The Austrian School of Economics – a good theory with slim chances of becoming good policy

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Abstract. *The goal of this article is to prove that, starting with the Great Depression of 1929 – 1933 and up until today, the Austrian School of Economics has always positioned itself "against" the status-quo. In other words, the official economic policy did not build on its theoretical foundations. Considering this as our starting position, we attempt to prove that this was a bad course of action for the economic policy, as well as for the wellbeing of the individual. For the economic science, the fact that the Austrian School did not sign the pact with political compromise is a positive thing. In this context, we will present how the usual marriage between science and politics takes place by using the Keynesian example, and all the consequences that follow from such an affair.*

Keywords: *economic policy, Austrian School of Economics, economic growth, liberal values, rule of law, welfare state, fiscal tyranny, progressive taxation.*

Defining the problem

Through its entire theoretical edifice, the Austrian School (considered as a whole, not divided based on the Mises / Hayek distinction) was, and still is, paying attention to law making; law making which it did not refuse to guide, but to whom, considering the way things happen in the real world, it attributed rather idealized features. Hayek's "The Road to Serfdom" [4] or Mises's "Planned Chaos" [10], "Interventionism: An Economic Analysis" [11] and "Economic Policy: Thoughts for Today and Tomorrow" [13] are just some examples of the manner in which two emblematic minds of the Austrian School concerned themselves with law making and economic and social policy. Judging by the aforementioned books and others, whose authors draw inspiration from Wieser, Bawerk or Menger, it can be clearly seen that the Austrian School has its own version of law making. Capturing its essence into one proposition would sound something like this: free market economy restricted only by laws designed to serve the individual, each and every single one in part and all alike.

The difference between the forms that political decisions have taken and the economic policy recipes suggested by the theoretical tenets of the Austrian School serves to show the nature and content of its position understood from a law-making point of view. If we take the time period between the first big economic crisis of 1929 – 1933 and the present day as the timeframe of the analysis, it isn't hard to notice that the Austrian School has always been "swimming against the current"; it did not set the tone, nor provided inspiring models for the official policy adopted by the world's states. In broad lines and in agreement with the main hypotheses and laws that came into being inspired by the ideational spirit of the Classical School, the Austrian School pitted itself against the tendency that the ever-increasing Keynesian influence exerted over the economic policies of the twentieth century. If, for what is admittedly considered to be the progress of a school of thought, this state of affairs can be conceived as a positive or negative development, is not a very easy thing to tell. From a methodological point of view, what ultimately validates or invalidates a theory is the result of putting it into practice. Or, during the 20th century, it was not the Austrian School that became acknowledged. Starting with the Lipmann colloquium in 1938, liberalism as a whole enters a period of "opposition" and the Austrian School followed suit. Its tenets and convictions did not offer solutions for the political hastiness and opportunism that the crisis of 1929 – 1933 demanded. In other words, what we are trying to say is that the conclusive decision factors for the 20th century were hastiness and improvisations conceived under the spur of the moment rather than long-term planning and resilience. In the short run and answering promptly to the necessities of the moment, the Keynesian doctrine imposed its convictions and inspired, in a consistent manner, the economic policy of the 1929 – 1933 period as well as that of 2008 – 2011. This is the typical manner in which the marriage between politics and science takes place.

One does not select the theoretical tenets that are meant to reform a drifting economy from the ground up, but rather those that serve in a timely fashion and in an all-encompassing manner an immediate political stake which, on many occasions, has an electoral flavour. In such circumstances, the following questions must be asked:

1) If the man of science writes and says exactly what the politician wishes to hear, should this approach consolidate the scaffolding of his theoretical construction?

2), Does economic policy gain a badge of approval and the status of being scientifically certified through such gestures, especially when, on the spot, the economy stops its stagnation and seems to resume its natural course?

Our opinion is that in such moments, scientific rigour gives way to "intellectual prostitution". The history of economic facts and ideas teaches us that, unfortunately, this was the model that stuck; what mattered was who and what whispered in the politician's ears about what must be done to find a temporary fix; the long term, the firmness of the construction mattered less because, knowing all too well whom we are citing, "in the long run we're all dead"! Especially in regard to such a dangerously permissive model, the Austrian School can only position itself as an opposing principle. Its theoretical tenets have to do with the long-term health of the economy and are in direct contradiction with political opportunism, provisional policies and populism.

