

# Praxeological Economics vs. Positivism:

## Ignorance and the Universities

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## Praxeological Economics vs. Positivism:

### Ignorance and the Universities

The aim of this essay is to try to explain why positivism has succeeded in professional economics, while subjectivist, or praxeological, economics has failed. It begins by describing positivism. Then it identifies two main reasons for this phenomenon. The first is that ordinary people cannot tell the difference between good and bad economics. The second is that the training ground for professional economics is the university. In modern times, the university is more likely than not to be funded by the government. In a democracy, government funding implies (1) a

competition for funds and (2) bureaucracy. Both of these characteristics favor positivism. A brief discussion of private universities follows.

## 1. Positivism and Its Success

Modern professional economists have adopted *positivism* – the very program of study that praxeological economics is designed to replace (See Mises, 1962). Positivism in economics today defines economic phenomena to include all behavior that is related to production and exchange for money. The overriding aim of positivism is to predict such behavior.

Suppose that the practitioners of positivism, so defined, adopted a proper strategy for achieving their aim. Then they would have to admit that to predict distinctly human action, they must put themselves in the shoes of the actors whose behavior they aim to predict. They would have to try to understand the actors' ends and means, as the actors themselves perceive them. Praxeological economics would be essential to their work and they would have to use the method of imaginary constructions. To comprehend interaction among many distinctly human actors, they would have to contrast an image of the robot evenly rotating economy with an image of an economy that contained the entrepreneur role.

But the practitioners of positivism seldom think about their work in this way. Those who admit the need to incorporate assumptions about means and ends ordinarily assume that actors are passive maximizers who possess quantifiable bits of knowledge about their physical environment. On the basis of this assumption they deduce outcomes of the maximizing behavior that they express by referring to a mathematical equilibrium. Then they try to match those outcomes with observable behavior. They "test models" to see which has the "best fit." The observable behavior is typically in the form of statistical data.

Cruder researchers simply observe behavior and seek regularities in the data, asserting that regularities constitute a theory of behavior. The salient feature of the typical positivist work, however, is that it neglects distinctly human action. It treats human actors as robots without regard for what the praxeological economist claims to be the truly human character of economic action. It has no place for entrepreneurship as we understand it in praxeological economic theory.

From the standpoint of the evolution of knowledge, it may seem strange that positivism would have succeeded in professional economics. In order to explain this, we must recognize two points: (1) that the untutored mind cannot distinguish good from bad economics and (2) that the training ground for modern professional economics is the university. I consider each in turn.

## 2. Good and Bad Economics

The first and most fundamental reason for the success of positivism is that ordinary people cannot accurately judge competing claims about what constitutes good economics. Consider the most important insight of modern praxeological economics. It is that in order to understand the market economy we must use the method of imaginary constructions. We must use this method to isolate distinctly human action in the form of entrepreneurship from the routine or ordinary behavior of consumption, saving, production and supplying factors. This insight is the product of an evolution of thought that spanned more than a century. It required contributions from a number of different great minds at various times in its history. Even today, some of the most respected minds in the economics profession do not recognize it. One can hardly expect ordinary people to appreciate it.

Ordinary people also cannot appreciate theoretical physics. However, the accomplishments of natural science are a direct indication of the success of its methods. Ordinary people can observe the day-to-day applications that improve their quality of their lives. Suppose that you doubted that the corporations, the research institutes, and even the university professors in the field of natural science must be using methods that work. Surely, you would lose face. Your peers would first plead with you to observe the products of invention. Then they would ignore you, or worse. In economics, however, there is ordinarily no unambiguous indication of success. But this is not true for all cases. Policy makers have learned to solve the problem of inflation. They know that when the money is controlled by government agents who inflate the currency, higher prices will be the result, other things equal. However, they did not learn this by applying the methods of positivism or praxeological economics. They learned by experience.

The more complex lessons of economics are not so easy to learn. The effects of anti-monopoly policies, price controls, subsidies, taxes, and other government interventions cannot be deduced so easily. If such policies had their full impact immediately, there would be ample, first hand evidence of the difference between good and bad economic reasoning. In jurisdictions where good policies were followed, we would observe immediate improvements in the wealth of the ordinary person. Where bad policies were followed, we would observe reductions. But the effects of these economic policies are felt over a long term. The reason is that individuals take time to adjust – to bring their entrepreneurial talent to bear on the particular conditions that a policy introduces. Also these effects are combined with other changes that occur for reasons unrelated to the policy. For most policies, ordinary people have no good way to differentiate good from bad.

