

## 'Austrian Economics' Booms in Popularity, Busts Mainstream Myths

Thursday, May 27, 2010 by Jason Riddle

*Austrian Economics* is neither a narrowly focused study on the economy of Austria nor an investigation into the management of California's economy by Arnold Schwarzenegger – though the latter may have potential for a good Austrian economic joke. Austrian economics is a school of economic thought. The name is derived from the nationality of its intellectual pioneers whose critical contributions to the field of economics during the late nineteenth and early twentieth centuries include explanations of opportunity cost, time preference, marginal utility, subjective theory of value, capital theory, monetary theory, interest theory, and the theory of the business trade cycle.

Despite winning a Noble Prize for Economics ([F.A. Hayek, 1974](#)), exploding Marx's *Labor Theory of Value* in the 1880's ([Eugene von Bohm-Bawerk](#)), developing the theory of marginal utility and explaining the historic origin of money ([Carl Menger](#)), and writing possibly the single greatest economic treatise in human history ([Ludwig von Mises, Human Action](#)), Austrian economists are largely unknown to the general public today and go unmentioned in our schools' history books. Over the last few years, Austrian economics has seen a dramatic resurgence in popular notoriety. Thought leaders such as Lew Rockwell, Tom Woods, Peter Schiff, Bob Murphy, and the Honorable Ron Paul have put the spotlight directly on Austrian economic theory. What is behind the recent popularity boom? Perhaps more importantly, why have the Austrian's teachings been kept neatly from the public?

Renewed popularity is primarily due to the [Austrian Theory of the Business Trade Cycle](#) explaining the causes of economic booms, busts, recessions, and depressions. Economists using the Austrian theory predicted the Great Depression, the recessions of the 1970s and 1980s, as well as the most recent financial collapse with precise accuracy – although followers of the Austrian school would explain that their economic 'predictions' are analogous in process to predicting the length of the hypotenuse on a right triangle when the the length of the corresponding two legs are given.

In contrast to the mainstream economic approach which uses trial and error to generate and test hypotheses based on historical data, the Austrians use a distinct methodology of applied logic. The Austrian method of discovering and explaining economic truths uses reason to logically deduce truths from fundamentally self-evident starting points such as human action.

The comparison of trade cycle predictions to triangles makes sense. In much the same way the logically deduced truths of Euclidean geometry can be applied to any triangle, the Austrian's logically deduced theories are applicable to any economy, irrelevant of size or social structure. Economic laws are the same for an individual, a household economy, a centrally planned economy, or a market society. All economic activity ultimately reduces to the purposeful action of individual humans.

Austrian theory makes rational sense because the distinct methodology grounds its conclusions to reality. Here are a few basic examples of theories the Austrians emphasize:

- The market is a network of events caused by the choices and actions of individuals. It is a process, not a static 'thing'.
- Every individual has a unique set of needs, preferences, and desires – including differences in when they want certain things. A good only has economic value in the mind of the valuer.
- People always prefer present goods to future goods, all other things being equal.
- The cost of any action is the cost of the next best alternative you have to give up in order to perform the action.
- Before anything can be consumed by someone, it must first be produced by someone (harvested, created, built, etc.). Before people can invest in the production of capital goods without frustrating the current level of consumption - before investors take the time to build tools to be used to produce future consumer goods - there must be adequate real savings to sustain consumption while resources are devoted to the investment. (See Bob Murphy's article on the [Importance of Capital Theory for an illustrative example](#)).

The above illustrates why Austrian economics is often referred to by its students as “sound economics”, “commonsense economics”, “household economics”, or maybe most appropriately just “economics”. These concepts may seem obvious today but were unsolved pieces of the economic puzzle that perplexed great thinkers for centuries.

Building on basic truths, Austrian economists consistently apply the use of deductive reasoning to the nature of human action to develop deeper, more complex, but no less evident, theories of economics. After all, economics is the study of individual human actors trying to solve the problem of allocating scarce resource with alternative uses.

But why then, if these theories are so evidently practical and accurate, is the Austrian school of economic thought quickly dismissed (or worse, never acknowledged) by mainstream economists? Although many essential Austrian theories have since been incorporated into mainstream economics (mainstream economists do recognize some Austrian achievements as valid) it is frequently purported that the differences between Austrian economics and *Classical/Neo-Classical* economic schools are not wide enough, or the thought achievements of the Austrians are not significant enough to warrant a separate “Austrian” school of thought.

