

A Kirznerian Economic History of the Modern World

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I think the history of How I Discovered Israel illuminates the trouble that Austrian economics has had against Samuelsonian economics (which we commonly but self-defeatingly call the “mainstream”). And it shows how in the end the Austrians can save economics from itself.

In college during the early 1960s I had been taught to respect at least Schumpeter, which was reinforced as a graduate student when I specialized in economic history. In college I had a roommate, a brilliant electrical engineer, who would break from solving second-order differential equations by reading Ludwig von Mises’ Austrian classic *Human Action*. But I was the *official* economics major, so I supposed that what my teachers were telling me in classes about Keynesian economics and social engineering was the Real Thing. My roommate’s Misesian hobby was obviously “conservative” nonsense.

Oy veh iz mir. How I wish I had earlier read Mises—the senior colleague of Friedrich Hayek and the teacher of Kirzner! It would have sped up my intellectual development by two or three decades, and given me more respect for the entrepreneur-centered thinking of my friendly opponent early in my career as an economic historian, the historian David Landes. It might have allowed me as early as the 1970s to use the Kirznerian entrepreneur to make progress on the puzzle of economic growth—instead of having to wait until the 2000s, painfully extracting myself over the decades from a Samuelsonian-Friedmanite devotion to equilibrium and routine.

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In my first year of grad school in 1964 I was assigned to read some of Böhm-Bawerk's theory of capital, though without getting much out of it. Otherwise my first training was purely Samuelsonian and Keynesian and Chamberlainian—though when writing my dissertation on economic history I started to see that competitive supply-and-demand economics was more useful, and tilted that way. The progression was Prince-Kropotkin left anarchism (discovered at the local Carnegie library in 1956 at age 14), Joan-Baez socialism (age 16), Keynesian economics (age 19), engineering economics (age 21), supply-and-demand economics (age 25), fully Chicago-School economics down to $MV = PT$ (age 30), Austrian economics (age 48), and finally, age 68, humanomics, an economics for complete humans. Notice the slowing down.

The first time I heard of Kirzner's work was in the 1970s when I was teaching at the University of Chicago. Its Press had published one of his books (Kirzner 1973; and later Kirzner 1979). But in Hyde Park in the 1970s even the Chicago School—which in those days was itself outside the Samuelsonian mainstream—was contemptuous of Austrian economics, to the small extent that it paid attention to it. The high theorists at Yale and Princeton and Berkeley sneered at our lack of mathematics. But we Chicago-School economists sneered in turn at the Austrians' lack of math, and their Misesian disdain in those days for empirical work. The Austrian economist Mario Rizzo was a student at Chicago, and later I came to admire his breadth as a scholar. But as I paged through Israel's books during the 1970s—I wouldn't claim to have actually *read* them—I didn't get the point.

Israel's point about entrepreneurship, which much later was the main influence on me of his ideas, was of course not all that difficult to understand: an old-fashioned way to put it is that the unhirable factor of production has to be something like Israel's notion of "alertness." Entrepreneurship can't be something that can be provided routinely, such as the services of banking or management. It *must* be creative. I vaguely understood the point, because after all Schumpeter and Frank Knight, whom I did read, had stressed that the entrepreneur is the residual claimant. But as a Harvard-trained economist in 1968 with a Chicago-School job I was not much interested in Austrian ideas. My failure to appreciate the importance of the insight shows the blinding force of ideology in economic thinking. Indeed, my early work as an economic historian, from about 1964 to 1975, was a sustained attack on the idea that entrepreneurship was important to economic growth.

I did not feel the need to educate myself seriously about Austrian economics until in the 1980s I met the blessed Don Lavoie, a student of Israel's, in a context in which another Austrian, Karen Vaughn as chair at George Mason, was trying to hire me. I had by then turned to rhetoric, the study of the available means of unforced persuasion. Yet I was still a materialist so far as entrepreneurship was concerned, and confined my study of speech ways to those in academic economics itself. Science, I understood, was about rhetoric. But the economy was Real.

Lavoie persuaded me at least that hermeneutics was the listening side of the speech that a rhetor gives. Don and I were postmodernists together, and chatted amiably with pomo Marxist economists such as Jack Amariglio and Stephen Cullenburg about our belief held in common that facts in science do not speak for themselves (Amariglio and McCloskey 2008; Lavoie 1991). All of the rhetorical/hermeneutic economists, left and right, including my old ally in rhetorical studies of economic science, Arjo Klamer, kept saying to me: "You know, McCloskey, rhetoric has to do with the *economy*, too." I couldn't see it.