The Austrian School is not at all popular; it does not speak directly to "the masses" and it does not support political views by making abstraction from its essential tenets. Elitism confers it its characteristic distinction. Although the works of important Austrian economists are not meant to provide reading material for the working class, they do not wish it harm, quite the contrary. The fact that countries who adopted liberal values in order to build their economic policies now experience economic growth represents a confirmation that liberalism, even in an indirect manner and as a mixed doctrine, did, in the long run, its duty. Thus, in the long run, the apparent opposition of the Austrian School is a masked one. But are we willing to validate such analyses when no government lasts for a century and it is only interested in short time spans? Or, in the end, what is it that interests us, the continual well-being of the individual, or a present state of wellbeing that lend itself to descriptions and concrete promises. Unfortunately, present wellbeing is the ground where political agendas meet electoral purposes. Long term wellbeing remains confined to the realm of science. The economists, who knew how to speculate this type of "logic", impressed and were glorified. Those willing to die for an idea, all too aware that such conduct will send them in the realm of ungratefulness, remained unpopular, unwanted by the policies of the day and their doctrines became "cold". Keynes followed by Stiglitz [17], Krugman [7], Piketty [14] and so on, serve as examples of the first case; the Austrians, without exception, prove the second case. Who truly wins and who loses? In regard to that which constitutes a solid lesson on economic dynamics, Keynes is nothing more than a temporary, questionable success and a sure loss in the long run; the Austrians, on the other hand, start off as an apparent, short term, loss and deliver long-term success. On the trajectory at whose end the Austrian School will prove not only the solidity of its theoretical tenets but also its direct, practical, utility, only ascribed to this course of action does it profit from the chance of being "against the status quo". This, we believe to be for the good of the economic science and of the individual. In the following sections, we will try to demonstrate this hypothesis, and the argument will be structured on three levels, each one corresponding to a specific confrontation of competing concepts belonging to the doctrines of liberalism and interventionism.

The rule of law vs. The welfare state

The Austrian conception about the origin, development and the operations of a state based on the rule of law have no equal in the economic literature as far as the force of arguments and the elegance of style are concerned. Mises, and especially Hayek, excel on the subject.

Mises tackles the problem by framing it in the context of the individualism – holism relation. He is compelled to admit that the individual is born in an already organised social environment, one in which individual behaviours must find a way to coexist and assert themselves. It is possible that, in a certain context, a contradiction may appear between the goals of the individuals and the general one, that of a pre-existing society. In search of a compromise, Mises is not willing to weight "superior social advantages" against "immediate individual sacrifices" [Mises, 12, p.155]. Like all Austrians, Mises finds collective wellbeing to be an indecipherable and indefinable concept. For the potential conflict between individual and society, he sees democracy as the only way out. And he does so because "It provides a method to submit, in a peaceful manner, the government to the will of the majority" [Mises, 9, p.158].

Hayek also notices the latent, but the very real potential for conflict between the goal of the individual and that of the community. Continuing Adam Smith's line of thought, he is compelled to admit that the Smithian spontaneous order is not sufficient to support social order. Apart from the dominant spontaneous element, he also accepts the regulatory element, acknowledges "consciously created" laws, laws made by the people for the people, but, very importantly, laws that concern the whole but not the separate, individual agent. Precisely because of the last cause, since it is difficult to reconcile the goal of each individual with the general goal of the community, the state comes into being. It comes into existence to "*... draw attention to the rules on which the spontaneous order rests and ... to provide the services that spontaneous order can't adequately provide*" [Hayek, 5, p.56].

Hayek's ideas about the state have remained a generous theme for further consideration. Concerning our subject, we are particularly interested in two of his conclusions. First of all, the Hayekian state represents much more than the Smithian "night watchman". But it represents more only in regard to the extent of the area that it must administer – as a "producer of order", Hayek's "services" have a more encompassing sphere of action. In effect, Hayek remains grounded in Smith's vision, by conceiving the state as a sum of rules, of good practices that play a coagulating role in people's actions, thus enabling the existence of social life. Secondly, the Hayekian state retains a part of the essence that defined the state as it was understood by the first liberal economists – the physiocrats. We are thinking of its essential role, that of a wise teacher whose main attribute is to "enlightening" people, to help them discern between what matters to them personally and what is of interest for all of them, indiscriminately. Since the trend of this enlightening process is a beneficial one, the logic of the minimal state becomes obvious. In other words, the Austrians, much like the first liberal economists and philosophers, desire a powerful state, but one that is reduced to its absolute minimum size.

