

THE AUSTRIAN SCHOOL: 150 YEARS

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1. Introduction

The year 2021 marks the 150th anniversary of the Austrian School. In 1871, Carl Menger published his *Principles of Economics*, marking the birth of this school of thought. Besides some notable contributions by “Austrian” economists, this school of thought has produced voluminous work aligned to the historical context of the time as well to important preoccupations of “mainstream” economics. This short paper is a companion to the figure shown at the end, which tracks the most important or recognized work of the Austrian school (top) and mainstream economics (bottom).

Of course, a graph such as the one in this paper cannot be complete. Still, it offers a forest view of some of the most influential work. The location of some authors may also be questioned. For instance, there are some conflicting opinions on whether Wieser belongs to the Austrian School. Or if Buchanan is not as Austrian as other economists (especially his book *Cost and Choice*). The following sections point out some relevant work, parallelism, and trends during the first 150 years of the Austrian School.

2. The synchronized beginning

The beginning of the Austrian School is well-known. Menger (1871) independently arrives at the marginal theory of value more or less at the same time than Walras (1874) and Jevons (1871).¹ However, besides this crucial contribution, Menger (1883) also participated in a fundamental debate, the *methodenstreit*. It is challenging to comprehend the Austrian School's epistemological stance without understanding the nature of this debate. The topic was no less than the nature of economics as a scientific discipline. The historicist school argued that there were no economic laws. Menger had the opposite view. Menger's position required discussing the scientific *foundations* of economics. The scientific foundation of economics as a science was a central topic of research by Mises (1933, 1949, 1957, 1962) and a long-time career project by Hayek (1948, 1952a, 1952b, 1967, 1978). Mises's (1933) work on economics' epistemological problems briefly precedes Popper's (1935) *The Logic of Scientific Discovery*. In 1933, Mises provided examples of how empirical information can inform economic theory and what are the limits of empirical refutations. A comparison between Mises and Popper must acknowledge that while Mises focuses on economics' epistemological problems as a *complex phenomenon*,² Popper's focuses on natural sciences' epistemological issues.

The preoccupation with epistemological problems does not start with Menger nor end with Mises and Hayek. Machlup (1936, 1955, 1961) and Rothbard (1957) stand out. In particular, Machlup (1955) is credited for advancing some of Lakatos (1978) arguments. Machlup and Rothbard participated in an important debate of the time regarding the role of hypotheses in economics and how they can be tested. Besides Hutchison (1938), to whom Machlup is replying, this is also the time of Friedman's *Essays in Positive Economics* (1953).

The Austrian School's beginnings include the (1) development of a marginal theory of value and (2) a debate on epistemological foundations of economics at the same time as the Vienna Circle.³ The second topic

¹ On the birth of the Austrian School and the differences between Menger on one side and Jevons and Walras on the other see Cachanosky, J. C. (1995) and Mises (1969).

² Even though Hayek (1967, Chapter 4) is typically associated with the term *complex phenomenon*, Mises also used the term. In short, a *complex phenomenon* is a phenomenon that is too complicated to be developed by the human mind, even if it can be studied by the human mind *once* it comes to exist through a *spontaneous process*. A typical example is language, which is the result of repeated human interaction rather than human design, and yet has grammatical rules that can be discovered and understood.

³ The Vienna Circle (1924 – 1936) was a group of philosophers and scientist with a long-lasting influence in the 20th century philosophy of science. Some of its most well-known members include Moritz Schlick, Otto Neurath, Rudolf Carnap, Richard von Mises, Karl Menger (the

was more German-centered and probably marked the seed of what years later will become apparent. Even though the Austrian School and mainstream economics share basic economic laws (such as the analytical tool of demand and supply), they have different epistemological roots. The different epistemological roots are also a reason for the common misconception that the Austrians oppose empirical work. However, the Austrian School is not anti-empirical (a misreading of the Misesian *apriori*); it is against logical positivism, a position much more present in mainstream economics than the one found among Austrian friends. In Lakatosian terms, the Austrian School and mainstream economics have a different *hard-core* (see Zanotti & N. Cachanosky, 2015).

3. The socialist economic calculation and authoritarian issues

3.1. Socialist economic calculation

The opposition of the Austrian School to socialism is also well known. It is important to keep in mind that the economic definition of *socialism* is the absence of private property of the means of production. Today the word *socialism* may mean something entirely different, such as policies geared towards income distribution. Yet, the socialist debate started with the proposal of eliminating private property to create a utopic communal society.