It is true that most thoughtful people today embrace private property rights and free trade. In today's world of relatively free information, ordinary people have the resources available to learn about the failures of central planning and trade restrictions. But they do not associate these propositions with the methods used by economists. Capitalism and free trade have enabled ordinary people to acquire great wealth in relation to alternative modes of economic organization. But people today do not attribute the great wealth they have derived from these policies to advances in economic theory.

### **3. Economics in the Universities**

Virtually all professional economists today have been trained in modern universities. The fact that ordinary people cannot accurately judge competing claims about what constitutes good economics has two profound implications for this training. First it implies that we cannot expect ordinary voters to put pressure on government-funded universities to cause good economics to be taught. Second, it implies that we cannot expect consumers to put pressure on private universities to cause good economics to be taught. Since these are the training grounds for practically all of those who are regarded as economists in everyday life, it is not surprising that praxeological economics has not been a significant product of university education.

If we want to find out why professional economists today are positivists, we must understand economics departments in universities. To do this, it is necessary to divide universities into classes and then consider each class. The first class consists of universities that are under the direct supervision of governments. We can disregard the case of dictatorships, since these will ordinarily take on different characters depending on the aim of the dictator. A smart dictator would probably use universities, including economic departments, to help shape public opinion. But little more of a general nature can be reasonably said about this form of government. Thus, we shall mainly be interested in universities that are funded through democratic governments. The second class is private universities. We discuss each in turn.

#### **Government-Funded Universities in a Democracy**

The typical citizens of every modern democracy seem to feel a duty to allocate government funds to support universities. Government-funded universities have two characteristics that seem to dominate the incentive structure of the various functionaries. The first is that they are part of the overall competition for funding from legislatures. The second is that they are bureaucratic. We discuss each factor in turn.

#### **Competition for Funds**

Like all cases in which democratic governments spend money, the result is competition to supply the services or to qualify in other ways to be on the receiving end of the money. The presidents of universities and the chairpersons of economics departments participate in this competition. Suppose that a university president wants to succeed in competition with his peers. Then he must cater to public opinion, as it gets filtered through the political system. Because the president in large measure controls the funding to the various departments, he gives the department heads a subtle message. Through his policies, he implies that departments that do the most to please legislators will receive a higher share of the money allocated for department budgets than those who do not. Accordingly, if a department head wants her department to grow relative to others, she must either raise money outside the university or help the president.

Within the university, there are several competitive tactics that a department head might consider using. First, she might appeal directly to legislators by providing services that the legislators regard as good for themselves or for their election campaigns. This tactic is risky. If the legislator who the chairman supports happens to lose, the consequence may be less revenue for the university. Accordingly, it is likely that the university president would discourage such special appeals to particular legislators. The same applies to a second tactic: providing special services for campaign contributors. Besides the risk that a favored candidate might lose, a challenging candidate who learned about special services provided to an incumbent might be able to increase his chances of unseating the incumbent by revealing such special treatment and promising to cut funding to universities in which it occurs. A third tactic is safer: providing services to the community. At election time, the recipients of university services will be more disposed to favor incumbents who they perceive as being responsible for encouraging the university and, correspondingly, the community service provided by it. And, other things equal, the incumbents will presumably confirm the constituency's expectations by favoring the university over other its competitors in the budget competition. What kinds of services can an economics department provide for community members? Examples of relatively safe actions she might take consist of (1) helping to prepare students for jobs, (2) offering classes to help students qualify for government jobs or university jobs that require advanced degrees, (3) providing what the heads of other job-oriented departments regard as service courses. Not that if incumbents are defeated by challengers, the newcomers would be hesitant to sanction the university since they would also want to obtain the votes of community members.

## **Bureaucracy**

The second characteristic of government-funded universities is their bureaucratic nature. The reason for bureaucracy is that citizens in a modern democracy demand the kind of accountability and relative independence that only bureaucracy can provide. Government bureaucracy has two salient features. The first is the desire of bureaucrats to avoid responsibility for unpopular decisions. The second is their desire to expand the bureau's size.

### *Avoiding Responsibility*

Attempts to avoid responsibility become significant to economics departments when decisions must be made on hiring, firing and promotion. To avoid responsibility for errant subjective judgments, presidents and department chairpersons base their decisions on quantifiable, or countable items. The typical items used are (a) the number of words published by a professor in qualifying journals, (b) the number of citations by other members of the profession, (c) the number of students taught, and (d) grades on student evaluation forms.

Neither praxeological economics nor positivism seems to have an edge with respect to the first two of these yardsticks. [It is true that major universities seem to rely on peer review to determine the *quality* of the words published and that the distribution of peers today is strongly skewed in the direction of positivism. However, our concern here is why positivism rose to such prominence in the first place.] The difference seems to lie with (c) and (d). So we discuss each in turn.