Anyway I learned from Don and Karen Vaughn and Jack High as exemplars that Austrian economics was not merely a pointlessly vicious doctrinal war against ones natural allies carried out on the field of German texts, as some Austrians still appear to believe. I learned that Austrian economics could be brought to the study of our actual world, which was Don's project until his too-early death. In the 1990s at last I reread some of Kirzner. I started to get it. I was drifting towards accepting the force of words *in the economy*. My main thought was to add a persuasive, rhetorical stage to Israel's account of entrepreneurship. With Klamer I wrote a paper in 1995 claiming that "sweet talk," persuasion, rhetoric accounted for a quarter of annual earnings (Klamer and McCloskey 1995). Yet Israel's way of thinking was still not central to my own.

I wrote in 2006 *Bourgeois Virtues: Ethics for an Age of Commerce*, which continued my agonizingly slow march since 1980 away from a wholly materialist and mechanical view of the economy. But it was not until I returned as it were to economic history fulltime, in the late 2000s, in order to write *Bourgeois Dignity: Why Economics Can't Explain the Modern World*, that I truly Got It. Or so I now imagine.

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What I got with a jolt around age 65 was that economic growth since 1800, the Great Fact of an increase of real income per head by a factor of anything from a factor of 16 (using the most conventional statistics in the countries that were

richest at the outset) all the way to (if you properly account for improved quality) a factor of 100, had very little to do with routine, Samuelsonian/ Friedmanite/ Douglass-Northian adjustment of marginal cost to marginal benefit. That is, mere supply-and-demand efficiency does not explain the modern world. On the contrary, it was explained by creativity (the non-economist's word) or with innovation (the Samuelsonian word) or with discovery (the Austrian word). Of course, since using Robert Solow's Residual heavily in my anti-entrepreneurial work around 1970, I had realized that most of growth is about innovation, not investment. But like other Samuelsonians since Solow I kept trying and trying to find some routine attainment of equilibrium with which to explain innovation, investment in another guise. (Unified growth theory has since the 1990s taken up the task of explaining the Great Fact with routine investment [Galor 2011].)

For example in the early 1970s, inspired by Steven N. S. Cheung (my office mate at the University of Chicago), and by Ronald Coase across the way at the Law School, I studied the legal history of England during the eighteenth century with the Samuelsonian prejudice about economic "incentives" and "efficiency." I wanted the story to be one of moving from bad allocation to good, from a point away from the intersection of supply-and-demand curves to the blessed, efficient intersection. The changing institutions, I reckoned, simply let the intersection occur. The idea was delightfully mechanical—and it was exactly what my Samuelsonian training and my Friedmanite employment told me. It became in the 1990s the dogma in the parts of economic history and economics inspired by Douglass North's ruminations about "institutions"—which one can find in the first volume of our Annual Proceedings here (North 2009, 1990, 1991). I find it still in the otherwise dazzlingly good and true work of Hernando de Soto, reported on in the second volume (de Soto 2011).

I started to realize during the 1970s in my studies of legal change—which came to focus on the enclosure of open field agriculture (McCloskey 1972 for example)—that the timing of institutional change in England fits poorly with its economic change. But it took decades for me to make the Austrian leap. The marginal product curves in the economy as a whole moved out violently (and hardly at all, for example, in newly privatized open fields in the eighteenth century), by a factor of one hundred, far, far too much to be explained by routine changes in institutions, even educational institutions, even property institutions—which after all had come and gone many times before in human history. North and de Soto do not recognize that China, for example, had secure property for millen-

nia before failing to have an industrial revolution, and that ancient Rome had laws of contract and property, and ancient Greece had banks and wide trade, and Mesopotamia had detailed records of ownership without the slightest signs in the ancient world of a Great Fact.

