the new Austrian government’s control and rationing of foreign exchange for imports and exports; the impact on the Austrian foreign exchange rate due to monetary expansion to finance the government’s huge deficit spending; a specific policy agenda to bring the country’s financial house back into order, and the need for cooperation from both businesses and labor unions if this was to be achieved without Austria’s currency collapsing into a hyperinflation; the claims that holders of bank notes of the old Austro-Hungarian Bank could make on the new Austrian National Bank in the postwar period; Austria’s fiscal problems in the period after the end of the inflation; and the lessons for banking reform after the collapse of several banks in 1931.

(An appendix to the volume includes a talk that Mises delivered at his famous private seminar in the spring of 1934 on the methodology of the social sciences shortly before he moved to Geneva, Switzerland; and the curriculum vitae that his great-grandfather, Mayer Rachmiel Mises, prepared for the Habsburg Emperor in 1881 as part of his ennoblement that gave him and his heirs the hereditary title of “Edler von.”)
It is in the second volume of the *Selected Writings: Between the Two World Wars: Monetary Disorder, interventionism, Socialism, and the Great Depression* (2003), that the reader finds a large collection of Mises’s many articles and policy pieces from the 1920s and 1930s dealing with the Great Austrian Inflation, fiscal and regulatory mismanagement by the Austrian government, and the negative effects of numerous forms of government intervention and controls before and during the Great Depression; the volume also includes his critiques of socialist central planning and his defense of praxeology, the science of human action.

The third volume of the *Selected Writings* (2000) focuses on Mises’s writings mostly from the first half of the 1940s on the theme of *The Political Economy of International Reform and Reconstruction*. In the midst of the Second World War, Mises lectured and wrote on the pressing issues of how Europe, small nations, and underdeveloped countries could recover from war and poverty and start on the path to economic renewal and prosperity.

Each volume begins with an introduction in which I try to explain the historical context of the period in which Mises wrote the pieces included in that particular volume. I have also tried to assist the reader with annotated footnotes explaining some of the ideas, persons, events, and geographical locations to which Mises refers in the texts.

### 3. MISES’S THREE POLICY HORIZONS AS AN ECONOMIC ANALYST IN INTERWAR AUSTRIA

What comes out from reading Mises’s policy writings from this period of his European career is that if you had asked him a fiscal, or monetary, or regulatory-policy question in the context of his role as analyst at the Chamber of Commerce, he would not have said, and did not simply say, “laissez-faire” – abolish the central bank, deregulate the economy, and eliminate taxes.

In the give-and-take of everyday Austrian politics and policy decision-making, Mises accepted that there is certain institutional “givens” that must be taken for granted, and in the context of which policy options and decisions must be worked out.

Though he never expresses it explicitly, Mises seemed to usually think with three policy “horizons” in his mind.

The first, and the more distant horizon, concerned the most optimal institutional and policy arrangements in society for the fostering of the classical-liberal ideal of freedom and prosperity, based on the knowledge what he thought sound economic theory could provide. This is captured most frequently in the books and articles he was writing outside of his narrower role as Vienna Chamber of Commerce economist, such as presented in *The Theory of Money and Credit*, or *Socialism*, or *Liberalism*, or *Critique of Interventionism*.

The second horizon was closer to the actual circumstances of the present, but focused on the intermediary goals that would be leading in the direction of that more distant, “optimal” horizon. For example, the need for ending paper money inflation and reestablishing a gold-based monetary system for general economic stability, without which the market or-
der and economic calculation cannot properly function. Or the need to shift Austrian fiscal policy in a direction that would reduce the burden and incidence of the tax structure to end capital consumption and instead foster private-sector investment and capital formation.

I should mention that as a policy analyst thinking in terms of a classical-liberal normative framework, Mises did not advocate “tax neutrality” – that is, a low tax structure that would fund those minimal, limited-government functions, but would not attempt, outside of this, to “influence” the behavior or choices of the market participants. He believed that such a low tax system should be structured in such a way that it should foster and generate incentives for investment and capital formation. The tax structure, in his view, should be designed to stimulate production, not current consumption.

And the third horizon in the context of which Mises analyzes and proposes economic policies, is the current situation and the immediate future. In other words, how do you design the concrete bylaws and rules for a central bank to prevent it from following an inflationary monetary policy, including the transition to and implementation of specie redemption, and the policy tools it should then use to maintain the exchange rate and convertibility?

4. SPECIFIC PROPOSALS, NORMATIVE PREFERENCES, AND SECOND-BESTS IN DESIGNING POLICY

In the 1970s, Murray Rothbard once criticized Milton Friedman for advocating “indexation” of prices and wages as a method to reduce some of the negative effects from an ongoing inflation. But in 1922, during the worsening Great Austrian Inflation, Mises actually proposed “indexation” of wages and prices, as well as government revenues and expenditures to reduce deficit fiscal pressures, maintain real standards of living for many in the society, and eliminate some of the inflationary distortions on economic calculation – as a part of a specific policy agenda to bring the inflation to an end. And he explained how the indexation should be implemented and linked to the international value of gold.

Likewise, Mises did not just say, “Cut bureaucracy and its spider’s web of regulatory controls.” He first explained what was inefficient and unnecessary in the three-tiered Austrian bureaucratic system of federal, provincial, and municipal regulators and taxing authorities. Then he proposed what specific reforms should be introduced, how they could be “experimented” with in some of the smaller regions of Austria to see how they worked before

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extending them to the rest of the country, and how best to overcome the resistance of those in the bureaucracy fearful of losing their jobs.\(^8\)

In designing a new fiscal order for Austria in the post-World War II era, Mises proposed eliminating all income taxes and many – but not all – corporate and business taxes. But how, then, do you finance the costs of government? He presents an agenda for implementing indirect taxes on a wide variety of consumption items, and especially what today would be called “sin taxes” and “luxury taxes.” Government welfare-state expenditures were not going to just disappear. So, employers would be taxed to cover existing social-insurance expenditures. But overall, his fiscal policy plan for a reconstructed and reformed Austria was all meant to foster capital formation through predominately consumption taxation to cover government expenditures.\(^9\)

And in a lengthy monograph that he wrote during the Second World War devoted to economic reform in an underdeveloped country like Mexico, he took as “given” that the politics of Mexican society was not ready to fully privatize, say, the national railway system or the oil industry. So as a “second best,” Mises proposed transforming the railway system into a government-owned but privately managed corporation with strict rules and procedures to assure it was run in a relatively “business-like” manner with the least likelihood of political interference. He even supported limited and temporary subsidies to assist poor Mexican farmers to establish themselves as more-successful private enterprisers.

And on tariffs, he did not propose immediate abolition of trade barriers in Mexico. He accepted that there were many industries that had grown up behind the tariff walls, and that they would resist immediate repeal of trade protectionism. So, instead, he advocated “incrementalism,” i.e., a gradual reduction of the tariff barriers over several years.\(^10\)

He even supported the use of limited “trade retaliation” against countries that have raised their import taxes against the goods of one’s own nation; this was meant as a means of nudging that trading partner back to a freer trade policy, but without moving in the direction of any form of trade protectionism.

Indeed, in the years after the First World War, Mises even suggested using the League of Nations to impose economic sanctions on countries that did not reestablish gold-backed currencies in place of inflation-ridden paper monies, as a method to move the world on to a sounder monetary system!\(^11\)

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\(^11\) Ebeling, ed. *Selected Writings of Ludwig von Mises, Vol. 2: Between the Two World Wars: Monetary Disorder, Interventionism, Socialism, and the Great Depression* (Indianapolis, IN: Liberty Fund, 2002), Ch. 26: “The Return to the Gold Standard,” [1924]; also, p. 152: “The goal of these international agreements must be to
5. PAYING FOR THE COSTS OF WAR: TAXES OR BORROWING?

To give one more indication of Mises’s thinking on specific fiscal policy alternatives and choices, there is a passage in *Human Action* in which he says, rather cryptically in passing, that there may be good reasons under certain circumstances to fund some government spending through short-term borrowing. One only understands what he meant by this by reading a lecture he delivered in 1916 on the problem of funding the costs of the government’s war expenses.

In this lecture, he praises the military successes of the Austrian army and the industriousness of Austrian businessmen in providing the manufactured goods required to fight the war. Mises reminds his listeners that borrowing does not enable the current generation to shift any part of the costs of a war to a future generation. Current consumption could only come out of current production, and this applied no less to consumption of finished goods designed for and used in war. Whether the war was financed by taxes or borrowing, the citizenry paid for it today by foregoing all that could have been produced and used if not for the war.

Then he explains to his audience what today often is sometimes referred to as the “Ricardian equivalence theorem,” named after the early 19th century British economist, David Ricardo. In his 1820 essay on the “Funding System,” Ricardo argued that all that the borrowing option entailed was a decision whether to be taxed more in the present or more in the future, since all that was borrowed now would have to be paid back plus interest at a later date through future taxes; therefore in terms of their financial burden the two funding methods can be shown to be equivalent, under specified conditions. Ricardo, however, also pointed out that due to people’s perceptions and evaluations of costs in the present versus the future, they were rarely equivalent in their minds.

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reintroduce the gold standard in every country in the world, which can be achieved without difficulty if the League of Nations imposes a punitive duty on the exports of those countries that refuse to stabilize their monetary system.

12 Ludwig von Mises, *Human Action, A Treatise on Economics* (Irvington-on-Hudson, NY: Foundation for Economic Education, 4th revised ed., 1996) p. 227: “A good case can be made out for short-term government debts under special circumstances... Financing a war through loans does not shift the burden to the sons and grandsons. It is merely a method of distributing the burden among the citizens. If the whole expenditure had to be provided by taxes, only those who have liquid funds could be approached. The rest of the people would not contribute adequately. Short-term loans can be instrumental in removing such inequalities, as they allow for a fair assessment on the owners of fixed capital.”


But Mises raised a different point in favor of certain benefits to debt financing for the government's war expenditures. Many who would not have the liquid assets to pay lump-sum wartime taxes would either have to sell off less liquid properties to pay their tax obligation, or would have to borrow the required sum to pay the tax. In the first case, a sizeable number of citizens might have to liquidate properties more or less all at the same time to improve their cash positions, which would put exceptional downward pressure on the market prices of those assets. This would impose a financial loss on those forced to sell these properties and assets to the benefit of those who were able to buy them at prices that would not have been so abnormally low if not for the war and the need for ready cash to pay the tax obligation.

Secondly, to the extent that some citizens would need to borrow to cover their wartime tax payments, the private individual's creditworthiness undoubtedly would be much lower than that of the government's. As a consequence, the rates of interest these private individual's would have to pay would be noticeably higher than the rate at which the government could finance its borrowing. Thus, the interest burden from government borrowing that would have to be paid for out of future taxes would be less for the citizenry than the financial cost from them having to borrow the money in the present to cover all the costs of war through current taxation. Hence, it was both patriotic and cost-efficient, Mises said to those listening to his lecture, to buy war bonds in support of the war effort.

Thus, we find Ludwig von Mises explaining why, given the reality of government spending, under certain circumstances government deficit spending may be more desirable (from the taxpayers' perspective) than a fully tax-funded balanced budget!

6. MONETARY INSTITUTIONS, INFLATION, AND MARKET ALTERNATIVES TO CURRENCY COLLAPSE

Toward the end of the First World War and then in its aftermath, Mises had to deal with the specifics of monetary institutional reform. After the signing of the separate peace between the Central Powers and Lenin's Bolshevik government in Russia in March 1918, large areas of western European Russia were occupied by Imperial Germany and Austria-Hungary, including Ukraine. The Austrian occupation zone included parts of central and southern Ukraine. Mises was assigned as the officer in charge of currency matters in this part of Ukraine, with his headquarters in Odessa.

An independent Ukraine had been declared in Kiev during this time, and as a result Mises prepared an outline of the institutional rules and procedures that should be followed by any Ukrainian central bank that might be established. All bank notes issued and outstanding should be at all times “covered” by gold or foreign exchange redeemable in gold equal to one-third of the bank's liabilities. Bank assets in the form of secure, short-term loans should back the remaining two-thirds of the notes in circulation. Mises admitted that there might be particular institutional and historical circumstances that would have to be
taken into consideration in setting the conditions under which certain types of borrowers might have access to the lending facilities of the Ukrainian central bank. But what was crucial for Ukraine to have a sound monetary system were ample reserves for redemption of bank notes on demand and limits on the term-structure of the loans made by the bank.\(^{15}\)

But Mises’s monetary policy concerns became acute in the immediate aftermath of the end of the First World War. As the war closed the Austro-Hungarian Empire began to fall apart with the declared independence of a new Czechoslovakia and Hungary, and a Serbian-lead Yugoslavia.

With the end of the war, Mises returned to his position with the Vienna Chamber of Commerce. And he was shortly to take on responsibility for the Austrian Section of the League of Nations Reparations Commission. His written contributions during the next year and a half seem almost Herculean, considering that he was working far more than a nine-to-five day. His two most well-known works from this period are Nation, State and Economy and his essay on “Economic Calculation in the Socialist Commonwealth.” People who knew Mises at this time suggested that there was, also, the possibility that he might have been called to serve as Austrian Finance Minister.\(^{16}\) But he was not. Instead, through most of 1919, the Austrian Minister of Finance was Joseph A. Schumpeter.