In reality, this could not be further from the truth. While conclusions reached between mainstream economists and the Austrians are sometimes compatible, the divide between approaches is one that cannot be reconciled. The rigid methodology of logical deduction used by the Austrians is incompatible with the “trial and error” empirical hypothesis testing used by mainstream economists. For the specific reason that Austrian economics provides a transparent view of reality, logically linked by a chain of reason– it is politically unpalatable. Austrian economics, because it presents an undistorted cause-effect relationship between public policy and economic impact, is a real threat to those in power. Politics, not merit or validity, keeps the ideas of sound economics conveniently out the mainstream and out of public view.

Economists (Austrian and other) have categorically and systematically refuted many of the most basic, yet egregiously fallacious principles governing mainstream economics. In 1959, Henry Hazlitt destroyed the Keynesian magnum opus chapter by chapter in [The Failure of the New Economics](#). Yet, politicians and talking heads in the media still reference these failed economic theories as a kind of unquestionable gospel truth.

According to Hans-Hermann Hoppe, Professor Emeritus of Economics at UNLV, during an interview for the [Turkey-Association for Liberal Thinking](#):

*“Mainstream economics is irrelevant, but open to the idea of social experimentation and engineering (how else can one test one’s hypotheses?). That’s why the modern interventionist state is willing to fund the entire exercise. In contrast, Austrian economics is of great practical importance, but it is generally opposed to economic interventionism as counter-productive. Not surprisingly then, AE receives little or no state support.”*

The history of the repression of Austrian economic thought is not new. In fact, the name *Austrian Economics* was actually coined by the then prevailing German *Historical* school of economic thought in hopes that the designation would carry with it the negative stigma associated with the perceived inadequacies of the lagging Austrian culture of the time.

During the early part of the twentieth century, as the war between socialism and free-market ideology waged, Austrian economists were dismissed as mere apologists for capitalism. The social experiments of the Statists collapsed in economic ruin for the very reasons the Austrians explained decades earlier. Presently, the failed ideology is still championed by proponents of centralized bureaucratic regulation. Politicians continue to blatantly ignore economic fact in striving toward an ends that the means will not and cannot attain.

Today, the Austrian school is dismissed by mainstream economists and financial leaders as 'inflexible', 'outdated', or at best 'interesting in theory'. These same people look at the recent economic tragedy as some kind of mystery and wonder why the formula that failed before is failing again. Our leaders ignore that the crisis was caused by artificial expansion of credit by the Federal Reserve and think more credit and more government spending is the solution. Here are just a few examples of recent quotes from the mainstream. These words would be laughable if the consequences were not so tragic:

*"The impact on the broader economy and financial markets of the problems in the sub-prime markets seems likely to be contained."* [Ben Bernanke, Chairman of the Federal Reserve – March 28, 2007](#)

*"This is far and away the strongest global economy I've seen in my business lifetime."* [Henry Paulson, US Treasury Secretary – July 12, 2007](#)

*"I expect there will be some failures. I don't anticipate any serious problems of that sort among the large internationally active banks that make up a very substantial part of our banking system."* [Ben Bernanke, Chairman of the Federal Reserve – February 29, 2008](#)

*"We're closer to the end of the credit crisis than the beginning."* [Lloyd Blankfein, CEO Goldman Sachs – April 10, 2008](#)

*"Despite a recent spike in the nation's unemployment rate, the danger that the economy has fallen into a 'substantial downturn' appears to have waned."* [Ben Bernanke, Chairman of the Federal Reserve – June 9, 2008](#)

*"Yet many economists, myself included, actually argued that the [ \$787 billion government spending] plan was too small and too cautious."* [Paul Krugman, Nobel Laureate, Professor of Economics at Princeton, Columnist for the New York Times – March 8, 2009](#)

*"To fight [the 2002] recession the Fed needs more than a snapback; it needs soaring household spending to offset moribund business investment. And to do that...Alan Greenspan needs to create a housing bubble to replace the Nasdaq bubble."* [Paul Krugman, Nobel Laureate, Professor of Economics at Princeton, Columnist for the New York Times – August 2, 2002](#)

As this article is written, the [Financial Crisis Inquiry Commission](#) is in the middle of a fifteen month (9/17/09 – 12/15/10) crusade to "...examine the causes, domestic and global, of the current financial and economic crisis in the United States." This dog and pony show is not only a waste of time and tax payer money, as the cause was already explained by reputable economists before the crisis even happened, but there is little doubt the blame fingered by the FCIC investigation will conveniently be shifted away from the real culprit.