Holland and England 1600-1800, by contrast, I realized at last around 2007, witnessed an obvious and historically unique improvement in the dignity and liberty of the bourgeoisie, apparent for example in the invention of the science of political economy itself. The surrounding *institutions* of the economy were centuries old in northwestern Europe, and had full parallels all over the world. North and de Soto are transfixed by the example of the U.S.A. Unhappily, they do not have a wide historical view, and so they (and especially North, the economic historian of the pair) do not test their ideas against historical counterexamples. Startlingly the recent book by North, Weingast, and Wallis (2009, which Doug was summarizing in Volume I here), though modestly subtitled “A Conceptual Framework for Interpreting Human History” does not have in its index a single entry for “China,” “Ottoman Empire,” “Japan”; hardly anything on Holland; or much of anything but England, France, and the U.S.A.

Routine reshufflings of the sort that North and de Soto favor could not explain the most surprising event in human secular history. (We Christians, incidentally, think that the most surprising spiritual event in human history has already happened; Rabbi Kirzner, the leading disciple of Rabbi Isaac Hutner, has another opinion). I had faced repeatedly 1964 to 2010 the failure of oomph in the routine, Samuelsonian arguments, such as accumulation inspired by the Protestant ethic, or trade as an engine of growth, or Marxian exploitation, or imperialism as the last stage of capitalism, or factor-biased induced technical change, or Unified Growth Theory. My colleagues at the University of Chicago in the 1970s, Al Harberger and Bob Fogel, pioneered the point that Harberger Triangles of efficiency gain are small (Harberger 1964; Fogel 1965). None of the allocative, capital-accumulation explanations of economic growth since Adam Smith have worked scientifically, which I show in depressing detail in *Bourgeois Dignity*. None of them have the quantitative force and the distinctiveness to the modern world and the West to explain the Great Fact. No oomph.

What works? Creativity. Innovation. Discovery. The Austrian core. And where did discovery come from? It came from the releasing of the West from ancient constraints on the dignity and liberty of the bourgeoisie, producing an intellectual and engineering explosion of ideas. As the banker and science writer

Matt Ridley has recently described it (2010; compare Storr 2008), ideas started breeding, and having baby ideas, who bred further. The liberation of the Jews in the West is a good emblem for the wider story. A people of the book began to be allowed into commercial centers in Holland and then England, and allowed outside the shtetl and the ghetto, and into the universities of Berlin and Manchester. They commenced innovating on a massive, breeding-reactor scale, in good ways (Rothschild, Einstein) and in bad (Marx, Freud).

Ridley explains how the evolutionary biologist Leigh Van Valen proposed in 1973 a Red Queen Hypothesis that would explain why commercial and mechanical ideas, when first allowed to evolve, had to run faster and faster to stay in the same place. Economists would call it the dissipation of initial rents, in the second and third acts of the economic drama. Once breeding ideas were set free in the seventeenth century they created more and more opportunities for Kirznerian alertness. The opportunities were alertly taken up, and persuasively argued for, and at length routinized. The idea of the steam engine had babies with the idea of rails and the idea of wrought iron, and the result was the railroads. The new generation of ideas—in view of the continuing breeding of ideas going on in the background—created by their very routinization still more Kirznerian opportunities. Railroads once they were routine led to Sears, Roebuck and Montgomery Ward. And the routine then created prosperous people, such as my grandfather the freight conductor on the Milwaukee Road or my great-grandfather the postal clerk on the Chicago & Western Indiana or my other great-grandfather who invented the ring on telephones (which extended the telegraph, which itself had made tight scheduling of trains possible). Some became prosperous enough to take up the new ideas, and all became prosperous enough under the Great Fact to buy them. If there was no dissipation of the rents to alertness, and no ultimate gain of income to *hoi polloi*, no third act, no Red Queen effect, then innovation would not have a justification on egalitarian grounds—as in the historical event it surely did have. The Bosses would engorge all the income, as Ricardo in the early days of the Great Fact had feared. But in the event the discovery of which Kirzner and the Austrian tradition speaks enriched in the third act mainly the poor—your ancestors, and Israel's, and mine.

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Discovery depends on alertness (Kirzner 1976: 83). A big or small entrepreneur, encouraged by dignity and enabled by liberty, alertly notices an opportunity, and takes it. To have good effects in social terms, of course, the alertness cannot be

of the monopolizing sort that people have so persistently sought, or of which the Tammany Hall politician George Washington Plunkitt spoke in 1905: “There’s an honest graft, and I’m an example of how it works. I might sum up the whole thing by sayin’: ‘I seen my opportunities and I took ‘em’” (Riordan 1905). Such “opportunities” to extract bribes out of a government-enforced monopoly will at best shuffle the community’s income from the taxpayer to Plunkitt. More likely the shuffling will reduce the size of the pie. Kirzner has always observed that criminals and corrupt politicians, too, exhibit entrepreneurship. But factually speaking the new dignity and liberty for the bourgeoisie that gave us our new gadgets and new institutions have not been matters of power and theft.