But, nonetheless, he formulated several possible monetary policies during the first half of 1919, meant to deal with the onrush of events during those uncertain months. In three fairly lengthy papers he dealt with three distinct but interrelated questions. How shall a previously unified monetary system be separated into different national currencies? How might the private banking sector create a transition to a new currency after government mismanagement of the monetary system will have brought about a sudden inflationary collapse of the currency? And, how might two separate national currency systems be unified or reunified into a single monetary regime?

The first monetary crisis in early 1919 was the disintegration of the unified monetary system of the now collapsed Austro-Hungarian Empire. The newly independent successor states had started embossing official stamps on Austro-Hungarian bank notes on their territories, declaring that only these would be considered legal tender within their respective nation-states.

In April 1919, shortly before the Austrian delegation left for France to be given the formal terms for peace from the Allied Powers, Mises prepared a paper titled “The Austrian


\(^{16}\) F. A. Hayek, “Ludwig von Mises (1881–1973)” in Peter G. Klein, ed., The Collected Works of EA. Hayek, Vol. 4: “The Fortunes of Liberalism,” (Chicago: University of Chicago Press, 1992), pp. 132–33: “There was a time then when we thought he would soon be called to take charge of the finances of the country. He was so clearly the only man capable of stopping inflation and much damage might have been prevented if he had been put in charge. It was not to be.”
Currency Problem Prior to the Peace Conference,”¹⁷ in his role as the senior economist responsible for financial matters relating to foreign affairs at the Chamber of Commerce. He outlined alternative possibilities that might be followed in establishing a new monetary order in the wake of the collapse of the Austro-Hungarian Empire and its unified currency system. He discussed the possibilities of maintaining a common single currency area with a single central bank, or a monetary union with independent central banks, or completely independent national currencies issued and managed by separate central banks.

Mises assumed that none of the successor states would opt for the first alternative. So, whether the successor states were to finally adopt a monetary union of national central banks or national central banks each making independent monetary policies, the matter concerned how all the people presently holding notes issued by the Austro-Hungarian National Bank would convert them into units of the respective new national currencies. He suggested that those residing in the respective successor states should have the freedom of converting their old notes into either the national currency of the new country in which they resided or into the currency of any other of the successor states as they found most convenient and useful. The same free choice of currency conversion should apply to those holding quantities of the old notes in countries outside the territory of the former Empire, as well.

The additional problem to which the currency conversion would be tied, Mises said, was the distribution of the Austro-Hungarian prewar and wartime debt among the successor states. He offered a detailed formula of how the distribution of this debt and the conversion of the old notes into new currencies might be reasonably balanced without an undue financial burden on any one of the new countries.¹⁸

But in the spring of 1919, a far greater problem confronted the new Austria: the danger of runaway or hyperinflation. With state spending seemingly out of control because of the welfare-redistributive programs introduced by the Social Democratic and Christian Social coalition government, and especially the cost of subsidized food for the urban populations, the monetary system seemed headed for collapse. In the first half of 1919, the Austrian money supply increased from 831.6 million crowns in March to 8.3 billion crowns in July. The note issue reached 12 billion crowns by December 1919. In a paper marked “confidential” that he prepared in May 1919 for the bankers and businessmen connected with


¹⁸ The peace treaties divided the Austro-Hungarian prewar debts into two categories, secured and unsecured. Secured debts, e.g., railroads against which the property had been secured for the loan, were charged to the county in whose territory the property was now located. If the property was located across more than one of the successor states, each country was responsible for the portion of the debt corresponding to the amount of the secured property under its jurisdiction. Unsecured debt was distributed among the successor states on the basis of the fraction of the tax revenue its territory had supplied to the Austro-Hungarian monarchy. For a more detailed summary of the debt allocation process following the signing of the peace treaties, see Leo Paslovsky, Economic Nationalism of the Danubian States (New York: Macmillan, 1928), pp. 42–47.
the Chamber, Mises presented a proposal “On the Actions to be Taken in the Face of Progressive Currency Depreciation.” He was cautious to say that it was neither certain nor inevitable that a currency collapse had to occur. But if it did, Austria, and particularly Vienna with its large urban population, could be faced with social disintegration, food riots, and mass destruction and theft of property as the value of the medium of exchange fell to zero.

If the currency were to suffer a rapid collapse, the government would have lost all legitimacy and trust in relation to monetary matters. It would fall on the shoulders of the private sector—banks and businesses—to devise the mechanism to bridge the gap between any such dramatic and rapid collapse of the old currency and the spontaneous shift to the use of alternative monies by the citizens of the society.

Why did the private sector have to prepare for such a contingency? Because, Mises said, “We can hardly expect the government to be of any help.” For five years they had done nothing but follow “a disastrous inflationary course.” Therefore, he stated, “It is up to us citizens to try to do on our own what the government is failing to do for us. All we can hope from the government is that it will not stymie the endeavors of its private citizens. In their own interest and in the interest of the community, the banks as well as large industrial and commercial enterprises must take the necessary preparatory steps to avert the catastrophic consequences that will follow from the collapse of the currency.”

Mises presented a plan to these elements in the private sector to use export revenues and sales of assets to accumulate cash reserves of small denomination units of Swiss money to use as the temporary emergency medium of exchange. He estimated that the amount needed for the purpose was approximately 30 million Swiss francs. There were approximately 1.5 million employees who were neither self-employed nor working in the agriculture or timber sectors of the economy. Assuming that the average monthly income was 1,500 crowns, the total monthly income to be covered would be 2,250 million crowns. At the going exchange rate that came to 22.5 million Swiss francs. Assuming a need for an additional 150 million for government monthly subsistence, unemployment and pension incomes, that added another 1.5 million Swiss francs. To meet any unplanned contingencies, Mises suggested adding an extra 25 percent, to be on the safe side, for a total of 30 million Swiss francs.

The money would be used to pay salaries and pensions and to loan to the government and other employers in the market so that the population would have access to a medium of exchange in which they could have confidence. This would be necessary only until normal export sales and capital transfers supplied the required quantities of gold or foreign currencies to use as the permanent substitute monies in a post-inflationary Austrian economy.

These were “expedients for the moment of the collapse,” Mises explained. Because, “As soon as government interference in the monetary system is eliminated by the collapse of the

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currency, free market forces will automatically come into play that will supply the economy with the exact amount of money it needs. Sales to other countries will build up at that moment, and will attract the requisite money into the country.” Goods might have to be sold at very low prices on the world market, “but that is the inescapable consequence of the disastrous currency policy that will have been pursued earlier.”

He also explained the process by which private banks could form an informal consortium to jointly cover the costs and clearings of providing alternative small-note private currencies. “The collapse of the currency will almost certainly have so thoroughly undermined general confidence in the state’s monetary system,” Mises suggested, “that it will take some length of time before the public will again be willing to use any form of money issued by the state.”

While Mises alluded to the possibility of a private monetary order without a central bank in the wake of a currency collapse, realistically central banking was and would remain the prevailing monetary regime. The question then arose as to whether the new Austria should have its own independent central bank and national currency or instead should be integrated into a common currency area with the new postwar Germany. Indeed, Mises stated, “It is beyond doubt that some day we will carry through a political union with Germany. It is perfectly clear that at such a time the fusion of the Austrian and the German currency systems will take place.” But he also said, “We must remember that the time of such a currency merger is especially critical,” for various political and international reasons.

When Austria was declared to be a republic in November 1918, the second article of the document stated, “German-Austria is an integral part of the German Republic.” Both inside Austria and among the Allied Powers, there was a strong opinion that an independent Austria as it had been constituted with the break-up of the Austro-Hungarian Empire was not viable as a separate political entity.

When he looked back at this period immediately after the First World War in his Notes and Recollections, written in 1940, Mises said that on the issue of Austrian unification with Germany, “The situation [of Austria’s apparently paralyzed political and economic situation at this time] sometimes made me vacillate in my position on the annexation program. I was not blind regarding the danger to Austrian culture in a union with the German Reich. But there were moments in which I asked myself whether the annexation was not a lesser evil than the continuation of a policy that inescapably had to lead to catastrophe.” Yet in certain passages in essays written in 1919 it is clear that at the time Mises was persuaded that unification with Germany was a “political and moral necessity.”

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21 Ibid., pp. 63–64.
22 Ibid., p. 60.
23 Ibid., p. 61.
24 Mises, Notes and Recollections, p. 87.
25 Ebeling, ed. Selected Writings of Ludwig von Mises, Vol. 2: Between the Two World Wars: Monetary Disorder, Interventionism, Socialism, and the Great Depression, Ch. 9: “Vienna’s Political Relationship with the Provinces
In 1919, he said that Germany was in the throes of its own inflationary disaster. This made it wiser at this moment to devise a way for Austria to find its own way out of the monetary collapse that might be in front of it. “We are not abandoning the idea of a Greater Germany when we envision a currency merger as a means to a joint ascension rather than a means to a joint decline.” If Austria solved its monetary problem it would be offering to Germany “an example for the proper conduct in critical times like these.”26

In spite of the fact that in the Treaty of St. Germain, which was presented by the Allied Powers to the Austrian delegation in France in June 1919, it was stated directly that Austria was barred from unification with the new German Republic, the sentiment for Anschluss persisted. At the end of June 1919, Mises finished a lengthy paper on the very theme of “The Reentry of German Austria into the German Reich and the Currency Question.”27

Political unification of Austria with Germany necessarily would mean monetary unification, as well. If the two countries were respectively on the gold standard, the unification would be relatively simple; but the dilemma, Mises pointed out, was that both countries were on paper currencies. No successful unification would be possible until Austria and Germany had abandoned inflationary methods of financing their government expenditures. But this, in turn, would require a coordination of fiscal policies, and in Mises’s view this meant a subordination of Austrian financial policy to that of Germany’s. “This agreement can hardly be conceived as determining anything but a settlement under which Germany assumes over German Austria all those powers of expenditure and revenue that she has in the other federal [German] states,” including the conversion of Austrian debt into the national debt of Germany.28 Independent budgetary policies, including deficit spending during the period leading up to conversion of the currencies, could only create pressures for inflationary policies or continuing accumulations of debt that would only forestall the unification process.

Another central reason for the ending of inflationary policies in both countries leading up to unification, Mises argued, was that monetary expansions were non-neutral and took time to work their full effect through the structure of prices.29 For the market to settle upon a rate of exchange for purposes of the currency conversion between the Austrian crown and the German mark, which would more or less reflect their equilibrium purchasing power parities, there needed to be a period during which the inflationary influences would have worked their final effects on the respective price systems in Austria and Germany.

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27 Ebeling, ed. Selected Writings of Ludwig von Mises, Vol. 2: Between the Two World Wars: Monetary Disorder, Interventionism, Socialism, and the Great Depression, Ch. 6: “The Reentry of German-Austria into the German Reich and the Currency Question” [1919], pp. 65–86.
28 Ibid., p. 74.
29 Ibid., pp. 75–76.
For the transition to a common currency, Mises suggested the German mark could first be introduced as a “core” or reserve currency in Austria, with a specified ratio of exchange at which the Austrian bank would be obliged to redeem Austrian notes for German marks, and vice versa. Increases and decreases in the number of units of Austrian currency in circulation would be dependent upon deposits or withdrawals of marks from the Austrian banking system. The Austrian National Bank would no longer be an independent authority that determined the quantity of money in the country (similar to the idea behind a currency board). Final unification would then come through the German central bank redeeming all Austrian bank notes for marks at a specified ratio of conversion, after which there would be only one monetary system and one currency in use in both countries.

But no great advantage would accrue from monetary unification for either Austria or Germany unless it was permanently joined by a renunciation of inflationary monetary policies. “The positive effects of having overcome the pernicious effects of monetary ‘particularism,’” Mises concluded, “will not be enjoyed by the entire German people unless in matters of currency policy they will have taken a stance in favor of renouncing any inflationary measures.”

### 7. AUSTRIAN ECONOMIC POLICY AND THE GREAT DEPRESSION

As it was, the Allied Powers prevented any attempt at either a monetary or political unification of the new Republics of Germany and German-Austria. Throughout the 1920s, Mises turned his policy attentions to trying to limit the government spending and taxing. In monetary affairs, Mises assisted in writing the bylaws on the basis of which the Austrian Republic reestablished a monetary system based on the gold-exchange standard.

In late 1928, for example, in an essay on “The Currency and Finances of the Federal State of Austria,” he happily pointed out that Austria’s monetary situation had been successfully stabilized with the country’s return to a form of the gold standard. But in fiscal affairs the Austrian government continued to tax too heavily and spend too freely. Budget deficits continued to plague the government’s finances, but this was primarily due to the inefficiency and costliness of two nationalized industries: the forestry sector of the economy and the national railway system. If these could be privatized and put into competent private business hands, not only would these two areas of the Austrian economy be potentially run for a profit, but also the government’s overall budget would be in balance, if not even a surplus.