Böhm-Bawerk (1896) is not known only for his early contributions to capital theory. He is also renowned for his criticism of Marx, which remains one of the leading reactions against Marxism.

The Austrian School's preoccupation was not just intellectual curiosity; it was motivated by leading Marxists and real-world political changes. Mises's (1920, 1922) work on socialism coincides with the establishment of the Soviet Union.⁴ His work changed the nature of the debate and became influential in the development of mainstream economics. Common assumptions such as that of "perfect information" are a reaction to Mises' challenge. Of course, the long debate regarding economic calculation and socialism also involves Hayek's (1948) work.⁵ Also, Mises' (1919) little-known work on the relationship between nation, state, and the economy is published soon after the end of World War I. This work is published when new countries appear due to the collapse of old empires and deals, among other topics, with the critical question of the difference between a nation and state..

3.2. Authoritarian governments

The rise of the Soviet Union and World War II (WWII) led Hayek to worry about the role of legislation in protecting freedom and limiting the power of the government. Maybe Hayek's most famous work by the general public is *The Road to Serfdom* (1944), published towards the end of WWII. Yet, Hayek's preoccupation with this topic continued through the Cold War (ca. 1947 – 1991). In particular, on the constitution of liberty (Hayek, 1960) and the relationship between law, legislation, and liberty (Hayek, 1973, 1976, 1979b). Hayek was also the leading founder of the Mont Pelerin Society in 1947, immediately after the end of WWII.

The profession, of course, shared Hayek's concerns about the world after WWII. Keynes (1919) famously warned about the economic consequences of the peace treaty of the Great War and publicly talked about *The End of Laissez-Faire* (1926). During WWII, Schumpeter publishes his *Capitalism, Socialism, and Democracy* (1942). In the early 1960s, James Buchanan (1963, 1967, 1968, 1975; 1962; 1977) starts to work on a long-term project on the role of institutions in securing a limited government and protecting individual liberties. This work is well-aligned with Hayek's work on law, legislation, and liberty. In more recent times, the perestroika reform in the Soviet Union led to revisit the topic of socialism by Don Lavoie (1985a, 1985b) and Peter J. Boettke (1990, 1993).

son of Carl Menger, mathematician), Kurt Gödel, Felix Kaufmann, Alfred Tarski, Willard Van Orman Quine, Ernest Nagel, Oskar Morgenstern, and Frank P. Ramsey.

⁴ Mises' argument was that (in a large community) in the absence of market prices there is no efficient way to figure out the rational allocation of resources. Independently to Mises, Max Weber (1921) and Boris Brutzkus (1921) offered similar arguments to those of Mises.

⁵ As a secondary literature on this topic, see Boettke (2018), Caldwell (1997), Coyne, Leeson, and Boettke (2005), and Lavoie (1981). Skarbek (2008) notes that Hayek stands among the Nobel Prize Winners most cited by other Nobel Prize Winners.

4. The Mises-Hayek-Kirzner entrepreneurial Journey

The arguments against socialism's feasibility (in a large community) require paying attention in *who* uses prices and *who* decides how to allocate scarce resources. Naturally, the entrepreneur plays a central role in the development of the Austrian theory of the market process. The emphasis is on how a market *moves towards* equilibrium instead of on what the equilibrium conditions are. The market movements towards equilibrium may be spontaneous and still driven, unintendedly, by entrepreneurs.

It can be argued that there is a Mises-Hayek-Kirzner evolution of entrepreneurial theory. Mises (1920, 1922) pointed out that the entrepreneur's economic calculation is a necessary condition for the market to work efficiently.⁶ Prices are the natural input for calculating profits and losses, which is what the entrepreneur does. Hayek (1948, Chapter V) pays attention to the *meaning* of competition, contrasting how competition looks in the real world to how it looks in the mainstream's formal treatment. Interestingly, Hayek (1978, Chapter 12) talks about competitions as a *discovery* process. Disequilibria is not given information; it is an unknown to be discovered. The next step in the development of a theory of the firm is Kirzner's (1963, 1973, 1974, 2000) entrepreneurial *alertness*.⁷ In basic microeconomic models, the entrepreneur is an absent figure. Somehow the economy is already in equilibrium, which has no role for the entrepreneur. Even though mainstream and Austrian economics have followed a different path in the theory of the firm and the entrepreneur, they do share a concern about this topic.