Such an optimistic claim runs counter to a good deal of thinking on the left and on the right. The French historian Fernand Braudel, for example, had a vision in 1979 of a routine world of normal profits for little people. Economists call it the “stationary state.” It is not just normal and steady. It is stagnant. By contrast, real innovation—the modern innovation that has made the average poor person rich by historical standards—depended, Braudel claimed, on bribery, force, and fraud. Yet the history suggests not. Most innovation depended on Kirzner’s alertness in *good* deals, good in every way. That is, it depended on noticing opportunities for supernormal profit that in the context of a new liberalism of dignity and liberty proved to be good for most of us.

Innovations can be bad: mustard gas and asbestos insulation were. It is easiest to see that innovation can be bad by thinking of artistic or scientific examples, to which Israel’s theory of alertness also applies. For example the scientific innovation of eugenics, reaching its dismal height in 1945 but now revived by writers such as Stephen Pinker, was indeed an innovation, and scientific. It was not “pseudo” or “junk” science (which are qualifiers used by uncritical admirers of science to protect it from democratic scrutiny). In 1910 almost all the *best* scientists believed in sterilizing poor people and Jews, if they could get their hands on them. And in the 1920s the governments of Germany, the U.S., Sweden, and, worst of all, Norway let them.

The market provides one test of goodness. That is one reason that Austrian economists see the static merits of markets as essential to their dynamic. My Samuelsonian masters taught me to view the test of efficiency as the **end** of history. They were uneasily aware that economic growth depended on something other than getting to the contract curve—after all, their own Robert Solow, with Moses Abramowitz and Edward Dennison, as I said, had shown that routine capital ac-

cumulation didn't explain growth. Yet they went on dragging the argument under the lamppost of allocative economics. On the ameliorist left and the fascist right the solution was to dream of infant industries, economies of scale, corrections by industrial policy, and criticism of externalities to be corrected by the superior intelligences gathered in Washington. The Austrian alternative is to think of static efficiency as a good, first test of a proposal's long-run merit. Then let time tell.

The problem with all the economic explanations lies deep within classical and most of subsequent economic thought: the conviction that shuffling stuff around makes us a little better off, which is true; and therefore that the shuffling makes us as rich as modern people are, which is false. Trade. Transportation. Re-allocation. Information flow. Accumulation. Legal change. As Kirzner expressed it, "For [the British economist flourishing in the 1930s Lionel] Robbins [and the Samuelsonians], economizing simply means shuffling around available resources in order to secure the most efficient utilization of *known* inputs in terms of a *given* hierarchy of ends" (Kirzner 1976: 79). Yet the path to the modern was not through shuffling and reshuffling. It was not by the growth of foreign trade or of this or that industry, here or there, nor by shifting weights of one or another social class. Nor indeed was it by reshufflings of property rights. Nor, to speak of another sort of reshuffling, was it by rich people piling up more riches by shuffling income away from their worker-victims. They had always done that. Nor was it through bosses being nasty to workers, or through strong countries being nasty to weak countries, and forcibly shuffling stuff toward the nasty and strong. They had always done that, too. Piling up bricks and money and colonies had always been routine. "Foreigners shall rebuild your walls," says the Lord to Jerusalem through His prophet Isaiah, "and their kings shall be your servants. . . . Your gates shall be open continuously. . . that through them may be brought the wealth of nations and their kings under escort" (*Is.* 60:10,11). The new path was not about anciently commonplace theft or accumulation or commercialization or reallocation or conquest of foreign kings or any other reshuffling. It was instead about discovery, and a creativity supported by novel words. In terms of the seven principal virtues, the routine of efficiency that Samuelsonian economists love so passionately depends only on the virtue of Prudence (the analysis of the virtues derives from Aristotle, Aquinas, and Adam Smith—the three A's—and is detailed in *The Bourgeois Virtues*). What I am claiming here is that Austrian discovery and creativity depends also on the other virtues, in particular on Courage and Hope. (I am working now on later volumes which will test whether the conversational