The leaders in Washington and the reporters in the mainstream media continue to claim that no one could have possibly seen the crisis coming on like it did. Economic phenomena is not a mystic occurrence. If you are interested in another perspective, see what the Austrians have been saying before and during current financial crisis. Here are some good resources to get you started:

- Search YouTube for "[Peter Schiff Was Right](#)".
- Visit [Mises.org](#) the largest institutional economics site in the world. Here you will find a wealth of free information. These folks saw it coming for years.

- Read [Meltdown](#) by Thomas E. Woods, Jr. The author accurately places the blame for the crisis on interventionist monetary policy and explains the basic Austrian principles in simple terms.
- Read [CrashProof 2.0](#) by Peter Schiff. This was written in 2006 (and includes updated commentary from 2009). Schiff explains the coming crash with precision and offers advice on avoiding the coming financial pain.

Sound economics does not tell us whether one course of action is more or less preferable to another. It simply provides information that if a specific action is pursued, a specific result can be expected. It provides the information needed to act appropriately to obtain a preferred outcome. Politicians from both sides of the political fence go to great lengths to disassociate any cause and effect relationship. They renounce sound economics in order to hide the true costs of their political agenda. These costs, however, don't go away. Reality collects what is due in the form of recessions, depressions, or worse.

So who's advice do you want to follow? The guys that didn't see it coming? The guys that caused the current economic crisis? The guys that are applying the same medicine today as they did in the 1930s when they turned a recession into a depression and a depression into a decade and a half long economic catastrophe?

The recent boom in popularity around Austrian economics is happening because intelligent people around the world are tired of being fleeced by those in power and are looking for answers from the folks who told the truth and got it right. Despite the rhetoric about recovery, America is in the biggest financial crisis of its young history. I'm going to listen to what the folks who predicted and explained every recession in the last century are saying....and they are saying that if we stay the current course, things are getting much worse before they get better. **A \$ A**

*"Everyone carries a part of society on his shoulders; no one is relieved of his share of responsibility by others. And no one can find a safe way out for himself if society is sweeping towards destruction. Therefore everyone, in his own interests, must thrust himself vigorously into the intellectual battle. None can stand aside with unconcern; the interests of everyone hang on the result. Whether he chooses or not, every man is drawn into the great historical struggle, the decisive battle into which our epoch has plunged us."*

Ludwig von Mises, [Socialism](#)

## References

- De Soto, Jesus Huerta. Money, Bank Credit, and Economic Cycles. Unión Editorial, Madrid, 1998.
- Ebeling, Richard. The Austrian Theory of the Trade Cycle. Ludwig von Mises Institute, 1996.
- Taylor, Thomas. Introduction to Austrian Economics. CATO Institute, 1980.
- <http://mises.org/tradcycl.asp>
- <http://www.econlib.org>
- <http://mises.org/article.aspx?id=1455>
- <http://www.federalreserve.gov/newsevents/testimony/bernanke20070328a.htm>
- <http://www.bloomberg.com/apps/news?pid=20601087&refer=home&sid=akVfP6K8sz3k>
- <http://www.msnbc.msn.com/id/25068662/>
- <http://www.guardian.co.uk/business/2008/feb/29/useconomy.subprimecrisis1>
- [http://money.cnn.com/magazines/fortune/fortune\\_archive/2007/07/23/100134937/index.htm](http://money.cnn.com/magazines/fortune/fortune_archive/2007/07/23/100134937/index.htm)
- <http://www.nytimes.com/2009/03/09/opinion/09krugman.html>
- <http://fcic.gov/hearings/>

All content is the copyrighted work of **A-Equals-A.com** unless otherwise indicated. ALL RIGHTS RESERVED.