A Primer on Austrian Economics

Unsurprisingly, not all economists agree on how to approach what used to be called "political economy". Adam Smith in 1776 defined it as "an inquiry into the nature and causes of the wealth of nations". It was understood that the default state of mankind was poverty, so the question was how people become wealthy.

There are various "schools" of economics that base their thinking on different ideas. Some of those ideas are nonsense and promote a lot of bad thinking and false conclusions. For example, the "labor theory of value" (central to Marxist theory) holds that the value of something is determined by the total amount of labor required to produce it. This would mean that there is no such thing as wasting labor on things people don't want or need, and that a hole dug by hand is worth more than a hole dug by machine because more labor went into it. People who pay for excavation don't want to pay more because more people were involved, let alone because it took longer to complete the work.

The ideas that the Austrian School of Economics is based on were taught at the University of Salamanca in Spain back in the 1400s. They observed that natural and consistent causes and effects could be identified to explain things like value and price. They taught the subjective theory of value and the law of supply and demand. They advocated private property ownership and freedom of exchange. They opposed taxes and price controls and regulations that inhibited creative enterprise (what later became known as "laissez-faire").

People continued to teach and build on these ideas alongside others for centuries. In 1871, Carl Menger (an Austrian, hence the Austrian School) published his *Principles of Economics*. As a professor of economics at the University of Vienna, he explained things like the subjective basis of economic value, marginal utility, and the origins of money. He was a classical liberal who taught that economics was about individual choices, as opposed to others who taught that economics was about accumulating data in service of the state. Following Menger, others like Eugen Bohm-Bawerk continued to clarify additional things like the effect of "time preference" (a preference for satisfaction of wants sooner rather than later) on interest rates.

In 1912, a young Ludwig von Mises published his research in his book *The Theory of Money and Credit*. He presented an outline of what later became known as the Austrian business cycle theory and was appointed to the faculty of the University of Vienna. During the next few years, Mises served as an officer in World War I. Once that was over, he published his book *Nation, State, and Economy* in 1919. Mises taught against Bolshevik-style policies popular among socialists, and they tried to destroy his career over it (what is today commonly known as being "cancelled"). They successfully prevented him from being hired as a professor at the university again. In response, Mises published his book *Socialism* that effectively proved that price discovery and optimal use of resources is impossible under Socialism because without market prices, there is no means of logical economic calculation. Mises made it clear that socialism results in chaos and civilizational decline.

During the 1920s and 30s, Mises continued to teach and develop deductive economics privately, which he later called “praxeology”, or the logic of action. His most famous student, Friedrich von Hayek, won the Nobel Prize in Economics for his work outlining how prices effectively operate as market signals that help individuals co-ordinate their plans and activities. Hayek also served in World War I and wanted to avoid the mistakes that led to the war. He found that the best way for him to do this was to teach economics, which he did at the London School of Economics, the University of Chicago, and the University of Freiburg. His most popular book *The Road to Serfdom* helped to popularize the classical liberal movement in America after the New Deal and World War II.

Mises and Hayek left Austria in the 1930s to avoid the Nazi takeover. The Nazis hated Mises because he was a sworn enemy of national socialism, which is why they confiscated many of his papers and hid them during the war. Mises continued to write and published his magnum opus Human Action in 1949. Mises never again held a full professorship, but he did gather students at New York University such as Henry Hazlitt (author of the famous *Economics in One Lesson*) and Murray Rothbard (prolific libertarian author and theorist). Mises taught his seminars in New York until 1971 and died in 1973. The Mises Institute was founded in 1982 with the help of Margit von Mises, Hayek, Hazlitt, and Rothbard to promote the legacy of Austrian economic thought. That legacy spans many topics and continues to expand to deal with evolving technologies like cryptocurrency, as well as guide continued thinking in areas such as ethics, logic, and social organization.

Here is a short list of some fundamental ideas associated with Austrian Economics:

- The action axiom: people act based on their preferences to improve their well-being. Economists call this “praxeology” because it is based on humans making purposeful choices.
- Scarcity: resources are limited by physical reality, while human desire is not. There will never be enough of everything to satisfy everyone completely.
- Production must precede consumption. For example, you can’t eat a cake that hasn’t been baked first. Eating cake does not produce cake. You can’t eat your cake and save it for later, too.
- The future is uncertain, and saving resources for future use is a hedge against that uncertainty.
- Decisions to invest resources for future gains rather than consume them now are a reflection of preference in favor of increased satisfaction in the future over immediate satisfaction now. Economists sometimes refer to such delayed gratification as having “low time preference”.

- Property and property ownership records are not the same thing. Printing extra receipts does not mean more goods were produced or purchased. It just means an increase in claims on existing goods.
- Market prices are signals of value that reflect supply and demand. These signals help people coordinate and put resources to their highest and best use.
- Alternatives are sacrificed when decisions are made, which economists call “opportunity costs”.
- Market exchanges benefit both parties or they would not take place, given that both parties value what they receive more than what they offer. Austrian economists often refer to the study of exchanges as “catallactics”, meaning the study of how the terms of such market exchanges (ratios/prices) are reached.
- Interest is the price of borrowing money over time.
- Entrepreneurship is the activity of organizing systems and undertaking risks associated with allocating resources to uses of potentially higher value.