society honoring such a commercial Courage and Hope depended in turn on a new, bourgeois construal of the virtues of temperance, justice, love, and faith.) As a result, previously unknown inputs were discovered (coal for steam engines; then coke for iron; then natural gas to replace the sickening coke burnt in French kitchens), fresh hierarchies of ends were articulated (in the new political economy, for example, which tended to the democratic end of general vs. privileged prosperity; in the new politics, which tended to the radical end of strict equality), new goods and services were created (black tulips, common stocks, reinforced concrete). All of it was very far from routine Prudence. The new path around 1700, on account of the change in rhetoric, led by around 1800 and especially by around 1900 to shocking innovations in factory machinery and in business practice. It was supported and extended by shocking innovations in politics, with the result that as early as 1832 a few countries protected your life, liberty, and pursuit of innovation from progressive or conservative assault. The result was the Great fact.

To put it another way, economics in the style of Adam Smith, which is the mainstream of economic thinking, is about scarcity and saving and other Calvinistic notions (see Nelson 1991, 2001). In the sweat of thy face shalt thou eat bread, till thou return unto the ground. We cannot have more of everything. Grow up and face scarcity. We must abstain Calvinistically from consumption today if we are to eat adequately tomorrow. Or in the modern catchphrase: There Ain't No Such Thing as a Free Lunch (TANSTAAFL).

But over time, taking the long view, modern economic growth has been a massive free lunch. Discovery, not reshuffling, was the mechanism, and the springs were the nonprudential virtues. As Kirzner put it, entrepreneurship is not about optimal shuffling, since a hired manager can carry out such a routine. "The incentive is to try to get something for nothing, if only one can see what it is that can be done" (Kirzner 1976: 84). A new rhetorical environment in the eighteenth century encouraged (literally: "gave courage" to the hope of) entrepreneurs. As a result over the next two centuries the production possibility curve leapt out by a factor of one hundred.

A Max U (utility maximization) model, as much as I have loved such a Samuelsonian-Beckerian idea, and have written numerous books and scores of articles in its praise, cannot work to explain real innovation. Routine maximizations, such as by the extension of foreign trade or by investment in routine projects of swamp drainage or canal digging, do not explain the modern world. What explains it, as the Austrian economists would put it, is discovery. And, as they (such as Kirzner)

argue correctly, a real discovery, Mokyr's "macro invention" (1990), is never an outcome of methodical investment, but always an accident in the prepared mind and in the open conversation. There is no U to max and no constraint to obey if real discovery is at issue, as against routine exploration for, say, oil. About oil, the startling macrodiscovery was that you could get it in bulk from the ground and then use it to make kerosene and then gasoline. By contrast, investing an optimal amount in drilling for additional oil, after the discovery of the idea, is a project of rational search. The difference (I speak again to economists) is the same as between Knightian risk (which is calculable, and therefore often insurable and therefore partially avoidable in a world of Max U) and uncertainty (which is not). No one would have bet on Europe in 1500, or on England in 1600, or on the factor of one hundred in 1800. It was uncertain—as in "astounding."

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Notice that from a wider perspective there is something very strange about the modeling and mathematics of Samuelsonian economics. It is: *nobody talks*--except to say yes/no to offers expressed in numbers of dollars. "Toyota Avalon in good condition: \$9,600." "No." The automobile customer might feel moved to add, "Because I can get the same for \$9,400 down the street: shame on you for charging more than he does!" The seller might be similarly moved to say something like, "My good friend, that would be a mistake: the seller down the street is a nasty case." But in the economic theory of markets such remarks lack point. They are, as the game theorists put it, mere "cheap talk." They do not signal anything of import, precisely because they are cheap. If they worked, everyone would use them, and therefore they would stop working.

Is it a scientific problem that Samuelsonian economics and its mathematics of social entities has no room for talk, which humans do so much? Not necessarily. That some people are left-handed is not something that economics needs to acknowledge, unless perhaps an economist were studying the market for scissors. Institutional economists of an older variety often claim that Samuelsonian economics is, say, bourgeois, and suitable therefore only to the Bourgeois Era. You will hear them claiming that an African economics suits Africa, and an Indian economics India. The Samuelsonian economist merely smiles and carries on taking a first partial derivative.

