

Comment on Von Mises
By [Dr. Mason Gaffney]

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Comment on von Mises

(Excerpt from letter to a friend, 11/95)

Thank you for sending von Mises' Chap. 8, "Inconvertible Capital," from his **Epistemological Problems of Economics** (date?). Yes, he is indeed saying what I said (later), and Ricardo said earlier. "Too much" fixed capital is not the heart of the problem, but too little circulating capital.

His exposition of his central point here is weakened by his primary concern with another matter, i.e. flaying "socialists," mostly anonymous. I am suspicious of those who lump people in a class and condemn them all without citing or even naming them. Makes one infer that he hasn't really studied their ideas.

Keynes and George had in common a belief that the sources of capital formation are adequate, and the supply elasticity is effectively infinite. The bottleneck is demand, which they would pry open (each in his own way). At the local, and even national levels, supply is indeed highly elastic. Worldwide? There it is less so, and in a worldwide cycle, such as we now have, the supply of (circulating, or liquid) capital can be a choke.

Clark, Seligman et al. went to the other extreme and proclaimed capital supply to be generally inelastic, making capital just like land. Von Mises, p.221, picks up a trace of this crabbed spirit when he faults socialists for not saying where "resources for construction and equipment" (i.e. capital) are to come from. The correct Austrian answer, I believe, would derive from what he says on p.227 (but fails to follow through with).

> "The sum total of available capital consists of three parts: circulating capital, newly formed capital, and that part of fixed capital which is set aside for reinvestment[1]."

To get more circulating capital, therefore, there are two ways: form new capital, and reinvest CCAs into circulating capital. George also saw that domestic capital could be converted to business capital. George was clumsy with capital theory, and denied domestic capital was really capital at all. Therefore, he saw this as another form of capital formation. No matter: a rose by any other name. The effect is the same, and

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[1]Today, the nat. accts. call this Capital Consumption Allowance (CCA).

there is indeed a reservoir of domestic capital available to tap, as George perceived, and most others overlook.

Keynes' optimism centered on forming new capital, which he saw as a simple function of income, in a positive feedback loop which only needs a governmental push. FDR named it "pump-priming," and today his successors say "jump-starting." In Keynes' earlier **Treatise on Money** he had made Austrian points, too (Austrianism was the idiom of the 1920s).

You have, if you will allow me, picked up a bad Georgist habit of referring to "monetarism" as "Keynesianism." Keynes did not advocate lowering interest rates via central bank policy: he and his followers consider that weak and ineffectual, and refer to it as "pushing on a string." Rather, Keynes favored borrow and spend, or tax and spend, he didn't much care which: spending was the idea.

One weakness with forcing down i.r.s is the resulting malinvestment: too much capital frozen in fixed forms.

Your two kinds of insolvency have two different names, in my observation. A mere mismatch in the time basis of assets and liabilities is what I have been taught to call "insolvency." What you call "real insolvency" (assets < liabilities) is what I call "bankruptcy."

How can the market know? "Marking to market" should be legally mandated, or at least enforced by those who set accounting standards. Instead, as you know, it is considered gauche, "not done," "bad manners," "*outré*," etc. It is something like keeping assessed values up to date. A strength of von Mises' chapter is his repeated insistence on the importance of honest current valuations.

A downswing is often marked by a radical shift in the terms of trade between current goods and future goods: future goods (hence durable goods) fall in terms of current goods. This does not hurt the holders of current goods so much as the holders of future goods. Cash is king, and current goods are next to cash.

After a downswing, I disagree that "the boom cannot really get going without an artificial increase in credit ..." A boom can begin when all holdout prices fall so the factors can make reasonable bargains with each other. Only if that premise is lacking is more "credit" needed - and only then if the creditors are willing to suffer losses to make things go.

This piece by von Mises has historical value, but he did a better job, I think, in Ludwig von Mises et al., 1983, **The Austrian Theory of the Trade Cycle and Other Essays**, Auburn: The Ludwig von Mises Inst. Gottfried Haberler is also good in an older work, **Prosperity and Depression.** Apparently Arthur Spiethoff did excellent work in the field, but has not been translated from the German.

In my view, the speculative rise of land prices does double damage. True, it serves as collateral for loans destined for malinvestments, that is one kind of damage. However, it also gives a false signal to investors prompting them to substitute capital for land, more than is economically warranted. This is the Lorelei that prompts malinvestments. By comparison, Austrian "forced saving" is a lesser force, I believe.

pp.228 ff., von Mises on "the adaptability of workers" shows his worst side, I believe: elitist, disrespectful of labor ("culturally backward masses"), adulatory towards "entrepreneurs" ("nimble of mind"). No doubt this helped him raise funds. I suspect it is also what turned these "culturally backward masses" against Austrian solutions to the great depression, and opened the door to 50 years of Keynes.