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30 Ibid., pp. 78–82.
31 Ibid., p.86.
When the Great Depression began in the early 1930s, Mises turned his attention to demonstrating that it was various government interventions and monetary mismanagement that had generated the earlier unsustainable boom that finally collapsed and created the downturn. He fought against the political irrationality of foreign exchange controls that were put into affect following the panic runs on the Austrian banking system in 1931. He also opposed the proposals for alleviating the Depression through reflationary policies and currency devaluation. All too little avail, unfortunately.

But in this context it is worth pointing out that Mises emphasized that to the extent that such reflationary and devaluation policies pushed prices up from the lower levels that normal market recovery would have established, any monetary deflationary policy to bring prices down again would be unjustifiable. Any intentional price deflationary policy would be a wrenching process resulting in “a sharp reduction in prices, along with a period of severe adjustment.” Or as Mises expressed it several years later that proponents of proposals for monetary deflation to counteract a prior monetary inflation “do not realize that by this procedure they do not undo the social consequences of the first change [the earlier monetary inflation], but simply add to it the social consequences of a new change [a monetary contraction]. If a man has been hurt by being run over by an automobile, it is not remedy to let the car go back over him in the opposite direction.”

8. CONCLUSION

I have summarized and analyzed many of Mises’s policy views and prescriptions during this period from before the First World War through the interwar period of the 1920s and 1930s, and into the years of the Second World War in several of the chapters in my book, *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition* (Routledge, 2010).

In earning a living at the Vienna Chamber of Commerce in the Austria of his time, Mises could not simply propose and advocate a desired vision of what he considered to be the free
and prosperous classical-liberal society of tomorrow. Given the ideologies and politics guiding, and the economic policies being implemented by, the Austrian government in the first four decades of the 20th century, Mises had to articulate detailed and specific alternative policy prescriptions that he surely first had to win support for within the Vienna Chamber of Commerce, and then make the case for in the wider arena of Austrian public opinion and policy decision making.

Even as that uncompromising and principled proponent of individual liberty and the free market, Mises was called upon in his role as policy analyst and advocate to sometimes devise “second-” and “third-best” policy proposals in an imperfect world dominated by collectivist and interventionist ideas and practices.

Separate from the “pros” and “cons” of each of the actual and specific monetary, fiscal, and regulatory policy changes and reforms that he presented during those years, what stands out most clearly is the guiding idea that implicitly runs through all of them. This guiding idea was Mises’s attempt to think about and construct them in a way that if implemented and successful would move the society away from the abyss of socialist and interventionist destruction, and back in the direction of a freer and a more prosperous classical-liberal society.

That Mises was not able to fully succeed in his attempts to do this in the Austria of his time was not his fault. As he explains in his *Memories*, written shortly after he arrived in the United States, he tried to be the liberal “conscience” of his country. He did help to prevent Austria moving in a totally socialist direction in the years immediately after the First World War, and he did assist in ending Austria’s Great Inflation in 1922–1923. But the tide of nationalist, socialist, and racist collectivism was too powerful in those years to reverse its course. As Mises mournfully says in his *Memories*, the final destroyer of interwar Austria came from outside in the form of the Nazi annexation of the country into Hitler’s Greater German Reich in March of 1938.

So what can we learn from Mises’s extensive and detailed policy analyses on a wide variety of issues from those earlier decades of the 20th century? I would suggest that, first of all, we gain an insight into the interaction between “theory” and “practice” at work in the mind of Ludwig von Mises. We can get a better understanding of how theory guided him to in thinking about and devising policy proposals, and how the practical policy affairs of everyday Austrian life during this time clearly challenged Mises’s own thinking about the nature and working of the market order and the effects when the state throws sand in the machine through its various forms of interventionism and government planning.

And, second of all, for those who have sometimes asked, “Well, but how do you apply Austrian Economics to the ‘real world’ of public policy?” here is the answer by the

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38 Ibid., p. 75.
economist who has been considered the most original, thoroughgoing, and uncompromising member of the Austrian School over the last one hundred years! His policy analyses provide us with warning signs and guideposts to assist us in thinking about and designing better policies for our own time.

Friedrich A. Hayek once remarked, when looking back at the events in Austria and Ludwig von Mises’s place in the decades before the Second World War, “That they had one of the great thinkers in their midst the Viennese have never understood.” Mises’s body of writings – on theory and policy – from this period enables us to appreciate what the Austrians, to their great misfortune, did not.

LUDWIG VON MISES AND LIBERTARIAN ORGANISATIONS: STRATEGIC LESSONS

J.G. HÜLSMANN

ABSTRACT

The most important vehicle through which Ludwig von Mises spread his ideas was his writings. But his impact was also leveraged through personal association with like-minded people in various private networks and organizations. The present paper highlights the more general significance of Mises’ personal experience, by putting it into a wider historical context. We argue that it was no accident that his influence was amplified through private rather than public organizations. The emergence of influential libertarian organizations such as the Foundation for Economic Education and the Mont Pèlerin Society can be interpreted as a belated “free-market” reaction to increased government control of economic science during the previous seventy years. Just as libertarian scholarship in the 19th century was most successful because it relied on private initiatives and private organizations, the new organizations that came into their day after WW II were successful for exactly the same reason. The implication is that the best way to promote libertarian scholarship (and possibly the only way to preserve it) is to embed it within a purely private institutional framework.

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1. INTRODUCTION

Ludwig von Mises was involved, at three different junctures of his life, in libertarian organisations: in the 1920s, he was a member of various free-trade organisations; in 1938, he was a prominent participant of the Walter Lippmann Colloquium in Paris; and after World war II, he cooperated with Leonard Read’s Foundation for Economic Education, with Frederick Nymyer’s Libertarian Press, and became a founding member of the Mont Pèlerin Society. In order to put his interaction with these organisations into historical context, we will start off by considering briefly how libertarian scholarship tended to be organised in the 19th century. Then we will turn to the 20th century case of Ludwig von Mises, first characterising his general contributions to libertarian scholarship and then discussing his involvement in the aforementioned organisations. We will conclude by highlighting the historical continuity between Mises and the 19th century champions of laissez-faire.

2. ORGANISATION OF LIBERTARIAN SCHOLARSHIP IN THE 19TH CENTURY

The political history of Western civilisation is to a large extent the history of the battle between the champions of government power – the court intellectuals – and the advocates of liberty.

For most of Western history, the front lines in this battle had nothing to do with economics. The case for liberty was made in terms of divine providence ordaining ethics and justice for man. In the 16th century, then, the conviction that there were unshakable theological criteria for the arbitration of political conflicts crumbled under the impact of the protestant insurrections. Henceforth, the debate was increasingly secularised and cast in terms of natural prudence. One brainchild of this approach was the new science of political economy, which emerged in the 18th century and provided the scientific underpinning of political liberalism.

Classical liberalism in its heyday featured a great number of innovative economists who continued and amplified the writings of the French physiocrats and of Adam Smith and David Ricardo. Their writings inspired an international classical-liberal movement led by men such as Cobden and Bright in England, Bastiat in France, and Prince-Smith in Germany. By the 1860s, this movement had swept the United States and all Western European countries including Germany. The practical nub of their insights was that the material conditions of mankind could only be improved through production and exchange, and anything that stood in the way of production and exchange was liable to be abolished without harm for society. Government was therefore justifiable only insofar as it provided services that

free associations of private individuals could not provide. According to Adam Smith and many others, it had to provide police and military services, roads, bridges, and seaways, as well as a whole bundle of what would later be called public goods. According to the early 19th century French school of the industrialistes (Ch. Comte, Ch. Dunoyer, and others), government’s only role was to provide security services. They expected this role to diminish constantly as a consequence of the increase of human culture; the utopian future of Western civilisation lay in a society without government. The most radical thinkers among the classical liberals saw no rationale for government at all. In their eyes, the production of security could be entrusted to private enterprise just as all other branches of production. In the famous words of Gustave de Molinari: “Either this is logical and true, or else the principles on which economic science is based are invalid.”

In short, the classical-liberal agenda aimed at a more or less dramatic reduction of the role of government, and by the 1850s this agenda had become open-ended. The most courageous thinkers – men like Molinari, Spencer, Stirner, and Puydt – had even won respect for the intellectual enterprise of thinking about a society without state.

The classical-liberal economists were by and large barred from entrance to the traditional public institutions of higher learning, which cultivated old-style reasoning on political issues under government control. This was no great disadvantage in those days, because there were few publicly employed economists anyway. The competition of economic theories and policy proposals took place in a truly free market for ideas. Its protagonists were men of independent wealth; they did not have to bow before the powers that be. To spread their new science, they built up a number of small-scale institutions ranging from loose networks of personal and literary contacts, newspapers and scholarly journals to more or less tightly organised political campaigns and free-trade associations.

The free market for ideas was decisive for the sweeping victory that the classical liberals achieved by the mid-1800s. By the 1860s, the political and intellectual establishment in all Western countries perceived the liberal breakthrough as a mortal threat to their position and rightly so. The old-regime governments now set out for a strategic response based on two pillars: on the one hand, an anti-liberal coalition between the conservative establishment and the young socialist movement; on the other hand, creation of a market for professional economists with the purpose of controlling the market for ideas. Governments started creating a great number of professorships of political economy at their universities.

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44 For example, the Censeur européen (1820s and 1830s, run by Dunoyer, Comte, and Tierry), English Anti-Corn League (founded in 1838), Libre échange (founded by Bastiat in 1844), Kongress deutscher Volkswirte (founded in 1863).

45 On the important German case, which provided the model for similar strategies in other countries, see Ralph Raico, *Die Partei der Freiheit* (Stuttgart: Lucius & Lucius, 1999).
and to fill the majority of these new positions with convinced statists. They had speculated that the venerable authority of the universities would outweigh the authority of the pioneers of the new science. This proved to be correct. The very meaning of economic science - its nature and significance, and its political implications - came to be redefined under the impact of a government-enacted, large-scale hiring process.

Entire schools of economics came into being, the “national” character of which was determined by those in control of the nominations. The strategy was first applied in Germany, where the authorities substituted the Historical School, under the tight control of Gustav Schmoller, for economic science in virtually all universities of the Reich. And from there it spread to other countries. In France, the authorities of the Third Republic “ensconced a rival school in newly created and highly prestigious university chairs throughout France, professionalising French economics and stripping the mainly non-academic liberal school of its unrivalled intellectual authority.” In the United States, the new American Economic Association, founded in 1885 by German-trained economists, went down the road of Schmollerism too. In Russia, the authorities apparently felt Schmollerism was too tame and started hiring Marxist professors for its chairs of political economy, thus digging the grave of the Czarist regime.

A few years earlier, a more subtle, but equally terrible attack on classical liberalism was launched in Britain. The initial impetus came from John Stuart Mill, who under the influence of his socialist wife started practising the lethal art of intellectual compromise. He made it intellectually palatable to use the word “liberalism” for the designation of political programmes of the purest social-democratic sort. The absurd high point of the Millian wave was reached in 1934, when University of Chicago economist Henry C. Simons circulated a manuscript with the promising title “Positive Program for Laissez-Faire” in which he called for the nationalisation of enterprises that could not withstand market competition.

48 On the US case see Salerno (2001: 25). Among the more prominent US economists who received their graduate education in Germany were Sumner, Taussig, Fetter, Ely, Seligman, and J.B. Clark. On the role of the American Economic Association, which was set up in 1885 after the model of Schmoller’s Verein für Socialpolitik, see the comments by Richard Hofstadter, *Social Darwinism in American Thought*, in particular p. 147; Samuel Rezneck, “An American Depression, 1882-1886,” *American Historical Review*, January 1956, p. 294.
50 This redefinition went virtually unnoticed until Ludwig von Mises restated the classical liberal case in the late 1920s. Mises called Mill “the great advocate of socialism. All the arguments that could be advanced in favour of socialism are elaborated by him with loving care. In comparison with Mill all other socialist writers - even Marx, Engels, and Lassalle - are scarcely of any importance.” Mises, *Liberalism*, p. 195. Keynes concurred: “From the time of John Stuart Mill, economists of authority have been in strong reaction against all such ideas [individualism and laissez-faire].” J.M. Keynes, *The End of Laissez-Faire*, pp. 25f.
The redefinition of political economy by the power of sheer numbers and taxation, along with Mill’s authoritative redefinition of classical liberalism, combined into a mighty one-two punch that completely reversed political ideals and the political agenda. Whereas in the classical-liberal era, the tacit goal of political reform had been the reduction of government power, now it was the opposite. The new ideal was no longer a society that had emancipated itself from government intervention, but an all-encompassing government ruling a socialist society of its own design. There were a few classical liberals left, men such as Gustave de Molinari, Vilfredo Pareto, Julius Wolf, Ludwig Pohle, and Edwin Cannan. But they fought a rear-guard action against an overwhelming crowd of government-hired intellectuals worshiping their employer. The new socialist-statist ideal had swept the minds and monopolised the imagination of the rising generation. At the end of World War One, the classical liberalism movement was all but dead.