But if a certain activity bulked very large in the economy—larger in most countries than foreign trade, say, or larger than investment expenditure—then a

scientific suspicion would be aroused. And that is the case of talk. In particular, persuasion beyond mere transmittal of offers and acceptances and information is in fact a startlingly large item in a modern economy. We economists might have to stop ignoring the fact, if it is a fact.

Is it a fact? David Lodge's novel, *Nice Work*, shows an English professor, Robyn Penrose, seeing that the managing director she was assigned to watch was first and last a persuader:

It did strike [her] that Vic Wilcox stood to his subordinates in the relation of teacher to pupils. . . . She could see that he was trying to teach the other men, to coax and persuade them to look at the factory's operations in a new way. He would have been surprised to be told it, but he used the Socratic method: he prompted the other directors and middle managers and even the foremen to identify the problems themselves and to reach by their own reasoning the solutions he had himself already determined upon. It was so deftly done that she had sometimes to temper her admiration by reminding herself that it was all directed by the profit-motive. (Lodge 1988 [1990]: 219).

I repeat the finding of Klamer and McCloskey: to be statistical about it, and to speak of many people motivated by profit of a Max U character, about a *quarter* of national income, is earned from such merely bourgeois and feminine persuasion: not orders or information but persuasion, "sweet talk," you might say. Economists have centrally ignored it.

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In explaining the fact of 25 percent of national income being sweet talk a temptation of the modern economist is to try to model it in the style of Samuelson, as the outcome of still another adventure of the prudent person, Mute Max U. (I say "Mute" because we are talking about talking here, and Samuelsonian economics does not talk about it.) The modern Samuelsonian economist does so because it is her only model. If something—love or justice or courage—does not fall within a utilitarian maximization subject to a resource constraint, she has nothing to say. But language, I am suggesting, unless reduced to bits of information put through conduits between minds, as it cannot entirely be so reduced, cannot be modeled as Mute Max U.

The limits and patterns of human speech do of course limit and give pattern to the economy. Some conversations are impossible in humans. At the most abstract level, some sort of Chomskyan limits of deep structure might possibly apply, though it seems doubtful. Perhaps there are deals, orders, desires, plans that would be possible in a language of another species but are interestingly impossible, or at any rate difficult, in human language. Beings that were not differentiated individually, for example, would find orders naturally persuasive in a way that humans do not. Wittgenstein said that “to imagine a language is to imagine a form of life” (Wittgenstein, 1953: 19). He might as well have said that to imagine a form of life is to imagine a language. “It is easy, he remarked, “to imagine a language consisting only of orders and reports in battle” (Wittgenstein, 1953: 19). An army that is something other than a gang of Homeric heroes clashing one-on-one in single combat is a form of life that responds to particular orders issued by particular people. The phalanx on the left flank moves when the general speaks, as though it were an organism and not a collection of free citizens of Athens.

But economics still has something to say, in Austrian. Israel put his finger on what a free society achieves, from which we can understand how meaningful language works in one. “It [is] highly desirable to choose among alternative social arrangements those modes of organization that minimize [ignorance of knowledge that can be absorbed without decision and search, by the sheer noticing of it]. . . that is, those modes of organization that generate the greatest volume of spontaneous, undeliberate learning” (Kirzner, 1979: 147, 145). His assertion runs against the love of explicitness in modern life, the proliferation of handbooks on leadership and of axiomatizations of thinking. Surely, the handbook-writer avers, we need to transmit through a conduit to the student’s mind numerous bits of information, and if this can be centrally planned, all the better. Every schoolchild in France is on the same page at the same hour of the same day, thanks to the planners in Paris. But real innovation, Kirzner is saying, entails real ignorance, that is, “knowledge about which nothing is known” (1979: 144).

It can be put economically: *known* knowledge (shades of Donald Rumsfeld) earns its normal reward. If you know how to read a balance sheet you do not on that account alone become Warren Buffett, because so many other people know how to read a balance sheet. *Unknown* knowledge, on the other hand, generates supernormal profits. When sometime before 1211 an anonymous Florentine invented the idea of a double-entry balance sheet, then he, or his Italian imitators, could pick up the profit from the innovation, and did (Origo, 1957 [1986]: 109).

Once the reading of balance sheets was widely known, however, the supernormal profits fell to zero.