### *The Student Numbers Game*

Teaching praxeological economics is a one-on-one task. It requires correcting each false step in a student's reasoning. Relative to teaching social facts, mathematical models, and statistical techniques; it is a time-consuming and highly personal activity. The teacher must try to understand how the student thinks. No teacher of praxeological economics could be satisfied teaching a large class. Thus, one would not expect praxeological economists to be enthusiastic about winning a competition for student numbers. Confronted with classes that are larger than she believes she can comfortably handle, the praxeologist teacher faces a choice: (1) sacrifice her writing and research in order to make time for the additional one-on-one contact needed to teach effectively or (2) adopt some mass production strategy like multiple-choice examinations or testing the ability to express ideas by means of mathematical models. The second option not only reduces her effectiveness, it also gives students messages that are contrary to praxeological principles. The first strategy reduces her competitiveness in publishing.

Compare this with positivism. A positivist can teach facts, mathematical techniques, models, and statistics. In each case, an increase in the number of students in a class, within limits, does not noticeably effect the time that a teacher must spend preparing. Most importantly, however, the multiple choice or short-answer examination is especially amenable to such subject matter. This means that, beyond the first student at least, the time that a positivist must spend measuring the performance of a given number of students is substantially lower.

### *Student Evaluations of Teachers*

The teacher of praxeological economics wants to teach students how to put themselves in the shoes of actors. Some students are more ready than others to do this. Since there is no easy way to screen for such ability (and because a typical university teacher has no legal right to personally screen for it), the range of variation in a class is likely to be quite large. As a result, some students need substantially more attention than others in order to reach a given standard of ability. Indeed, some students may reach the highest standard in a very short time. If the praxeological teacher graded them according to ability, she would be inclined to pass such students with high marks after a couple of weeks. Other students may spend a whole semester and still not be able to competently put themselves in the shoes of economic actors. Students' abilities to conceptually exchange places with actors depends a great deal on their life experiences. It also depends on the extent to which they have not bought into the positivist program already. It depends very little on their previous classroom success, although basic intelligence is a requirement of success in both praxeological economics and positivism.

Unlike classes in factual learning and model construction, students who do not do well or who take much longer than others to receive a passing grade are at first unlikely to understand why. Compare this with positivism. If a student fails an examination on factual material, mathematics, model-building, or statistics; he is likely to attribute his failure to his lack of study or to the difficulty of the material. It is relatively easy for him to compare his ability to that of his classmates and thereby confirm his insufficiency. However, if he fails or falls behind in his class in praxeological economics, he is likely to be confused. He may say: "I have done well in other

classes and I have worked just as hard in this class as in the others. I just don't know how to please this teacher. Since this class differs from the others I have had and am taking now, my teacher is probably not teaching me very well."

Such a student is likely to turn to his classmates for help. Most of his classmates will not be as skilled as the teacher in moving him to a higher level of understanding. As a result, they will not be able to explain his failure. If he turns to classmates who are themselves behind or failing, they are likely to reinforce his idea that the teacher has been unhelpful. But suppose that he turns to a classmate who has already moved to a higher level of understanding. And suppose that the classmate succeeds in helping. Then the failing student is likely to feel that his learning was not due to the teacher but to his classmate's and to his own effort. The fact that the teacher arranged the incentives that induced the interaction and subsequent learning may go unappreciated.

In the typical bureaucratic setting, a person who uses the appropriate strategy to teach praxeological economics risks her security. On the one hand, the students who are most receptive to praxeological will have opportunities to succeed that are not available in their positivist classes. They will be pleased and may well rank the teacher as the best they have ever had. On the other hand, those who fail are likely to say just the opposite. From the standpoint of bureaucratic risk averters, this higher variation among student opinion is unwelcome. Students who like the teacher very much are unlikely to take the initiative to praise her to the chairperson and to the university president. However, students who dislike the teacher very much will complain. Complaints that "this is the worst teacher I have ever had" are likely to be particularly disturbing to a risk-minimizing bureaucratic department head who herself has little knowledge of praxeological economics. The threshold below which a student feels that it is useful to complain is likely to be reached by a larger number of students in a praxeological economics class.

To summarize, we might try to put ourselves in the shoes of a typical teacher who is on the margin between teaching praxeological economics or positivism. Teaching positivism is less costly in terms of the time that the teacher must spend on a class with a university-defined set of credit hours. And teaching positivism is likely to bring greater rewards on student-evaluation-of-teacher forms. This helps to explain why government-funded universities teach positivism far more than they teach praxeological economics. The real cause of the problem is not the lowly economics teacher. It is the department head's, the university president's, and ultimately the legislator's unwillingness in democracy to take responsibility for providing an environment in which the incentive to teach praxeological economics is substantially higher relative to positivism. Praxeological economics teachers could be given reduced teaching loads, the credit-hour system of determining a student's qualification for graduation could be changed, student complaints could be ignored, student evaluation forms could be thrown in the trash, and legislators could stand on principles. But voter ignorance of good and bad economics and the bureaucratic system in which the teacher operates makes this unlikely.