3. THE INTELLECTUAL SIGNIFICANCE OF MISESIAN LIBERTARIANISM

Then came Mises, and within three glorious years, he set out on a monumental backlash against statolatry. He burst on the scene with his 1920 article on the impossibility of economic calculation in a socialist commonwealth. His simple and elegant argument was devastating. After all, the case for socialism relied on its alleged higher productivity. But how could it be more productive than capitalism if the socialist planning board lacked the very terms in which to state the investment alternatives? Two years later, Mises published Socialism, an entire treatise on all relevant aspects of socialism. He elaborated on his thesis of the impossibility of socialist calculation, demolished the idea that there was something like an ineluctable tendency toward socialism, criticised the moral case for socialism, and then very effectively uncovered that destruction of individual lives and social institutions was the true nature of socialism. At the end of the book, nothing was left of the formidable ideal of the socialist state. As one admirer later put it, Mises had proven to be a modern version of St George, running his spear into a seemingly invincible dragon. In 1922, the monster was dead; the unquestioned ideal of the socialist commonwealth had been demolished forever.

But Mises did more than this. Five years later, in his book Liberalismus, he defended a radicalised version of classical liberalism, which in his pen resuscitated like a phoenix from the ashes. Two years later, in 1929, Mises closed his system of social analysis by dealing with the case for the “third way” – variants of which have plagued Western civilisation until the present day, most recently in the form of Blairism. In these works, Mises not only

unabashedly defended the central tenets of the Manchester School, which had by then fallen into general disrepute, but even topped them. He showed that any third-way system was inherently unstable because it could not solve the problems it purported to solve, and thus motivated ever more government intervention until the interventionist system had been transformed into outright socialism. Yet socialism was not viable. There remained only one meaningful item on the political menu: 100% capitalism.

Again and again, Mises insisted that there was no choice at all involved in this matter. It was ludicrous to speculate about some particular third way policy that would fit the sensibilities of a given society. Society was viable only to the extent that private property rights were respected, and that was it.

4. MISES’S INVOLVEMENT IN EUROPEAN FREE-TRADE MOVEMENTS

Throughout the 1920s and the early 1930s, Mises had been the representative of the Austrian Chamber of Commerce at international meetings, and in particular at the conventions of the International Chamber of Commerce (ICC). This experience proved to be satisfying and brought him in touch with a network of like-minded foreigners. He eventually consented to a – short-lived – participation in certain European organizations dedicated to the promotion of free trade.

He had been very reluctant to become involved in any organized political campaign. In a November 1924 letter, he declined an honorary executive position in an Austrian free-trade association, stating that as a matter of principle, he did not wish to adhere to any political or economic-political organization.52 This attitude changed during 1925, when he attended and enjoyed his first ICC congress, in Brussels, as an official Austrian representative. In the fall of the same year, he attended a conference of the International Free Trade Organisation in Vienna and again enjoyed the speeches delivered there.53 Due to such positive experiences, he eventually became involved more formally with other European free traders.

The Atlantic was in those days still too much of an obstacle for closer cooperation between Europeans and Americans. But it was not the only obstacle. Mises and several of his correspondents sensed hypocrisy on the side of certain American participants to the meetings of the ICC and other institutions. Before he left for his first ICC congress in June 1925


in Brussels, Mises shared these apprehensions with Eric Voegelin, who resided in the U.S. as a Rockefeller Fellow. Mises wrote that he expected to meet many men from overseas, but did not know “which sort of” Americans he was going to meet. Time would confirm this judgement rather than dispel it. In 1927, after attending the World Economic Conference of the League of Nations in Geneva (May) and the ICC meeting in Stockholm (July), he wrote to his friend Steiner in Paris:

This time the congress was not as interesting as the one in Brussels. The talks laboured visibly under the fatigue and exhaustion that remained after the World Economic Conference. The Americans have lost much of their enthusiasm for European free trade ever since they fear that the free-trade movement could spill over to the United States.

Steiner was not surprised, replying that he too could relate endless anecdotes on the topic “the Americans at home and abroad” or “preaching water and drinking wine.”

Nevertheless, Mises then became more formally involved with free trade organisations. In May 1927, he joined the press committee of Christian Günther’s Europäische Wirtschafts-Union (EWU), a journal based in Den Haag. Günther headed the Dutch committee of a European free trade organisation by the name of Europäischer Zoll-Verein (EZV). Over the next two years or so, other national committees would be set up and by 1929 the EZV counted many prominent politicians and academics among its members, for example, Aristide Briand, Paul Mantoux, Gustav Stresemann, Franz Oppenheimer, and Norman Angell.

Given the strong involvement of some of these men in party politics, it could hardly be surprising that the EZV came to pursue rather moderate goals, such as the harmonisation of tariffs within Europe. In early 1928, however, this toothlessness was barely visible. Thus when the International Committee of the EZV asked Mises to join its ranks and also to

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55 “Der Kongreß war diesmal nicht so interessant wie der in Brüssel. Die Verhandlungen standen sichtlich unter dem Eindruck der Ermüdung und Abspannung, die die Weltwirtschaftskonferenz hinterlassen hat. Die Amerikaner haben viel von ihrem Elan für europäischen Freihandel eingebüßt, seit sie fürchten, daß die Freihandelbewegung auch nach den Vereinigten Staaten übergreifen könnte.” Mises to Steiner, letter dated 11 July 1927; Mises Archive 62: 30. Mises here refers to the May 1927 World Economic Conference of the League of Nations, which was held in Geneva. Fritz Georg Steiner was the author of Die Entwicklung des Mobilbankwesens in Oesterreich (Vienna: Konegen/Studien zur Sozial-, Wirtschafts- und Verwaltungsgeschichte, 1913); Die Banken und der Wiederaufbau der Volkswirtschaft (Vienna: Manz, 1920); and Geldmarkt und Wirtschaftskrise (Vienna: Manz, 1925). During World-War II, he moved to New York City and was in touch with Mises until the early 1960s.


57 See Mises to Europäische Wirtschafts-Union, letter dated 19 May 1927; Mises Archive 86: 3
set up an Austrian committee, he accepted. It took not much more than a year for him to become thoroughly disenchanted with this decision.

The people from the EZV wanted Mises to be the president of the Austrian committee, but he proposed another man for this position, whom he had known both through Kammer business and privately for many years. Dr Ernst Geiringer was an executive of the Oelindustrie-Gesellschaft in Vienna and married to Trude Geiringer, whom Mises had met in World War I. By May 1928, the two men had found a suitable secretary in a Dr Breza, also from the Kammer. They now turned to fundraising and eventually won the support of influential businessmen from Germany and Austria by September of that year.

At that point, Mises must have had a somewhat clearer picture of the mentality of his new international associates. He had seen nepotism and other forms of dedication to purely personal goals that came at the expense of the cause of liberty. In July, he had withdrawn from the press committee of the EWU when Günther disassociated himself from EZV. Mises explained his decision by stating that he dreaded the proliferation of free-trade organisations. In fact, at a European free-trade congress that was held in Prague in early October 1928, no less than seventeen associations were present. It is possible that at this point already Mises had no more desire to invest his time parading in a circus of egomaniacs, and that he just waited for a convenient opportunity to take his leave.

The opportunity came after a few months, when members of the International Committee as well as members of the French committee campaigned against Austria’s adhesion to the German Reich (Anschluß question). Mises urged the International Committee to publicly step back from this position, lest the EZV could find no support in Austria. What this meant in particular was that neither he nor his Austrian associates could afford to be associated with either side of this highly partisan dispute – they were after all executives of semi-governmental organisations. When the EUV did not withdraw from its campaign, Mises and Geiringer left the organisation in February 1929.

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58 On Geiringer’s affiliation to Oelindustrie, see Mises Archive 89:12. Trude Geiringer later wrote that ever since she had first met Mises, she had felt to be a “war profiteer” because their friendship started in World War I. Her husband too felt great respect for Mises and liked to call him a sage. The Geiringer’s later emigrated to New Rochelle, NY and often met the Mises and the Schüllers. See the correspondence in Groven City Archive: Geiringer file. Was Richard von Mises’s wife (a Geiringer) related to this family?
59 See Mises to Ernő Bleier, letters dated 10 September 1928 and 22 September 1928; Mises Archive: 87: 15, 23.
60 He also implied that his name had been unacceptably associated, through EWU, with certain organisations and persons like the Austrian social-democrat MP, Emmy Freundlich. See Mises to Günther, letter dated 7 July 1928; Mises Archive 86: 21.
61 See the list in Mises Archive 87: 18.
62 See Mises to Ernő Bleier, letter dated 14 December 1928; Mises Archive 87: 57.
63 Geiringer wrote that it would be impossible for him to reconcile any form of opposition against a possible Anschluß “mit meinen Stellungen in den verschiedenen hiesigen Organisationen und Verbänden.” Geiringer to Bleier, letter dated 22 February 1929; Mises Archive 89: 7. Mises made a similar declaration; see Mises Archive 89: 4.
This was the end of Mises’s interlude with the organised free trade movement. He now concentrated again more on the battle of ideas.

5. MISES AND THE NEO-LIBERALS

The disagreement on the question of socialist calculation was but a symptom of a larger dissent emerging between Mises and his erstwhile comrades-in-arms.

Not only did Mises unabashedly defend the central tenets of the Manchester School, which had by then fallen into general disrepute, he went beyond them. He showed that any third-way system was inherently unstable because it could not solve the problems it purported to solve, and thus motivated ever more government intervention until the interventionist system had been transformed into outright socialism. But socialism was not viable. There remained only one meaningful option: 100% capitalism. Again and again, Mises insisted that there was no choice in this matter. It was ludicrous to speculate about some particular third-way policy that would fit the sensibilities of a given group. Society was viable only to the extent that private property rights were respected, and that was that.

This message resonated well with the old liberals, who marvelled at such a splendid restatement of the ideals of their youth. But Mises’s views were received less wholeheartedly by the rising generation, which had been raised in an intellectual environment soaked in statism. Their school teachers and university professors had come to endorse all the main ideas behind the case for socialism: the doctrine of class conflict and class struggle, the notion of the immiseration of the working classes under capitalism, and the belief that an unfettered capitalist system tended toward monopoly.

On the positive side, Mises had definitely dethroned full-blown socialism as a policy ideal. The energies of Hayek, Machlup, Haberler, Robbins, Perroux, and Röpke – men who would play a significant role in shaping post-World War II policies in the Western world – no longer served the idol of omnipotent government. This proved to be of decisive importance for the course of history. But Mises’s influence proved too weak to inspire in them the courage necessary for a wholehearted return to the kind of vibrant liberalism that had characterized the Manchester School and the worldwide laissez-faire movement of the nineteenth century.

Mises had not yet published the systematic treatise on economic science that would have clarified the scientific case for unfettered capitalism. He had presented some important elements of his general economic theory of social systems, but before 1940 it was not yet clear how these elements interrelated and on which general analytical framework they relied. In 1940, Mises finally published such a general treatise under the title of Nationalökonomie – Theorie des Handelns und Wirtschaftens. But by 1949, Hayek was forty-one years old and an established scholar; the book came too late for him, and it also came too late for the rest of his generation – for the Röpkes and Machlups and Robbinses and all the others Mises had steered away from socialism in the 1920s. In the minds of these men, Mises’s early work
on the impossibility of socialism and the ineffectiveness of interventionism had created a paradox. Mises had convinced them that full-blown socialism was neither feasible nor desirable; they were also persuaded that third-way systems were overrated. But many of them did not yet question the claim that nineteenth-century liberalism had failed because its economic program, laissez-faire capitalism, had not delivered the goods. They believed it to be a simple matter of fact that the unfettered free market tends toward monopoly, and that the nineteenth-century working classes had lived in misery because of laissez-faire capitalism.64

For these men, theory had disproved the viability of socialism, and history had proven the defects of capitalism. What was needed was a third way – a third way that could somehow get around Mises’s demonstration that interventionism was necessarily counterproductive. The solution that emerged in the 1930s was based on an intellectual construct that split the social economy into two elements: (1) an institutional framework, and (2) the processes that played themselves out within that framework – most notably the pricing process. According to this new creed, government should not meddle with the processes, but it did have to establish and maintain the institutional framework. This set of assumptions is characteristic of what has come to be called neo-liberalism.

We find a clear expression of the neo-liberal worldview in a paper Hayek wrote in 1935. Commenting on Mises’s theory of interventionism, Hayek observes that it did not follow from Mises’s argument that “the only form of capitalism which can be rationally advocated is that of complete laissez faire in the old sense.” He continued:

The recognition of the principle of private property does not by any means necessarily imply that the particular delimitation of the contents of this right as determined by the existing laws are the most appropriate. The question as to which is the most appropriate permanent framework which will secure the smoothest and most efficient working of competition is of the greatest importance and one which must be admitted has been sadly neglected by economists.65

The roots of the neo-liberal ideology went back at least to the 1880s and 1890s, when German economists of the Historical School and their American disciples became convinced that industrial concentration has harmful effects and required moderation through government intervention. One of the visible consequences of this mindset was the Sherman Act, which to the present day has replaced the power of consumers with that of bureaucrats. In Germany, the philosophy of the third way became pervasive in the Sozialpolitik insti-


gated under Kaiser Wilhelm. France followed, invoking the necessity of a tierce solution, as did the United States under the New Deal.