5. The Great Depression, capital theory, and business cycles

The 1930s saw the clash of Hayek's views with those of Keynes regarding the causes and solutions to The Great Depression. Before his famous *Prices and Production* (1931), Hayek (1929) was already concerned with monetary policy's role in economic crises. Hayek was not only challenging Keynes on the reasons and solutions to an economic crisis, but he was also challenging his approach to *how to do* economics. Hayek argued that Keynes' focus on macroeconomic aggregates concealed what is interesting (and important) in economics. Also because of his continental (Austrian) economic background, Hayek emphasized the role of capital theory in economics.⁸

According to Hayek, *The Great Depression* was not due to some irrational (animal spirits) behavior but due to the misallocation of resources. Those resources include capital goods. It is not just about labor as emphasized in Keynesian economics; it is also about how capital goods are used together and across time. Macroeconomic aggregates should not become blind to this problem. Yet, Hayek's use of the idea of a period of production (or *roundaboutness*) led to a road with no exit (see Hayek, 1941). Having reached a block with the concept of the (average) period of production, the Austrian School turned to emphasize that capital is heterogeneous through Ludwig Lachmann's work (1947, 1956, 1977).⁹ Capital theory was a major subject during the 20th century, including the participation of Clark (1899), Knight (1935, 1941), Hicks (1939), Dorfman (1959), Yeager (1976), and the participants of the Cambridge-Cambridge controversy to name a few.¹⁰

Despite efforts by Rothbard (1963), Horwitz (2000), and Garrison (2001), the Austrian business cycle theory (ABCT) has remained a marginal theory of economic crises. Yet, it did never wholly disappear. A sign that this theory has some valuable insights to offer despite any other shortcomings can be seen in its renewed energy during the 2008 financial crisis.¹¹ Directly or indirectly, several scholars turned to the old Mises-Hayek theory of business cycles to understand what happened and why (see N. Cachanosky & Salter, 2017). A reason why the ABCT did never completely go away is because of its level of generality. Loyal to Hayek's (1967) theory

⁶ It can be argued that Mises' understanding of 'capital' is institutional contingent (Braun et al., 2016).

⁷ Others, like Lachmann (1973), have taken a different kaleidic approach.

⁸ Mises and Hayek's work had a great influence in England before the Keynesian revolution took over. One of the most well-known cases is the adoption of Austrian ideas by Lionel Robbins (1932, 1934). For Hayek's influence at the London School of Economics, see Boettke and Candela (2020) and Caldwell (2004, Chapter 8).

⁹ Also see Lewin (2013).

¹⁰ For a review on the debates on capital see Cohen (2008, 2010; 2003) and the discussions in Lewin (1999). For an introduction to Austrian capital theory see Powell (2010).

¹¹ In recent work, the average period of production and the relative-price effect of the ABCT has been framed in financial terms by Lewin and N. Cachanosky (2020).

of *complex phenomenon*, the ABCT does not make *point* predictions; it makes *pattern* predictions.¹² To narrow down the pattern to something closer to a point prediction requires the addition of conditional assumptions (Machlup's *assumed conditions*, Mises' *real-world conditions*, or Lakatos' *auxiliary hypothesis*). Exactly how an ABCT will unfold depends on market regulations, other policy decisions, and several factors that are not part of the theory's *hard-core*.

6. Contemporary issues

6.1. Monetary institutions and free banking

Later in his career Hayek (1977, 1979a) pushes the argument of a competitive regime of fiat currencies. He was not alone on this. Benjamin Klein (1974) and John Nash (2002) shared a similar interest on the topic, while Friedman (1984) held a more skeptical view. To some extent, Hayek's proposal of currency competition advances some of the Euro's development discussions.¹³

Hayek inspired yet another research program, that of a free market of money and banking. It is also interesting that this was an early topic in Hayek's work. One of his doctoral students' dissertations became a well-known book on free banking and central banks' historical origins (Smith, 1936). Yet, different from looking at fiat currencies' competition, this research topic looked at free banking's monetary regime. White (1984) is the foundational work on the literature of free banking. This work does not only look at the issue of free competition in money and banking from a theoretical point of view, but it also looks at real-world experiences (N. Cachanosky, 2012; Dowd, 1993; Fink, 2013; Selgin, 1988, 1996, 2008; White, 1989, 2014).¹⁴