This isn't though the logic that was encouraged by the orthodox economy. Otherwise, James Buchanan would have had no material to work with, had things been different. On the contrary, the second half of the twentieth century and the beginning of the twenty-first one were dominated by the idea of ever increasing the role of the state. If this dance of statist joy would have lured in only pygmies, there would have been no danger. Unfortunately, "the great officials of science" overwhelmingly favour the expansion of the state's role. Let's study just a few examples.

On page 117 of Krugman's book The Return of Depression Economics and the Crisis of 2008 [7], he deceives us that he has liberal roots. He claims them as being Keynesian and tries to prove it by interpreting the author of The General Theory and professing, in the same manner, that the economic engine affected by the crisis could be repaired through "*a very limited kind of intervention which would not harm private property and the right of individual decision making...*" [Krugman, 7, p.117]. He does not let us indulge for too long in this illusion because on page 129 of the same book he tells us, explicitly, what the "Keynesian pact" means in times of crisis: a reduction of interest rates and a massive increase in public spending and taxation levels. Or, these have nothing to do with "a very limited kind of intervention". On the contrary, these measures represent a massive and drastic intervention in fundamental areas of the economy. As such, liberalism is nowhere to be found.

Another celebrated economist, Nouriel Roubini, beats the same drum as Krugman. In his well-known book, Crisis Economics: A Crash Course in the Future of Finance he does not seem to endow the "Santa Clause" version of the state, nor even Keynes himself. With phrases such as "*Non-performing banks go bankrupt, are restructured and born again*" [Roubini, 15, p.292] he seems to be convinced of the self-sustaining and selective virtues that the dynamic of free markets offers, even during crises. He even seems shocked that after the combined intervention of the government and the central banks, the other banks "… had the audacity to claim that their lousy actives were worth more than what every common judgment would afford. It's like putting lipstick on a pig" [Roubini, 15, p.298]. Roubini is convinced of the necessity to break out of the vicious circle because "… while continuously postponing for tomorrow that which we can do today, we risk letting the banks fall into a financial coma, turning them into undead entities dependent on public credit" [Roubini, 15, p.298]. An Austrian would follow through with this idea. That is after he would advance an alternative explanation for crises and the economic cycle. Roubini can't seem to conquer his fear that without intervention, the patient known as the economy in crisis will unjustly die. He quickly does away with the idea that "some banks must go bankrupt …" [Roubini, 15, p.304], gives up and compares the crisis affected the economy, a crisis created by a few undisciplined economic actors, with a giant apartment building which, because of one tenant's foolish activity of smoking in bed, risks catching on fire and burn to the ground. Therefore, even if the guilty banks should go bankrupt, such a lesson would "go unnoticed in the raging hell" [Roubini, 15, p.306]. To avoid such a scenario, so as not to "burn down" the economy, Roubini admits the need for intervention.

We could also add to the aforementioned ideas Stiglitz's generous lesson about the inexhaustible reservoir of collective wisdom that the state possesses. It is enough to read at least once Freefall: America, Free Markets, and the Sinking of the World Economy [17] in order to find out that without the state, no serious undertaking can be accomplished.

We can draw the following concluding idea: During the last great crisis, these last few names have been invoked to come up with solutions; these and all of Keynes's followers. No name and no idea belonging to the Austrian School have even been examined by the influential officials of the world. When will the time of the Austrians finally come?!

Money as an institution vs. money by the waggon! What about the banks?

It is unanimously accepted that in a modern economy, management at the macro level is inconceivable without money and banks. Mises spent a great deal of energy to demonstrate the incapacity of the socialist economy to use economic calculus, more specifically, monetary calculus. Calculus using physical units was deemed to be more faithful in expressing "great achievements". The refuse of money in socialist economies was based on their weak ability to faithfully convey economic results. Yet, the aforementioned aspect doesn't constitute the main difference between the role money plays in an interventionist regime, be it socialist or Keynesian, compared to a liberal one. It has more to do with the different manner of interpreting the genesis and functions of money and, consequently, the mission of the banks.