It is still a good idea for people to learn to read balance sheets, engaging in “search” that has a known reward to the MBA graduate or law student who engages in it. The opportunity cost of such searching may be good for the society, as against a worthless search for, say, learning to read the stars astrologically. But routine learning is not an innovation. National income does not actually fall, since learning to read balance sheets has a marginal product equal to its opportunity cost, at the margin, and therefore has intramarginal gains (“rents” economists call them, if not the “supernormal” profit of real entrepreneurship), whereas learning to read the stars does not. The intramarginal reward to routine learning sustains the national income. As a matter of fact, as an economist can persuade you in one of her maddening diagrams, it simply is the national income. But national income will not rise unless the innovation is Kirznerian.

“The ease of calculation provided by money,” writes Kirzner, “is thus not merely a device for lowering transaction costs relevant to deliberate search,” as the Samuelsonians claim when trying to understand sheer information (Kirzner, 1979: 150). “It represents a social arrangement with the ability to present existing overlooked opportunities in a form most easily recognized and noticed by spontaneous learners.” Kirzner makes a parallel point in his writings on entrepreneurship.

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Kirzner’s analysis is correct so far as it goes. What is missing from it, however, is, again, language. The alertness that Kirzner thinks of as the essence of entrepreneurship involves language in its fulfillment. Unfulfilled it is just another bright idea. The necessary, next entrepreneurial step of persuading a banker, a supplier, an employee, a customer, oneself is rhetoric all the way down. Kirzner does not treat the persuasive step, on the probably sound justification that he is a theorist, not a practical entrepreneur. But persuasion matters. A community of free speech briefly unique to Northwestern Europe after 1700 or so, for example, “represents a social arrangement with the ability to present existing overlooked opportunities in a form most easily recognized and noticed by spontaneous learners” (Kirzner, 1979: 150).

Tyler Cowen has noted that there is an odd omission in Kirzner’s view of entrepreneurship, namely, that it does not involve the *audience* for the acts of dis-

covery (remember Lavoie and a hermeneutics in the economy). After all, it is the cash applause of consumers that determines which innovation, or which artistic or scientific advance, continues to evolve. Kirzner and Immanuel Kant, Cowen notes, both sought a “law without a law” (as Kant put it) to leave a space for a creativity necessary to make sense of the modern world, and both therefore focus on the artistic “genius” or the economic “entrepreneur.” But “ironically Kant’s notion of genius is more consumer-oriented and more demand-oriented” than is Kirzner’s. “Kant starts with the ‘consumer’ (i.e., the audience) judgment of the product of the genius” (Cowen 2003: 12). What the Kirznerian argument needs is a role for the rhetor’s *audience*. The free play of imaginative faculties that Kant and Kirzner join in admiring are neither purely objective nor purely subjective (as Cowen points out, p. 13). They are, to coin a word, “conjective,” or as Cowen puts it “relative to human purpose” (p. 15).

The crucial point here was discovered in 2007 by Sarah Millermaier, who argues in the way of Jürgen Habermas that communication is after all a *cooperative game* (Millermaier 2007). A real conversation, “communicative action” in Habermas’ words, “specifies which validity claim a speaker is raising with his utterance, how he is raising it, and for what” (Habermas 1981 [1984/1987]: 278). I would put it that a real conversation entails serious and self-conscious rhetoric and hermeneutics. What Habermas calls “strategic” speech is on the contrary a reading *through* the speech to the “underlying” interests. It is speech meant to achieve a result external to the practice (to use, as Millermaier does, the language of still another student of these matters, Alasdair MacIntyre). Millermaier observes—and here with MacIntyre and myself—that the conversation must be ethical and the ethics must be of the virtues and therefore that what I am calling “real conversation” must draw on the seven principal virtues (McCloskey 2006 once again). Habermas constrains communicative action on the level of logic, pragmatics, and participation. Millermaier and I would constrain it on the more fundamental level of ethics.