The issue of endogenous monetary stability is an essential topic in monetary policy. Arguably, it is the main question surrounding any central bank policy and whether the monetary authority should enjoy discretion or abide by a rule. The free banking literature contrasts with the influential bank-run model by Diamond and Dybvig (1983). Once again, the Austrian and mainstream literature share a similar interest despite their different conclusions. The former trusts a free market can provide stable money while the latter holds a more skeptical view. In recent years, Austrian ideas have also been applied to the topic of cryptocurrencies (N. Cachanosky, 2019; Hazlett & Luther, 2019; Hendrickson & Luther, 2017; Luther, 2018a, 2018b; Luther & Olson, 2015; Luther & Salter, 2017; Luther & Stein Smith, 2020; Nair & Cachanosky, 2017; Selgin, 2015).

6.2. Self-governance

Another contemporary work in the Austrian literature relates to the spontaneous development of formal and informal institutions able to provide *governance* without a *government*. To what extent is *self-governance* feasible and desirable? This literature has some strong roots in Rothbard's (1973, 1975, 1982) anarcho-capitalism. The study of *self-governance* is a research program that pushes the limits on government scope (Boettke, 2005). The problem of *self-governance* has been the topic of study by renowned philosophers such as Robert Nozick (1974), scholars such as David Friedman (1973), and Nobel Prize Winners as Elinor Ostrom (1990, 2010).

The *self-governance* literature has become an interdisciplinary research program dealing with topics that range from empirical studies of stateless economies (Leeson, 2007; Powell et al., 2008) to social coordination among violent individuals such as prisoners (Skarbek, 2010, 2011, 2014) or even pirates (Leeson, 2009). The literature on self-governance is too long and diverse to cover here in detail.¹⁵

¹² A *pattern* prediction is not just a *point* prediction with a high confidence interval. Consider Hayek's (1967, p. 24) example: A claim that a rug has a pattern made of diamonds is easy to verify even if nothing is said about the color, shape, or size of the diamonds.

¹³ See White (1999, Chapter 12) for an assessment of Hayek's proposal. Also the discussion by Luther (2013) on the likelihood that Hayek's proposal will lead to a large number of different fiat currencies as opposed to Friedman's (1984) skeptical view.

¹⁴ Other "Austrians" follow Rothbard (1983) opposing fractional reserve banking and advocating for a 100-percent reserve banking (Bagus & Howden, 2010; Hoppe, 1994; Hoppe et al., 1998; Huerta de Soto, 1998; Hülsmann, 1996).

¹⁵ For a review of this literature see Powell and Stringham (2009).

6.3. Hermeneutics

The epistemological focus at the dawn of the Austrian School paid attention on the role that *understanding* (or *verstehen*) plays in economic phenomena (Hayek, 1948, Chapter 3; Mises, 1933, Chapter 3, 1949, Chapter II.8). The facts in economics are what individuals *think* they are. In economics, facts have a subjective interpretation. Social order is unintelligible without understanding the meaning of actions (Schütz, 1953). This focus on subjective interpretation relates to the modern hermeneutical turn in Austrian economics (Lachmann, 1977, pts. 2, 3; Lavoie, 1986b, 1986a, 1987, 1991, 2011; Machlup, 1978). The work of Lavoie on this topic is central but failed to produce a progressive research program.¹⁶

The issue of hermeneutics can be quite relevant. It brings epistemological understanding to the Austrian position regarding empirical work. Hermeneutics helps to understand that the Austrian school is neither post-modern nor logical positivist (Zanotti et al., 2020).

7. Conclusions

It would be quite a long task to cover all the work done in the last 150 years of the Austrian School. It is also inevitable to do some injustice by failing to cite some of the most recent work and using the “mainstream” and “Austrian” labels that may not sit well with everyone. However, the purpose of this short paper is to provide a general bird-eye view of the historical and theoretical relevance of topics that have traditionally been present in the Austrian literature. Rather than being off sync, the Austrian School has engaged in the most pressing issues of the time.

¹⁶ Rothbard (1989) expressed strong opposition to Lavoie’s project.

8. References

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