Two great contributions, well deserved to be catalogued as classical, are known on the subject. They are attributed to Marx [8] and Menger [9]. If one strips Marx of his ideological shell, one realises that he and Menger make the same claim: money was created in order to measure value. The need to make trading operations more effective determined the creation of money as a general equivalent to be used in the world of goods. After being certified by the history of economic facts, they gained the status of an institution, of proved and tried practice. The entire world, not just the scientific echelon, understood that their main function is to offer a standard for expressing value. All the other functions, including that of means of exchange, are derivatives of its main characteristic.

Of great importance to our subject is the statement that money is not created as an intentional act of will, be it personal or public. Menger is very explicit when stating that "*Money is not the product of an agreement on the part of economising men or the product of legislative acts. No one invented it*" [Menger, 9, p.262]. But if money is the result of a spontaneous process, the product of a „trading environment", must this necessarily mean that public authority, namely the state, has no contribution whatsoever? Menger is not taking things that far. "The fundamental heterogeneity of individuals" and, consequently, the heterogeneity of subjectively assessing values, compel Menger to accept the state only as an authority meant to enforce the value aspect of money. Otherwise, money is nothing more than a "shared belief", an institution boasting the characteristics of an "optimal choice". How can this type of optimality be reconciled with the state's prerogatives of not only enforcing the value of money, but also of determining, through administrative measures, the necessary quantity of money, is a question whose answer represents the end of an on-going dispute which Hayek and Friedman saw fit to resolve either through the "*denationalization of money*" (Hayek [3]) or through privatizing the process of monetary emission (Friedman [2]).

The origin of the argument can be found in Keynes's main work – The General Theory. Keynes was not so gullible to not realise that the main function of money is to act as a standard for expressing value. But it did not bode well for him that, according to said principle, there can be neither a greater nor a lesser quantity of money circulating at any given time in an economy than that which is necessary to give the measure of existing value and the purpose of the banks is to manage the process in order to preserve the health of the economy and the wellbeing of the individual. As an academic, he served science but he also wished to serve the state. Or, for his sake and the promise of fame, he feels puzzled. Keynes doesn't seem to care about the consequences and it became apparent that he signed a pact with the government when he wrote that "… if money could be cultivated as a harvest or produced in the same manner as a car engine, economic depressions could be avoided or ameliorated" [Keynes, 6, p.297]. If the tendency of lax monetary emission, freed from the limits imposed by the purpose of expressing value, is not sufficiently clear, on the very same page, Keynes writes that *"… money are like a bottomless sack for purchasing power when demand for them is rising*" [Keynes, 6, p.297]. Keynes's "scientific" thoughts will act as inspiration for all those who will see excess monetary emission, with no connection to the world of goods, as a solution to overcome a great crisis. Despite Hayek's warnings, Keynes's message made and is still making history. It inspired the New Deal and Mario Draghi's view that money is not that which economy says it is, but that which the government decides it should be. This concession comes bundled with the opinion endorsing the bank as a "lender of last resort". One cannot accept this line of thought unless one accepts that it is perfectly normal to mobilise trucks full of money if the Keynesian effective demand requires it, invoking the hypocritical assistance of the state and, at the same time, doing away with the laws of bankruptcy. Unfortunately, refuting such a point of view proves to be quite difficult. When officials, such as Alan Greenspan or Mario Draghi base their initiatives on "established" voices and the writings of Nobel laureates such as Stiglitz or Krugman, it is difficult to swim against the current. De Soto, Boettke, Salin or Hülsmann can only "shout". Their arguments fall on deaf political ears. The politicians can't (or rather won't) hear them!