Still the first programmatic statements of neo-liberalism were published only in the 1930s – again, unsurprisingly, in Germany and the United States. The most influential statement came from Chicago economist Henry Simons, who in 1934 circulated a working paper with the title “A Positive Program for Laissez Faire” – in which the word “positive” indicated that this program justified ample government intervention, whereas classical laissez-faire was a “negative” program in that it did not provide such a justification. Simons called on government to regulate money and banking, prevent the formation of monopolies, and provide minimum income for the destitute – a departure indeed from laissez-faire liberalism.66

These ideas perfectly expressed the feelings of a generation of economists who had been raised in a thoroughly statist intellectual environment, but who still knew the teachings of the classical liberals. F.A. Hayek, Wilhelm Röpke, Fritz Machlup, Milton Friedman, Michael Polanyi, Walter Eucken, and many others received their university training and their decisive intellectual impulses during the 1920s and early 1930s. During the later 1930s they began to acquire more senior positions and would, after the war, assume intellectual leadership on the Right.67 Their neo-liberalism animated the work of the postwar institutions that would stem the tide of growing statism, in particular, the Mont Pèlerin Society and the Institute for Economic Affairs in London. In more recent years, the neo-liberal agenda is carried forward by a new wave of educational institutions, such as the Institute for Humane Studies, the Cato Institute, and the Atlas Research Foundation. These individuals and institutions have shaped neo-liberal policies in the Western world since the end of World War II.

6. THE WALTER LIPPMANN COLLOQUIUM

Seven weeks after getting married, Ludwig attended a historical meeting of the champions of both “old” Manchester-style liberalism and of neo-liberalism. Margit probably forgave him and even joined him on the trip. Small wonder, the conference took place in Paris.

Neo-liberalism was at first a purely informal phenomenon. Virtually all of its proponents were economists who cooperated in a spontaneous network within a few institutions such as the International Chamber of Commerce in Paris. By the mid 1930s, the network had reached the critical mass needed for a more formal organization under the banner of


67 Some of them, most notably Hayek, later turned toward a more laissez-faire stance. But this turn came at a time when the neo-liberal steamroller was already well underway.
the new third way. One important step toward the organized appearance of the emerging
neo-liberal network was made when, in 1937, the American journalist Walter Lippmann
published a neo-liberal manifesto with the title Inquiry into the Principles of the Good
Society.68

The book appealed to European neo-liberals because Lippmann gave eloquent expres-
sion to their own deeply held views about the roots of the present political and economic
crisis. Those who still called themselves liberals rejected socialism but did not want to be
too strongly associated with the Manchester doctrine of laissez-faire. Lippmann placed
himself in opposition both to the old liberals and to the contemporaneous socialist agita-
tors. Lippmann’s middle-of-the-road position suited the pragmatic mentality of his country-
men. Americans tended to take a businesslike approach to political conflicts, seeking to
solve them through negotiation and compromise. Lippmann shrewdly presented both the
socialists and the Manchestermen as stubborn doctrinaires. He contrasted these “extrem-
ists” with his own practical-minded scheme. This resonated with the neo-liberal continental
European economists of the interwar period, who differed from Lippmann only in the
details they envisioned for the Good Society.

One of these was Louis Rougier (1889–1982), a philosopher at the University of Paris
and director of a “Centre Danubien.” Rougier considered Lippmann’s book a brilliant ex-
position of a consensus that had emerged among liberal scholars in the recent past, most
notably in books by Mises, Robbins, Lavergne, Marlio and Rueff.69 He quickly arranged for
a French edition of the Good Society70 and seized the occasion to convene a five-day collo-
quium in Paris “with the idea of reviewing the process of capitalism and of trying to define
the doctrine, the conditions necessary for its implementation, and the new responsibilities
of a true liberalism.”71

The event took place on August 26–30, 1938 at the International Institute of Intellectual
Cooperation and it assembled representatives of very different liberalisms. These men fell
into at least four groups with distinctly different views on the history, theory, and political
agenda of modern liberalism.

The first group, which represented the mainstream of neo-liberalism, promoted not only
practical, but also theoretical compromise with coercive socialism. They were willing to
compromise on any particular item to make their general agenda more palatable to the
voter. Their position can be thought of as “pro-market” social democracy.

Second, there was a small group of men such as Hayek who were dissatisfied with vari-
ous aspects of classical liberalism and endorsed a somewhat larger scope for government
intervention. In contrast to the first group, however, their fundamental concern was with

70 Walter Lippmann, La Cité Libre (Paris: Librairie de Médicis, 1938).
71 Louis Rougier, “Préface.” He later emphasised that the purpose was to define neo-liberalism. See Louis Rougi-
individual freedom and in time they therefore took an increasingly radical stance, moving ever closer to the classical-liberal position.

Third, there was an equally small group of men such as Alexander Rüstow who were reluctant to endorse classical liberalism root and branch, but their main objection was to the egalitarianism, such as it was, of its advocates. They argued that hierarchy was absolutely necessary for the maintenance of a free society, because only the authority implied in it would effectively transmit the cultural tradition of liberty. The great error of the French Revolution was that it had not only abolished the coercive hierarchy of the Ancien Régime, but also jettisoned the principle of hierarchy per se. In its egalitarian fervour, it had tossed out the natural-hierarchy baby with the coercive-hierarchy bathwater.

Fourth, and finally, Ludwig von Mises upheld nineteenth-century laissez-faire policies on refined theoretical grounds that he himself had developed over the past eighteen years. By the 1930s, he was acknowledged both within and outside libertarian circles as the most important contemporary representative of the Manchester School.72

The Lippmann Colloquium showed that three of Mises’s insights had had a profound impact on the neo-liberals. First, his demonstration that socialist calculation was impossible had liberated them from all notions that a full-blown socialist commonwealth was feasible or even desirable on economic grounds. Second, the socialist-calculation argument had convinced them that competitive pricing is of utmost importance and a defining characteristic of the free market. Third, they endorsed Mises’s original case for liberalism, which stressed that a private-property order was the only feasible system for the division of labor.

The latter two insights, however, came to be twisted so as to fit the neo-liberal interventionist agenda. Whereas Mises had simply stated that a calculation-based division of labour could take place only where private property exists, the neo-liberals set out to manipulate the legal and judicial systems in order to “improve” on the spontaneous division of labour that would have resulted from political laissez-faire. For these men, the market was critically important, but they believed that government intervention could enhance the “efficiency” and “fairness” of the market process. Unlike socialists, neo-liberals believed that the market took society in the right direction, but unlike classical liberals, they believed that the unhampered market fell short of its true potential.

72 See the leftwing Eduard Heimann, History of Economic Doctrines: An Introduction to Economic Theory (New York: New York University Press, 1945), p. 19. The anonymous reviewer of the French edition of Gemeinwirtschaft presented the author as “the uncontested head of the School of Austrian Economists” (Review of Le Socialisme in Les Industries Mécaniques, Paris, June 1938). When Louis Baudin invited Mises to join the scientific committee of a new French journal of comparative economics in 1939, he told him that all political orientations would be represented in this committee, reason enough to have liberalism defended by masters such as Mises (see Baudin to Mises, letter dated May 18, 1939; Grove City Archive: Baudin file). The uniqueness of Mises’s role was still recognized some twenty years later by one of the last surviving students of the French laissez-faire school. Writing to Mises in September 1957, the professor A. Bastet said that Mises was the successor “to our master Yves Guyot” – who himself was the successor to Gustave de Molinari (1819–1912). And Molinari was successor to the great “proto-Austrian” Frédéric Bastiat (1801–1850). See Bastet to Mises, letter dated September 5, 1957; Grove City Archive: “B” file.
In a preface to the first German edition of the Good Society (1945), Wilhelm Röpke emphasized the orientation of neo-liberal policies toward the optimization of the social machine:

Thus the question is not: For or against laissez-faire? Rather it is: Which judicial order [Rechtsordnung] fits an economic constitution that is just, free, of the highest productivity, and based on a sophisticated division of labor?73

As a consequence of this particular interpretation of Mises’s theory of social systems, the neo-liberals also reinterpreted the significance of Mises’s insights about the importance of competitive pricing. Mises had argued that a rational division of labour could be based only on market prices for factors of production, which in turn required private ownership of these factors. In contrast, the neo-liberals focused exclusively on the prices themselves, neglecting the conditions under which free pricing occurs. For them, the practical conclusion of the socialist-calculation argument was not that government should not interfere with property in general, but rather that it should be kept from meddling with prices specifically. At the Colloquium, Lippmann was praised for his distinction between “market compatible interventions” and interventions incompatible with the operation of a market economy.74 Only direct interference with the working of the price mechanism were illegitimate. If the government limited itself to controlling only the legal framework within which the market participants would be left free to pursue their projects as they wished, then this intervention would be unobjectionable from a neo-liberal point of view.

The unifying principle of postwar neo-liberal theories was an attempt to justify liberty in some cases and state-sponsored violence in others, through one and the same theory. The most important products of these endeavours were the theory of public goods and the Chicago (Coasean) theory of law and economics.

Mises relentlessly criticized the neo-liberal interpretation of the significance of the socialist-calculation argument. From his point of view, the arbitrary distinction between the “play of the price mechanism” and the “framework of the market” was nonsensical. The nature of government intervention is to violate private property rights, thereby affecting the price mechanism in all cases. While it is true that certain phenomena result only from direct interference with the pricing process – shortages and surpluses, most notably – the larger issue of economic calculation remains. It is ultimately irrelevant whether government


74 Rüstow prided himself on having coined the phrase “liberaler Interventionismus” (classical-liberal interventionism) as early as 1932. See the copy of his letter to Volkmar Muthesius, dated May 23, 1955; Grove City Archive: Muthesius file. He probably referred to his talk at the 1932 Dresden meeting of the Verein.
intervention meddles directly with prices or indirectly through the “framework” of price formation; in either case, market prices are perverted.

7. LEONARD READ AND THE FOUNDATION FOR ECONOMIC EDUCATION

About a year after the inception of Mises’s NYU lectures, another institution would be established that would prove to be a pillar of the classical-liberal renaissance and give further leverage to Mises’s ideas. Leonard Read had come to the conclusion that his engagement with the National Industrial Conference Board was a waste of time and money. One of the main reasons for this ineffectiveness was that the Board was committed to a policy of “hearing both sides.” In practice this meant, for example, that at the bimonthly public conferences that the Board sponsored at the Waldorf-Astoria, both the champions of the free market and the advocates of government intervention were granted equal time to present their cases. Leonard Read believed this policy was based on a severe misunderstanding of what hearing both sides truly meant in the present context. In the words of his biographer:

The “other side” was everywhere – in government, education, and communication. Even businessmen had come to rely on government for restrictions of competition, for government contracts and orders, easy money and credit, and other favors. [...] How do you present “both sides” when “one side” is all around you, pre-empting the public discussion, and the “other side” is barely audible in the deafening noise of the former?75

Read thought any funds spent on yet another presentation of the statist view was money down the drain, and he felt he could not in good conscience justify this expenditure. At the end of 1945, he resigned his position and started visiting the donors to apologize.76 One of them, New York City businessman Pierre Goodrich, encouraged Read to think about setting up his own organization. Two months later, Read established the Foundation for Economic Education (FEE), which in July 1946 would move to the pastoral premises in Irvington-on-Hudson, several miles north of Manhattan, where it is still located.


76 Mises continued to be invited to other NICB conferences. For example, on May 16, 1946, he discussed the subject of postwar interest rates with Woodlief Thomas (a Federal Reserve economist), Friedrich Lutz, and Paul Samuelson. And on January 22, 1948, he took part in a symposium that dealt with the question: “Should we return to a gold standard?” Here he met Philip Cortney; among the other contributors were Albert Hahn and Michael Heilperin. See Grove City Archive: NICB files. He was probably also instrumental in providing his friend Walter Sulzbach with a job at NICB in 1946 or 1947; see Grove City Archive: Sulzbach file.
Read mobilized substantial corporate backing for this venture. He had a full address book and was personally acquainted with many executives and owners of the large corporations, some of whom also joined FEE as trustees.

The main activity of FEE was to send out pamphlets and letters explaining the "freedom thesis" to some 30,000 households. Read himself gave a great number of public lectures and together with his other staff, he would soon start offering weekend seminars and other educational programs. The pamphlets and conferences brought students throughout the country in touch with the writings of Mises and other champions of classical liberalism. Mises himself was one of the first economists hired for lectures and seminars on FEE's premises, and would remain its intellectual centre for more than two decades.

It would be hard to overstate the significance of the appearance of FEE. Though its activities were not noticed by a larger national audience, the very existence of this organization gave the scattered classical-liberal forces focus and orientation. It gave them what they had not had since the heyday of nineteenth-century liberalism: a home. FEE provided the material and infrastructure for an enthusiastic return to the ideals of the nineteenth-century laissez-faire liberals. To the key question about the proper functions of government, FEE's Manchesterian answer was that government should be strictly limited to the prevention of "aggressive force" or physical violence.