The situation would be somewhat different if the current mode that governments use to finance higher education was changed. Positivism would be less successful relative to praxeological economics if subsidies for higher education were given to consumers instead of to bureaucratic universities. However, so long as government agencies were in a position to decide

whether particular universities would receive subsidies, the basic problems of telling the difference between good and bad economics and of monitoring the bureaucracy would remain.

### **The Ever-Expanding University**

It is well known that bureaucracies tend to grow and proliferate. The typical member of a bureaucracy aims to become a department head – a leader of others. To do this, he must first have a department. Assume at first that a department of economics at a government-funded university consists entirely of praxeological economists. More specifically, assume that it consists of individuals who have different abilities in praxeological economics. Now these abilities are not countable. Thus, the department cannot easily defend its decisions about hiring, promoting, and firing to outsiders, including the university president. Put yourself in the shoes of the member with the least praxeological ability. You face the highest risk of being fired or not promoted. How can you improve your security? A good strategy is to develop some special field of factual knowledge and then propose that a new department or branch be created to teach the field. One who adopts this strategy hopes to be made head of the department or at least to achieve a more favorable position vis a vis his peers.

Isolating oneself in this way reflects another characteristic of bureaucracy – secrecy. By developing a new field, one can more reasonably claim to be the expert in that field. When challenged by arguments that his method of interpreting social facts is less skillful than that of the praxeological economist, he can reply that the challenger has not studied the field well enough to make an informed decision. To an outsider who knows little about the field and little about praxeological economics, the argument appears credible. Thus, by developing a new field, a faculty member can ward off criticism and conceal his lack of ability in the interpretation of social facts.

Of course, this same incentive for growth and secrecy applies across the university spectrum. Positivism is especially suited to this kind of expansion, since there is no end to the different types or manifestations of behavior that can be reported factually, aggregated, and otherwise described statistically, and modeled mathematically.

### **Private Universities**

Private universities are different. By definition, their funding depends partly on the tuition of consumers and partly on contributions from benefactors. [The modern private university also receives grants awarded by government agencies. To the extent that this occurs, it tends more to resemble the government-funded university. To avoid duplicating the discussion of the government-funded university, we assume that the private university receives no government funding.] But ordinary consumers and benefactors cannot judge the significance of praxeological economics. As a result, although they may prefer that good economics be taught, they have no way of registering their preferences.

However, some consumers and benefactors can make judgments. They are especially capable of judging whether a university economics department helps one learn about the benefits of private property rights and free trade. As a result, some private universities promote these things along with an environment in which praxeological economists can survive. However, promoting private property rights and free trade is not the same as promoting praxeological economics.

Nevertheless, the praxeological economist may feel comfortable in such a setting for two reasons. First, the first step methodologically in studying the effects of government policies is to form a clear understanding of the pure market economy, unencumbered by government action. Second, except possibly in situations where there are serious public goods problems and externalities (incompletely specified property rights), the praxeological economist believes that anyone who is capable of putting herself in the shoes of consumers would favor private property rights and free trade. Thus, a praxeological economist who wants to promote the welfare of his fellow human beings may in fact support these government policies. However, the special problems of goods with public goods characteristics and of externalities also require treatment. The true praxeological economist should feel uncomfortable promoting private property rights and free trade without adding provisos about these problems. Thus, the praxeological economist may feel uncomfortable in conversations with university personnel or students who appear to blindly promote unfettered private property rights and free trade.

More ominously, other positivist economists who advocate private property rights and free trade may compete with the praxeologists. A positivist who advocates private property rights on the basis of its track record relative to non-capitalist, closed economies is likely to gain the edge over a praxeological economist who studies public goods and externalities problems. Thus, even in the most favorable environments, the praxeological economist is likely to face competition and perhaps difficulty in gaining acceptance of his ideas.

### **Mises on Tradition**

One other factor is present in both the private and government-funded university. It is the tradition among those who control hiring, promotions, and firing of demanding that faculty not only teach but also contribute to the promotion of knowledge and science (*Human Action* 1966: 872-6) . They believe that each professor has a duty to publish papers and write books that will distinguish him as an expert in some field. Since these controllers ordinarily lack knowledge of praxeological economics, they must rely on peers to judge. Mises saw the effect of this tradition to be the proliferation of studies in economic history or, in terms of this note, reports of social facts. For example, university trustees can be proud of their economics professor who is an expert on Latin-American economies and who has just published the first book describing the farm policies of Bolivia.

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