"The Fiscal Tyranny" vs. The world empire of progressive taxation

"The Fiscal Tyranny" [16] is the title of an emblematic book, written in the Austrian tradition, which tackles the topics of anti-statism and interventionism. Through Pascal Salin's pen, the curious reader finds out that taxes, just like the state, are a necessary evil. One that we cannot make do without because we are "condemned" to live in a city, be it a civilised one, to whom we reach out when non-individualized public expenses are to be made in order to provide for the necessities of social life. It's clear that, in a purely liberal manner, Salin argues that the optimum solution is that of the minimum government and a minimum level of taxation. Throughout history, the state proved to be an inefficient and unskilled spender of money when it comes to better the condition of each and every individual, so it is wiser to let the individual take care of such affairs; to relieve the state and "free" him of as many public duties as possible. That this is almost impossible, given the "natural talent" that those in public offices display when it comes to spending in an unproductive and riskless manner other people's money, was proven by James Buchanan [1], winner of the Nobel prize in 1986. Yet Pascal Salin does not give in to despair and offers convincing arguments that question the so-called "humanist" principle of progressive taxation, the immorality and harmfulness of taxing inheritances, the treacherous nature of taxation through inflation, the statist pretension of harmonizing society through high and very high taxes on capital and so on, all these meant to represent examples in order to understand "*Why has the state grown so big?"* [Salin, 16, p.242].

There is no shortage of books and articles written against the doctrinal orientation of Pascal Salin. On the contrary, socialists of different nuances, statists and interventionists of all colours, they all have filled the world's libraries with demonstrations about the "civic blessing" that can be brought about through taxation. Out of all the aforementioned material, the book which I found representative and perfectly matched with "The Fiscal Tyranny", is none other than Thomas Piketty's Capital in the twenty-first century. It is infused with socialist, statist and interventionist essence, both at the micro but especially at the macro level of analysis. Taking on the task of sketching the structure of a socialist state for the twenty-first century, Piketty identifies the solution in the form of progressive taxation policy imposed by a global government. On page 869 of his huge one-thousand-pages book, he admits that his vision would be "a useful utopia", but one that is desirable and feasible. In stark contrast with Salin, Piketty sees in taxation the solution to "*determine the owners of capital to obtain the best possible performance*" [Piketty, 14, p.891]. For the first economist, taxation is theft and a destroyer of the incentives meant to stimulate production [Salin, 16, p.23]; the second one cannot conceive the harmony of the city and a generally good state of affairs without a maximal level of taxation (80% for big capital gains).

Which one of the two inspires the official policy of the states? Piketty is being lauded by Paul Krugman who writes on the cover of his work that this is „The book that will alter the way in which we perceive society and we think about economics". In the same country where Piketty enjoys the glory brought about by his rise to fame as a world-class economist, Pascal Salin is labelled as an economist "gone astray". His Mont Pelerin membership doesn't mean much. On the 20th of May 2016, Capital in the twenty-first century had 3270 citations according to Google Academic, while "The Fiscal Tyranny" just one! The cohort of freedom designing politicians, specialised in social engineering at all levels of society, fallen head over heels in love with the omnipotent state, was eagerly waiting for a Piketty like figure to emerge. Meanwhile, the economic science delivered on time and *en fanfare*, and the brass band was, quite literally, Nobel material. When will the time also come for Pascal Salin?!

Conclusions

The Austrian School was consistently concerned with law making. But it was a law version of its own making, one whose alpha and omega elements of both the theoretical discourse and practical action were designed in accordance with the liberal ideals of free market economy, clearly determined private property rights and minimal, law controlled state.

The result of the analysis conducted on the data set provided by the last century shows us that chances are slim for the theoretical tenets of the Austrian School to fully inspire economic policy. It would be far too beautiful to have governments run by the followers of Menger, Mises or Hayek. All that's left is for us to want them. Why? The Austrian School refused and is refusing still opportunism, hastiness and improvisation. In other words, it doesn't say what the politicians wish to hear. Positioning itself as a counter force, it serves as a political censor. It does not directly inspire politics but it keeps it in check. Enjoying a broad presence, its message, even though it is not needed, it is at least heard.

By refusing its generous offer, economic policy chooses short term gains over long term advantages. The recurring nature of economic crises is just one example. Always swimming against the political current, the Austrian School carries on only in the form of pure science. For the healthy nature of economic thought, this is an invaluable achievement. It has the value of an ideal that one can aspire towards, even though, at the moment, the twists and turns of economic policy are deceiving. Not being harnessed to the cart of official policy, the Austrian School has and will continue to have, the status of landmark and solid judging criterion of the economy.

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