Think of an academic discussion—perhaps one on how the way that language works in an economy adumbrates a humanistic science of economics going far beyond the prudence-only, Benthamite-Samuelsonian routine on which economists have been grinding for so long. Imagine contrary to the urgings of Rawls or Habermas or MacIntyre or McCloskey that the main speaker is *not* trying earnestly to uncover the truth, say, or to learn from the audience by listening, really listening. Suppose instead that he is focused entirely on some result

external to the practice of serious scientific inquiry—getting a job offer that will raise her salary at home, perhaps; or demonstrating to the admiring audience how very intelligent she is. Imagine that the audience is similarly engaged in a non-cooperative game (the Industrial Organization seminar held at the Law School of University of Chicago in the 1970s was like this when certain members were present, and others absent). Such a boys' game may be fun to play. But it is not serious conversation, not science—except in those cases in which the very science is run on boys' rules.

If speech is merely strategic, a non-cooperative game, then the only virtue in play is prudence. *Every attempt to characterize speech by a well-trained Samuelsonian economist is going to try to reduce it to such prudent tactics.* Economics is after all the pure theory of prudence, and in the Samuelsonian as against the Misesian form it supposes that there's nothing more to be discovered in achieving a prudent consequence. It is natural to the rhetoric of economics since Bentham and especially since Samuelson to imagine that all behavior is reducible to that of the charmless, unloving, and above all calculating fellow, Mute Max U, equipped with an optimal amount of "information."

Millermaier's point is that such a reduction is corrupting of real conversation. It makes impossible the mutual formation of meaning, which much of our economic life is about, and depends on. We engage in polite chatting around the water cooler and are able thereby to cooperate with our colleagues. If we engage in it obviously *for that purpose*, though, people catch on, and we find it more difficult to gain cooperation. An economic way to make the point is a paper by Paul Ingram and Peter Roberts in the *American Journal of Sociology* in September, 2000, "Friendship Among Competitors in the Sydney Hotel Industry." They find that the friendships among competing hotel managers in the 40 Sydney hotels in their study generate about \$2.25 million Australian more of gross revenues per year per hotel—for example, through recommendations of the competing hotel when it is fully booked—than would be generated by a hotel with friendless managers (p. 417). So far so good for Bentham and Samuelson and Becker. They add, however, "the critical caveat that the instrumental benefits of friendships are inextricably tied to the affective element," that is, you can't successfully fake friendship (p. 420; compare Mueller 1999, p. 39). The faithless ones get found out. Considering the depth of skill among primates in performing and detecting falsehood, this is not surprising. Both Prudence and Solidarity work. "Individuals who try to form and maintain friendships solely as a means to material gain will fail to

evoke trust and reciprocity.” That is, Prudence Only will not work, and so “those who would limit the intrusion of society into economy by . . . characterizing embedded relationships between buyers and suppliers as predictable outcomes of a repeated, non-cooperative game” are mistaken (Ingram and Roberts 2000: 418).

That’s another reason that prices and meanings cannot be sheer, non-cooperative games. It would be like insisting that married people *only* deal with each other instrumentally, in the style of a Beckerian marriage between “M” and “F.” As Millermaier observes, for another example, programs of corporate ethics that declare themselves as “using” values to achieve Mute Max U’s goals will undermine the cooperative game that makes language and ethics possible.

The puzzle of language in the economy, then, and the correct characterization of the conditions favorable to the entrepreneur, cannot be approached within Mute Max U models. To the extent that language is reduced to Mute Max U, it ceases to exhibit one defining characteristic of human language, which is, I hope you believe by now, *not* the mere transmission of information but the making of meaning and the imagining of novelties:

The mind, that ocean where each kind
Does straight its own resemblance find;
Yet it creates, transcending these,
Far other worlds and other seas,
Annihilating all that’s made
To a green thought in a green shade.

To put it another way, the Mute Max U model fits smoothly with the metaphor of speech as a conduit, which would be good news if human communication were largely a matter of transmitting preformed messages between minds. But Mute Max U does not fit at all with a rhetorical (or Wittgensteinian or Burkean or Austinian or Habermasian or MacIntyrian) theory of language. And it does not fit with Austrian economics, when properly extended to the persuasive role of the entrepreneur.

If these were just silly theories, amusing to the effete snobs in the Department of English but unworthy of the tough, masculine science of economics, and econowannabe sciences like political science or law-and-economics, then economics could go on ignoring them. But they are in fact the best thinking about what language is that the 20th century offered. It would be unscientific to go on insisting that all we economists can talk about is our old, if unreliable, friend, the

implacably silent Mute Max U. And it would be bad for the promise of Austrian economics.

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