Most importantly, it attracted young people interested in the intellectual case for liberty and ultimately brought Mises in touch with a self-selected group of students, who were much more receptive to the political implications of his ideas than were many of the attendees of his NYU seminar. Several students he first met at FEE conferences later joined the weekly seminar at NYU, where Mises could go into much more detail.

Last but not least, FEE provided some intellectual counterweight to the neo-liberal orthodoxy that was about to emerge from the University of Chicago's economics department. In 1947 and 1948 respectively, Frank Knight and Henry Simons (posthumously) had published collections of articles making their case for a libertarianism that was so watered-down as to be indistinguishable from social democracy. Other members of the Chicago School were Aaron Director and Milton Friedman. FEE's impact was of course comparatively minor, but without it, the Chicago School would have totally dominated the American free-market scene.

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77 The number of 30,000 was attained by early 1949. See Read's memorandum dated March 23, 1949; Grove City Archive: FEE files.

78 He was "paid a uniform amount at regular intervals" and therefore became, for technical reasons (tax laws), an employee of FEE in October 1946. See Curtiss to Mises, letter dated October 8, 1946; Grove City Archive: FEE files.


8. FREDERICK NYMEYER

At about the same time Read was setting up FEE in Irvington, New York, Mises made another acquaintance who would eventually turn into a long-term ally. In May 1946, Chicago businessman Frederick Nymeyer had finished reading Mises’s *Theory of Money and Credit*, which prompted him to write to the author and inquire about any further writings of his on the subject. During the following months, Nymeyer read *Omnipotent Government* and other available English-language writings of the Austrian professor. He was the ideal reader for Mises. He had received his economics education in the early 1920s, then worked for a while as a field representative of the Harvard Business Cycle Index. He was well acquainted with the monetary thought that prevailed in the United States. The *Theory of Money and Credit*, he found, “was a radically different approach than the mechanical Quantity theory” and he therefore “had some difficulty to adjust all my thinking to your exposition.” Part of the difficulty seemed to be the different use of terms, and Nymeyer then went on to raise questions about one of the crucial concepts of the theory: the demand for money. Mises agreed that the way he had put it – the demand for money being the demand for purchasing power – was ambiguous, and that a better way of putting it was to say that the market participants had a demand for cash holdings. He promised to revise his writings accordingly and to consider this point in his forthcoming treatise on economics.

This exchange was the beginning of a long-lasting alliance (though never a more personal friendship). Nymeyer soon commenced to read other Austrian works available in English, in particular Böhm-Bawerk’s *Capital and Interest*. Slowly, he became a dedicated admirer of the Austrian school. He was also a dedicated Calvinist and claimed, “Böhm-Bawerk has gone as far beyond Adam Smith as Calvin did beyond Luther.”

Mises’s agnosticism did not diminish Nymeyer’s admiration for the Austrian economist. And it did not prevent Mises himself from cooperating openly and productively with Christian libertarians in America. In Austria, such cooperation was almost out of the question, because the Christian Socialists had pushed the Catholic Church into an intellectual dead end. Only outstanding personalities such as Monsignor Seipel could overcome the socialist resentments against the liberal Mises. But in the States, things were different. A great number of the Protestant clergymen in America loved individual liberty and the free market and considered this love to result quite naturally from their Christian religion. Many of these men felt that Mises’s theories were complementary to their faith.

In correspondence with a high clergyman of the Church of England in Canada, who had read *Human Action*, Mises wrote:

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81 Nymeyer to Mises, letter dated May 20, 1946; *Grove City Archive*: Nymeyer files.
82 Nymeyer to Mises, letter dated June 12, 1947; *Grove City Archive*: Nymeyer files.
83 Nymeyer to Mortimer Adler, letter dated February 14, 1948; *Grove City Archive*: Nymeyer files.
I fully agree with your statement that the Gospels do not advocate anticapitalistic policies. I dealt with this problem years ago in my book *Socialism* [...]. I furthermore fully agree with your proposition that one does not find in *Human Action* “one word which is in opposition to the Christian faith.”

Mises enthusiastically welcomed the publication of the monthly periodical *Faith and Freedom* by Spiritual Mobilization, a Los Angeles based organization in December 1949. Of course, he knew very well that the majority of Protestant leaders championed some form of socialism or interventionism, and that while the Catholic Church “valiantly fights communism,” it did not oppose socialism. But these problems were outside of his field: “I think that only theologians are called to deal with the issue.”

This was also the opinion of Frederick Nymeyer. One of the mainsprings of his motivation for spreading Mises’s writings was precisely the complementary relation he perceived between laissez-faire capitalism and Christianity.

Mises and Nymeyer probably met for the first time in late January 1948. Nymeyer then started thinking about why the Austrian School of economics was not prevalent in the United States and he came to the conclusion that Austrian works were not sufficiently well known. In the fall of that year, he was ready to take action, relying in particular on his voluminous address book (“I know several of the outstanding entrepreneurs in the country. I sit on some important Boards of Directors.”). And at the end of January 1949, after several more encounters with Mises, Nymeyer came up with a plan: The idea was to set up a “Liberal Institute” under Mises’s leadership at the University of Chicago – Nymeyer was a friend of the dean of the business school – or at some other suitable university in the Chicago area. Nymeyer had already won over his associate Robert W. Baird and his friend John T. Brown, vice-president of the J.I. Case Company. By May 1949 they had talked to several other businessmen in the area.

At the end of April, the university had told Nymeyer that they would favour “unrestricted gifts” to be used with “academic freedom” – which meant that the university would select the staff of the proposed Liberal Institute. Mises commented:

> Based on this slogan [“academic freedom”] the universities are boycotting all those economists who dare to raise objections against interventionism from another point of view than that of socialism. The question of academic freedom is today not: should communist teachers be tolerated? It is rather: should only communists, socialists or interventionists be appointed? 

84 Mises to P.C. Armstrong, letter dated January 16, 1950; *Grove City Archive*: Armstrong file.

85 Nymeyer to Mises, letter dated October 12, 1948; *Grove City Archive*: Nymeyer files.

86 Nymeyer to Mises, letter dated January 25, 1949; *Grove City Archive*: Nymeyer files.

87 Mises to Nymeyer, handwritten manuscript of a letter in response to Nymeyer’s letter dated April 26, 1949; *Grove City Archive*: Nymeyer files.
But the resistance did not come only from within the universities. A few years later (and that much the wiser), Mises acknowledged the existence of another factor:

One of the worst features of the present state of affairs is the misplaced loyalty of the alumni. As soon as somebody dares to criticize something concerning a university, all alumni come to the rescue of their alma mater. Then we have the spectacle of big business defending the boycott launched by the faculties against all those who do not sympathize with interventionism, planning and socialism.88

In any case, the plan for a Chicago-based “Liberal Institute” under Mises’s leadership did not materialize. But Nymeyer and his friends probably had some influence in bringing Hayek to Chicago, and in the early 1950s he played a significant role in raising funds for Mont Pèlerin Society meetings.89

9. A CONFERENCE AT MONT PÈLERIN

Exactly one year after the establishment of the Foundation for Economic Education in New York, another organisation was brought into existence to provide a forum for the exchange and development of ideas that are relevant from a classical-liberal perspective. In distinct contrast to FEE, this organisation did not have any permanent headquarters; it was conceived as a society of academic scholars, and the life of this society mainly consisted in its annual meetings, which have taken place at different cities all over the world. Most importantly, however, this society was founded in the spirit of neo-liberalism; and neo-liberal scholars, politicians, and journalists have ever since represented the bulk of its members.

The society was a follow-up on the 1938 Lippmann Colloquium that Louis Rougier had organised in Paris. This time, the initiative fell quite naturally into the hands of Hayek, who was well known on both sides of the Atlantic – due to the success of Road to Serfdom and also because he was among the first Western intellectuals to renew contacts with his continental homologues after the war.90 In these meetings the idea of a libertarian association slowly emerged. Hayek certainly discussed the issue when he met Mises at the end of July 1946 in Mexico, but at that point there was not yet any concrete plan. From Mexico City he flew to Oslo, where Trygve Hoff organised a preparatory meeting to discuss this rather vague plan for the establishment of a neo-liberal association with various European intellec-

88 Mises to Nymeyer, letter dated May 17, 1952; Grove City Archive: Nymeyer files.
89 Nymeyer to Hayek and others, correspondence of spring and summer 1952; Grove City Archive: Nymeyer files.
90 For example, by January 1949, Hayek already paid several visits to Austria. See Charmatz to Mises, letter dated 27 January 1949; Grove City Archive: Charmatz file.
tuals, and there the plan for an “Acton-Tocqueville Society” must have taken shape.\footnote{See Hayek to Mises, circular letter dated 28 December 1946; \textit{Grove City Archive}: MPS files. Mises to Karl Brandt, letter dated 7 September 1946; \textit{Grove City Archive}: Brandt file. Mises had been in touch with Hoff prior to June 28, 1946. Hoff had written a libertarian manifesto during the war. He sent the manuscript to Sweden, from where an American diplomat was supposed to send it to Alfred Knop in New York. But the diplomat never did this, as Hoff was to learn after the war, because he found the manuscript “undemocratic” – which probably meant that it was too critical of the fundamental dogmas of America’s war ally. Hoff had also come to an independent discovery of the impossibility of economic calculation in socialism. Mises had the highest of opinion of the Norwegian economist. Hoff was “one of the few contemporaries whose judgment on the problems dealt with in Human Action is of consequence.” Miss to Hoff, letter dated 11 January 1950; \textit{Grove City Archive}: Hoff files.} By the end of the year, he had found the necessary funds to sponsor the event from Swiss (through Hunold) and American (Volker Fund) sources, and he wrote a circular letter of invitation to some fifty persons for a ten-day conference in the Swiss Alps, at the bottom of the Mount Pèlerin, close to the city of Vevey on Lake Geneva.

Hayek probably anticipated some trouble with Mises, because he apologised in handwriting on that same letter that he had not had the time to discuss his plan with him in any detail. His apprehension turned out to be right. Mises went through the roof, writing to Hayek that he could not leave NYU in April and that he “abhorred the idea of going to Europe. I have seen enough decline already.”\footnote{Mises to Hayek, letter dated 31 December 1946; \textit{Grove City Archive}: MPS files.} At the request of Hazlitt, he had written a four-page memorandum containing his “Observations on Professor Hayek’s Plan.” Here he stated that many similar plans to stem the tide of totalitarianism had been pursued in the past several decades – he himself had been involved in some of these projects – and each time the plan failed because these friends of liberty had themselves already been infected by the statist virus: “They did not realize that freedom is inextricably linked with the market economy. They endorsed by and large the critical part of the socialist programs. They were committed to a middle-of-the-road solution, to interventionism.” At the end of the memorandum, he stated his main objection:

\begin{quote}
The weak point in Professor Hayek’s plan is that it relies upon the cooperation of many men who are known for their endorsement of interventionism. It is necessary to clarify this point before the meeting starts. As I understand the plan, it is not the task of this meeting to discuss anew whether or not a government decree or a union dictate has the power to raise the standard of living of the masses. If somebody wants to discuss these problems, there is no need for him to make a pilgrimage to the Mount Pelerin. He can find in his neighborhood ample opportunity to do so.\footnote{Mises, “Observations on Professor Hayek’s Plan,” typewritten memorandum dated 31 December 1946; \textit{Grove City Archive}: MPS files.}
\end{quote}

In his letter to Hayek, he becomes more specific:
I am primarily concerned about the participation of Röpke, who is an outspoken interventionist. I think the same holds true for Brandt, Gideonse, and Eastman. All three of them are contributors to the purely socialist – even though decidedly anti-Soviet – *New Leader*.94

Still Mises did not rule out his participation, but suggested a postponement of the conference until September. This turned out to be impracticable, though, and Hayek undertook another attempt to convince his old mentor in early February. He downplayed the significance of Brandt’s, Gideonse’s, and Eastman’s connections to the *New Leader*, mentioning that he himself had written for this magazine. But more importantly, he argued that the programme of the conference was still quite open and that the main purpose of the meeting in Vevey, and of subsequent meetings, would be to win over especially those historians and political scientists, who still harboured wrong ideas on a number of issues, but who were willing to learn.95 This was apparently convincing enough. At Hayek’s suggestion, Mises got in touch with the main sponsor of the conference, the Kansas-City based William Volker Fund, and within a week travel arrangements were made through FEE.

The Mont Pèlerin Conference started on April 1, 1947 and lasted for ten days of sessions. Mises had left New York City on March 25, excited and curious to see Europe again after almost seven years. He probably travelled to the conference via Paris and Geneva, where he met Rappard and Mantoux.96 The meeting had only a minimum agenda and left large leeway for the participants to determine the subjects they wished to discuss in the course of the next days.

Mises and the six other New Yorkers – Read, Harper, and Watts from FEE, as well as Hazlitt, Gideonse (President of Brooklyn College), and Davenport (Fortune Magazine) – represented the Manchesterite fringe of the meeting. Hayek, Friedman, and Machlup were neo-liberals; people like Eucken, de Jouvenel, Knight, Polanyi, Popper, and Stigler were already rather liberal social democrats; and Allais, Röpke, and Robbins represented the far left of the Conference. Allais even could not bring himself to endorsing the rather vague “statement of aims” that all other participants approved on April 8.

In his opening address Hayek set the agenda for the post-war ideological reconstruction of the classical-liberal movement. It involved, Hayek explained, on the one hand “purging traditional liberal theory of certain accidental accretions which have become attached to it in the course of time” and, on the other hand, “facing up to some real problems which an over-simplified liberalism has shirked or which have become apparent only since it has

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94 Mises to Hayek, letter dated 31 December 1946; *Grove City Archive*: MPS files. Mises suggested that Hayek invite Montes de Oca and Velasco from Mexico, Maestri from Cuba, and Hytten from Australia.

95 See Hayek to Mises, letter dated 3 February 1947; *Grove City Archive*: MPS files.

96 See Mises to Montes de Oca, letter dated 13 March 1947; *Grove City Archive*: Montes de Oca files; Mises to Mantoux, letter dated 17 March 1947; *Grove City Archive*: Mantoux file.
turned into a somewhat stationary and rigid creed.” As later developments should show, the concrete meaning of this programme was 1) to exculpate classical liberalism from certain widely held criticism, for example, that the policies it had inspired had led to mass misery; 2) to distinguish the “modern” liberalism from its elder laissez-faire predecessor.

Some of the other scheduled talks were sufficient to justify Mises’s bad premonitions, though. For example, the German economist Walter Eucken explained that anti-monopoly legislation was not sufficient to combat monopolies. Further legislative inference was need in the field of corporate law, patent law, and trademark law. He championed two maxims of economic policy. First, although there was to be freedom of contract, this freedom was not to be allowed to limit in any way the freedom of contract of others. Second, monopolistic market participants should be forced to behave as if they were in “competition” – produce the same quantities and sell them at the same prices that would prevail in “competition.”

In short, Eucken dished up the same interventionist agenda that had already dominated the Lippmann Colloquium in 1938. At the time, Mises had been on his honeymoon in Paris, which might explain why his contributions to the discussions had been unusually tame. Now he was nine years older, but the honeymoon was over. He reacted with great determination and defended his laissez-faire position so vigorously that many years later his friend Lawrence Fertig still recalled the debate.

The exchange between Mises and his neo-liberal opponents set the tone in the MPS for the years to come. Although the libertarians around Mises were but a small minority, it was they who had the financial backing of the main American sponsors such as the Volker Fund, without which the MPS would have died out very quickly in those early years. As long as Mises took active part in the meetings, therefore, it was impossible to move on to simply discussing the technical details of government interventionism. Laissez-faire had made a comeback. It was not the majority opinion, but it was a debatable and debated political option – too much for some initial members such as Maurice Allais, who very soon left the Society for precisely this reason.

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98 Possibly Allais’ visit to FEE in October 1947 reinforced his concerns that the American libertarians were far too radical for his taste. The visit is mentioned in Herbert Cornuelle to Mises, letter dated 14 October 1947; Grove City College Archive: FEE files.
A NOTE ON MISES’S VISION OF SOCIAL HARMONY IN (CENTRAL) EUROPE

JOSEF ŠÍMA

ABSTRACT

This paper critically examines Ludwig von Mises’ plan for political centralization of Eastern Europe. We argue that while Mises is known for suggesting many practical short-term proposals to influence economic policy of the day in the name of classical liberal order, forming a heavily centralized state in Eastern Europe would not bring about the much desired goal of ending clashes between the nations of this region.

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1. INTRODUCTION

The teaching of Ludwig von Mises and his fellows from the Austrian School of Economics, most notably F. A. Hayek, have gained recently – as always in times of economic crises – access to the media and are helping shape policy debates. The power of the Austrian theory of the business cycle is especially winning the hearts of those who finally see the malicious consequences of money printing and realize the destruction caused by artificial booms to the economy’s capital structure. Though almost ignored in economic classrooms, a lot of students, bankers, businesspeople and academicians rediscover the beauty of the timeless teachings of Austrians; these people understand that the theory of economic crises, originating exactly a century ago – 1912 – when Mises published (in German) his first major book, The Theory of Money and Credit – is giving us fresh answers to today’s problems.

In this paper I will, however, not focus on the monetary aspects of Misesian thought. I want to critically examine where Ludwig von Mises saw reasons and where he looked for solutions to a much broader issue, the conflict among European nations. The reason is indeed that the European unification program of today is on the verge of a break-up; Mises’s writings on the issue of European reconstruction from the 1940’s are not as well-known as his thoughts on money, socialism, or economic calculation contained in his most widely read books; and he is talking about arrangements that are geographically linked to our region – Central and Eastern Europe.

The paper will be structured as follows. First, Mises’s general vision of a peaceful Europe will be sketched; then his political plan which was about to be achieved will be introduced; and finally his plan will be evaluated with the advantage of having over half-a-century of knowledge related to real European unification processes.

2. EUROPE’S CURSE AND EUROPE’S HOPE

Mises was a classical liberal and hence his world-view was deeply rooted in this tradition and clearly spelled out in his writings.100 One needs a private-property-based social order to eliminate conflicts; private property opens the door for division of labor and prosperity. In such a world – liberal world – there is harmony of interests among all people and social groups and hence incentives to co-operate. Goods, services and people move across borders in accordance with consumer demand and driven by entrepreneurial activities. For classical liberals the state is the guardian of such an order, protecting lives and private property against force and fraud. And as there is no political distribution of privileges or monopoly grants, no licenses, no tariffs and no subsidies, it makes no sense to turn wealth-producing activities into redistributive ones. Peace and prosperity are the ultimate consequence.

100 See especially his Liberalism published in 1927.
Unfortunately, this classical liberal utopia never fully existed, though for many years the ideal of free-trade, free-migration, free-competition had been powerfully defended in Europe and partially realized in the world to which Mises was born. Though far from perfect, compared to the tragedy of economic and political nationalism that culminated in the two world wars of the 20th century, massive inflations and dramatic growth of state power, the “old days” seem to be good enough to approximate in many respects classical liberal order. Ludwig von Mises and his family experienced both the beauty of the good times – as they moved to Vienna and contributed to the greatness of Viennese scientific and cultural life during the decades of unparalleled development of this city – and the decay of Vienna and Europe in general that came later. He saw the birth of Austrian Economics, became a key member of the school, and witnessed its great progress and famous victories in economic battles, only to witness within a few years his fellow Austrian economists perishing in the wars or leaving the country for new homes across the Atlantic or elsewhere. He could see Bohm-Bawerk or Wieser producing cutting-edge research in Austrian economics at the University of Vienna only to see in a few years how all this gets destroyed under the supervision of people like Hans Mayer whose politicized decisions dominated over academic standards. In brief, Ludwig von Mises had first-hand experience with statism taking over academia, statism destroying cultural and social life and statism, which in the form of national and international socialism, ultimately killed tens and hundreds of millions of people around the world. He was not, therefore – as many other pure theorists – an “armchair economist” when debating the merits of socialism. He – perhaps like no one else – knew where the essence of statism rests and how economically destructive the system is, and this provided him with all the predispositions to present a powerful message to future generations. And he did indeed – Mises wrote with passion and his rich expositions keep attracting thousands of students of society a century or more after they had been written. Sadly, current policies contribute to this process significantly and Mises’s analysis of socialism and interventionism generally and in the monetary field in particular are as relevant today as when they first were put in print.

He belongs clearly among the most powerful and outspoken advocates of freedom and markets. Mises teaches us that “there is no middle-way.” The dynamics of interventionism are unstoppable and once the state starts meddling with one thing, the next regulation must come soon and then the next one and yet another one until the whole economy is under full control of the almighty state. We can have either laissez-faire or socialism, and anything in-between is not stable. This is Mises’s case against government interventionism, seeming short-run recipes for prosperity and fine-tuning of the economy.

101 See his pioneering paper on impossibility of rational economic calculation under socialism and monumental books like Socialism, Omnipotent Government or Human Action.
3. STATISM IN EMERGENCY SITUATIONS?

Very often we see professional economists arguing for markets in “normal situations” during peace-time; however, when it comes to emergency situations, crises or wars, they suddenly become statists. Here allegedly the standard argument for markets does not hold true, and “we” have to do things faster or differently. A wide spectrum of authors fall within this category: those who advocate action against price gouging after natural disasters, Keynesians who advocate public work schemes during economic downturns, Friedmanites who suggest “provisions of liquidity” to cope with deflation or those who suggest war planning to speed-up military production. Mises never joined these economists and stuck to his standard argument that extended division of labor needs prices and entrepreneurs and hence we need prices of water to go up to create incentives for increase of its supply after major floods; we need price and wage adjustments in the economy’s structure to get back to sustainable production in order to overcome the crisis rather than yet another fiscal or monetary shock; and indeed we need efficiency in war industrial production which central planning – for the same reasons as during peace time – cannot provide us with. Mises stands firm cherishing the markets – after all his understanding of economics as a science formulating universally true knowledge does not give him any other option. There cannot be different economics for sunny days and rainy days.

However, Mises points to an interesting exception, as he sees it, related to Europe’s organization in the difficult times before and during World War II. In the middle of this great battle over the future of civilization, he compromises his free-market stance and – in the name of peace, humanity and freedom – calls for a strong state right here – in Central and Eastern Europe. As Guido Huelsmann reports:

Mises was convinced that this problem [of establishing peace in multi-ethnic nations] could only be solved within a federation of the east-European language communities (nations) under a strong Danubian central state. In early 1938, he laid out a confidential master plan for the necessary reforms in a ten-page paper with the title ‘Principles for the Creation of a New Order in the Danube Area.’

This plan was later elaborated into a more comprehensive paper called “An Eastern Democratic Union: A Proposal for the Establishment of a Durable Peace in Eastern Europe”.

We have to remember that Mises – in his role of governmental advisor and a public figure – recommended in his memos and policy papers many measures that attempted to push policy in the direction of markets “within given limits” or to “save the situation” in

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102 Jörg Guido Hülsmann, Mises: The Last Knight of Liberalism (Auburn, AL: Ludwig von Mises Institute, 2007), e-book, loc. 9302

a critical moment. As Hayek explicitly mentions and Guido Hülsmann in Mises’s biography reminds us, sometimes one has to take “essentially the policy of the desperado who has nothing to lose and everything to gain from a short breathing space.”

So here we have von Mises – considered by many people an extreme defender of laissez-faire – suggesting interventionist measures: one day coming up with a plan of progressive taxation (with lower marginal rates than suggested by others) and the next day even demanding “to put the printing press directly or indirectly to the financial service of the state and to provide, by the issue of banknotes, those means that cannot otherwise be provided” (He saw this as the only solution to a desperate situation in Vienna in 1919 which could prevent complete social collapse and violence). All these “practical suggestions” and “compromises” confirm that Mises was a man-of-reality and – after all – faithful to his utilitarian roots.

It is not surprising, therefore, to see Mises giving practical advice to government. What I believe is unusual is the fact that Mises’s plan for our region might have been a desperado policy step but of a different kind. It was not a “short breathing space” but suggested as a permanent measure to ensure peaceful co-existence of numerous nations and language communities in a world familiar to us – a world dominated by strong states doing many things.

As Mises says: “Our world is very different from ...liberal free-trade utopia. ...Our is the age of economic nationalism...” He explicitly criticized the Atlantic Declaration of 1941 for establishing two incompatible principles – peace and national self-determination. “These principles are incompatible with the conditions that have prevailed for ages in Eastern Europe,” Mises states.

4. EDU – ESSENTIAL FEATURES

The Eastern Democratic Union (EDU) was suggested to include the states of Albania, Austria, Bulgaria, Czechoslovakia, Danzig, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, and Yugoslavia, and several other provinces with mixed population, some one hundred and twenty million people. The EDU was designed as a very centralized state. As Mises argues:


A bilingual interdisciplinary journal
If there were linguistic or racial discrepancies between the populations of the individual member states, the union could not work. Federal government presupposes a strong feeling of national unity. A federation of the Eastern European nations could neither solve the minority problem nor the boundaries problem. All the factors which make these nations fight one another would remain and would shatter the union. The only possible constitution for such an Eastern Union would be a strictly centralized organization.107

A new constitution must be drafted, president or hereditary ruler appointed, the former independent states “will be nothing more than provinces.” The central government and the central parliament will have “all financial powers.” Local government will be allowed to impose real-estate taxes, but the laws regulating these taxes “have to be enacted by the central parliament.” All languages will be treated on equal basis and English used as an international subsidiary language. Schools will be only private as governments abuse the system of compulsory education, but the standards must be fixed by the central government and schools “subsidized by a lump sum for every pupil”. In terms of trade policy, Mises suggests that no protectionism is applied with one exception, namely a possibility to tax or ban import from countries which do not treat the imports from the EDU according to the most favored nation standard. Coins will be minted “by order of the EDU’s government and will be legal tender in the whole territory of the EDU.“

Mises – very knowledgeable of dynamism of interventionism – knew that half-baked plans do not work.

If the power of a nation is limited so as to exclude only some measures, the remaining power can be used for the annihilation of this restriction.108

So he carefully explains and gives examples of such off-setting behavior. If tariffs cannot be used in a discriminatory way, veterinary policy can easily be used in a protectionist way; if schools cannot be used against minorities, construction codes can be misused to prevent minorities from building schools, etc. etc. Mises spent years studying the dynamism of interventionism and hence he knew that there is no stable solution “in the middle.” Once you have some state involvement, you have to prevent people from circumventing it by closing all escape routes. A workable scheme must move toward more state, full centralization. Precise and clear in his argument as he always is, Mises is hence coming up with a detailed scheme suggesting a centralized Central European state as a means towards ensuring peace – among nations that have been fighting with each other for centuries and are prone


to keep doing it – and economic prosperity. Today, the venerable goals must be achieved by
different means; in Mises’s words,

Under the conditions of interventionism or socialism, economic unity can be
achieved only by a strong, strictly centralized government.109

An opponent can respond: Is it necessary, though, to suggest more centralization when
we know that half-centralization is not stable? Why not move in the opposite direction and
de-centralize and de-socialize? Is not Mises ignorant about an alternative solution? Indeed,
we do not need to lecture Mises on the merits of this argument. Mises wrote many books
on decentralization and one in particular on exactly the issue of interventionists measures
in a multi-ethnic environment – Nation, State, and Economy. In this book he explains how
centralization escalates conflicts among social groups and decentralization and secession
are proven ways toward more harmonious co-existence. “Whoever wishes peace among
peoples must fight statism”110, says Mises there, and adds, “The way to eternal peace does
not lead through strengthening state and central power.”111 He knew well the classical liberal
solution and was indeed its loud proponent. However, in the middle of the war, with Nazi
Germany, Fascist Italy, and communist Soviet Union at the borders, he did not believe in
a solution drafted for the world of liberal utopia. As a desperado policy step, he was willing
to grant the state huge power hoping that his noble motives behind the scheme will realize
and bring about the much desired social harmony.

5. CONCLUSION: ILLUSION OF A GOOD STATE

In a world of socialism of all stripes, a world of interventionism, a world of power-seeking
strong states, it is indeed dangerous to live. Indeed we are far away from classical liberal
market utopia. However, I believe Mises is wrong to expect that in such a world a “good
state” can be initiated and its power constitutionally limited. In a world in which ideas
of hatred and social parasitism prevail, conflicts will arise from time to time. However,
it seems to be safe to estimate that political centralization – in a world far from classical
liberal utopia – will not improve the situation. Conflicts among small states will cause less
harm than conflicts among more powerful, more centralized states. And indeed even if
Mises himself had drafted the original constitution of the EDU and the plan was realized
(which he realistically acknowledged is completely out of question for political reasons),
what would happen next? Even the US constitution has been “rewritten” over the centuries,

109 Ludwig von Mises, „Postwar Reconstruction“ in R. Ebeling, Selected Writings..., p. 16
111 Ibid., loc. 1680
not to speak of attempts to transplant this constitution to other places or the process of the “EU constitution” which deteriorated even before it was approved. With or without checks and balances, Mises’s constitutional plan would only give us a new centralized state which would sooner or later stop performing its task of protecting the minorities and would start growing. The “provinces” would be - maybe equally - taxed more and more; to Mises’s one exception to free trade, others would be added; in the name of equality, new “rights” would be created and inflation of legislation would follow. We see it too well in the case of the existing European Union, whose original documents were also dressed in the language of peace in Europe, economic co-operation, protection of small nations, freedom of movements. Once the rudimentary infrastructure of the European state was put in place, the circus of power-politics, rent-seeking and corruption got launched. The rules put in place to prevent the European leviathan to get loose were broken the very moment they were expected to start performing their role; and social forces initiated by the redistributive processes have created internal conflicts and hatred among nations and groups within societies, rather than the harmony and peace so much celebrated in official documents.

We cannot undo the harm that interventionism causes through centralization. There may not be a stable equilibrium between laissez-faire and socialism as Mises claims but the unstable system of interventionism can muddle in the “middle” for many decades with bad but not terrible consequences in terms of the standard of living for an average man. Analogously, the system of big states like Germany and Russia with politically fragmented Central Europe in-between may not be fully stable but can be stable enough to muddle forward for decades or centuries having its ups and downs – successful experiments and painful mistakes – with the process of learning in place.

Second best solutions are a double-edged sword. Alan Greenspan once said that he – chairman of the FED – is still in principle for honest gold money as he had stated earlier in his paper “Gold and Economic Freedom” but only after the whole world adopts free-trade. Until then paper money and central banks are the policies we have to favor. Some Austrian economists argue that they are in favor of free-migration but only when roads are private and antidiscrimination laws do not exist; until then the state has to assume the role of a gate-keeper. Misesian peace-forming, fully centralized state in Central Europe falls into the same category. We could easily see the merit of it and understand the motives but it would not deliver the fruits promised.

There were no quick solutions to prevent the consequences of evil doctrines back then – over half-a-century ago – as there are no quick solutions to today’s problems. There is an ongoing centuries-long battle of ideas that determines our future policies. Sound economic teaching is still our best hope as Mises explained so powerfully in the last section of Human Action. Hopefully, more and more centralizing states both in Europe and the US will not manage to take away from us all our rights and liberties in the meantime.
BOOK REVIEW

WHY NATIONS FAIL. THE ORIGINS OF POWER, PROSPERITY, AND POVERTY BY DARON ACEMOGLU & JAMES ROBINSON, 2012. NEW YORK: CROWN PUBLISHERS, 544P

Why is Mexico poorer than the United States? For Daron Acemoglu and James Robinson, the answer is straightforward: institutions, or – more specifically – the institutional heritage of the past. To make this concrete, in Why Nations Fail (WNF) they blame the encomienda – a rather brutal form of serfdom used by the Spanish in the process of colonization. After the defeat of the Aztec empire in 1521, the Spanish imposed the system as a means of extracting tribute from the local population. Each encomendero would be allocated a number of Native Americans, who would then be used essentially as slave labor.

In early Virginia and Maryland, Edward Wingfield and Lord Baltimore also tried to impose a manorial system upon the English colonists. But that system never took root because settlers had a multitude of other opportunities in the New World. The colonial institutions of North America gave most colonists – or at least the adult men – a say in how their colonies were governed.

The result, according to Acemoglu and Robinson, is that in Mexico, colonization ultimately led to the entrenchment of economic and political institutions that aimed at making a few rich at the expense of the many. But in the United States, colonization bequeathed institutions that have, despite their imperfections, catered to the needs of the population at large.

The main claim of WNF is twofold. First, differences in institutions – not geography or culture – are the key explanation for differences in wealth around the globe. Second, those differences are often a result of historical accidents, such as the different colonization strategies adopted in different regions of the Americas.

Daron Acemoglu and James Robinson do not need any introduction. Professors of economics at the Massachusetts Institute of Technology and Harvard, respectively, they are among the world’s most influential voices in the field. In 2005, Acemoglu received the John Bates Clarke Medal, an award given by the American Economic Association to outstanding
economists under the age of 40. In 2001, with Simon Johnson, the two published one of the most influential articles in the field of development economics.\textsuperscript{112}

In the paper, climate-induced variation in early settler mortality is used as an instrument for institutional outcomes. The idea is that adverse environments led the colonists to adopt extractive institutions (like in Belgian Congo), whereas in environments where Europeans could live healthy lives (like in Canada or the United States) they set up institutions that were very close to those in Europe.

While the book draws on a multitude of other research projects undertaken by Acemoglu and Robinson, the thread connecting it to this early paper on different colonization strategies is obvious: historical accidents and concatenation of elites’ incentives in the past is responsible for divergence of institutions. And, moreover, divergence in institutions is the main factor responsible for the observed differences in incomes and levels of economic development across countries.

How compelling is this view of uneven economic development? A large body of literature exists that argues that institutions do matter. From the Austrians such as Hayek, through Douglass C. North, to more traditional development economists, there seems to be a rising appreciation of the importance of institutions as the essential factor shaping the pay-offs associated with productive and unproductive behavior. Natural experiments – like East and West Germany, or North and South Korea – fit the institutional story rather well.

And revisiting the examples of the United States and Mexico suggests that Acemoglu and Robinson are right. As the book notes, the wealthiest man in the U.S., Bill Gates, is a self-made entrepreneur whose products have transformed the lives of more than a billion individuals around the planet. The richest Mexican, Carlos Slim, made most of his wealth by privatizing Telmex, previously Mexico’s national telecom company, and by collecting monopoly profits at a time when the demand for telecommunication services exploded.

But what exactly does their model tell us? At its heart, there is a distinction between inclusive and extractive institutions. Political institutions are inclusive when they allow broad participation through secure property rights, law and order, and relatively free entry of new businesses. In contrast, extractive institutions “are designed to extract incomes and wealth from one subset of society to benefit a different subset.”

Both inclusive and exclusive institutions are self-reinforcing – and so produce either virtuous or vicious circles of economic development. Combinations of extractive and inclusive institutions, on the other hand, are unstable – the authors argue that “inclusive economic institutions will neither support nor be supported by extractive political ones.” Likewise, under inclusive political institutions, those in power cannot easily use it to set up extractive economic institutions for their private benefit.

Seen through that frame, it’s no wonder that the elites in 19th century Russia or in the Habsburg Empire very often opposed economic changes that opened access to economic opportunity. Acemoglu and Robinson quote Friedrich von Gentz, an adviser to Austrian

\textsuperscript{112} Acemoglu, Johnson and Robinson (2001).
statesman Klemens von Metternich, who articulated the joint nature of political and economic institutions clearly: “We do not desire at all that the great masses shall become well off... How could we otherwise rule over them?” (p. 224)

What emerges from WNF is a thorough economic theory of institutional change. Economic and political institutions become extractive or inclusive based on the payoffs perceived by those who are making political decisions. Inclusive reforms, such as the extension of suffrage or the abolition of monopoly privileges, occur when the elites perceive that the benefits outweigh the costs. The payoffs are shaped by various considerations, including the threat of social unrest and revolution, efficiency gains from moving towards more inclusive economic institutions and the possibility of compensating the losers of such reforms.

Together with Tim Besley’s and Torsten Persson’s (2011) recent work, The Pillars of Prosperity, Acemoglu and Robinson’s book epitomizes the emerging consensus in the economics profession that the drivers of economic growth are the state’s capacity to provide public goods and to serve the population at large, not just the economic or political elite.

While the thrust of book is correct and is backed by serious scholarship, some concerns remain. Firstly, the literature on the importance of institutions for economic development is vast. What exactly is new and different about Acemoglu and Robinson’s contribution – not just relative to Besley and Persson’s work, but also relative to the earlier work by North, Wallis, and Weingast (2009)? The latter develops a model of institutional change that distinguishes between ‘limited access’ institutions and institutions with ‘open access’ and explains the self-reinforcing dynamics of both. Sounds familiar?

Secondly, one has to wonder about the explanatory power of Acemoglu and Robinson’s theory. In order to avoid complete determinism – which would normally be the result of postulating the self-reinforcing dynamics of institutional change – the authors argue that some decisions over institutions are more important than others. At ‘critical junctures,’ decisions are being made that are then reinforced by the overall institutional drift. If a society gets its institutions wrong at a ‘critical juncture,’ there is no coming back, at least not for some period of time. At the same time, ‘critical junctures’ are meant to provide some leeway to shifts away from either extractive or inclusive institutions.

However, how useful is that concept? It appears that we can only see ‘critical junctures’ in retrospect, and even then it is hard to see how they can ever be identified rigorously if we do not observe the counterfactual. Maybe England today would have looked very similar had the Civil War or Glorious Revolution not happened the way it did. In short, the notion of ‘critical junctures’ strikes as being an instance of trying to fit the theory into the observed history in a way that is not directly refutable.

Thirdly, while the authors are right to reject geography as an explanation for economic development, they are too quick to dismiss culture and mistaken policy ideas as alternative factors driving the rise and fall of nations. It is true, as the authors argue, that poor countries are poor because its political elites have chosen to create or maintain institutions that lead to poverty. But even if choices over policies and formal rules are guided by purely economic considerations, they are informed by expectations and beliefs of the policy makers, and by the prevailing social norms.
In a way, WNF provides theory of institutional change that revolves uniquely around self-interest, with incentives facing the political elites as the sole key determinant of the institutions that are adopted. But we know, from our daily experience, that quite apart from incentive problems, political elites – just like ordinary people – suffer from knowledge problems. It is thus reasonable to posit that epistemic constraints, or constraints on institutions and policies that stem from what policymakers know, don’t know or believe, are just as important as the immediate material incentives they are facing.

Denzau and North (1994, p. 27) make this point very starkly: “The performance of economies is a consequence of the incentive structures put into place; that is, the institutional framework of the polity and economy. These are in turn a function of the shared mental models and ideologies of the actors.” Besides the immediate issue of knowledge of effects of particular policies or institutions, some economic historians have argued that prevailing sense of approbation attributed to different human activities plays a role in the process of economic growth.

Sure, Why Nations Fail is an important book. However, it explains only a limited part of the story of economic success and failure of nations. To understand economic growth at a deeper level we need to go beyond neoclassical economics and have a serious conversation about what shapes the beliefs, cultural norms and values of societies, and the effects that these, in turn, have on our economies.

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