

### **BOOK REVIEW**

„ *The Austrian School: market order and entrepreneurial activity*”, by Jesus Huerta de Soto, first published in Spanish and translated in English by Edward Elgar Publishing Limited, Northampton Massachusetts, 2008.

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### **THE RISE, FALL AND REVIVAL OF THE AUSTRIAN SCHOOL OF ECONOMICS**

Why would anyone bother to write about the Austrian School of Economics in a Keynesian dominated era? Jesus Huerta de Soto, author of *The Austrian School: market order and entrepreneurial activity*, believes that the current state of affairs is probably the best reason to write about the importance of a heterodox school of thought.

#### **What is so special about the Austrian economics?**

From the very first pages of the book de Soto challenges the reader by asking a seemingly simple question: What is so special about Austrian economics? Is it the methodology? Is it the denial of the scientific method? Or maybe the importance that it emphasizes on the economic calculation which is unavailable to the state planner?

It's because all of these reasons, but most important because this school of thought has passed the test of time. Following the tradition of Marjorie Grice-Hutichinson and Murray N. Rothbard, de Soto firmly believes that the birth of the Austrian School of Economics (ASE), and for that matter of sound economics, can be traced back to its Iberian roots, in the School of Salamanca.

For the modern reader it may come as a shock to find out that Spanish scholars from the 15th century had free-market oriented ideas, but for de Soto this certifies the veracity of the doctrine which has been sabotaged by the Keynesian and neo-classical ideas during the last century.

### **The basics**

The first chapter lays the basic principles of the ASE in a schematic and easy to follow chart through a comparison with the neo-classical school of thought. Although the author feels sympathy for the neo-classical approach, he ultimately rejects its premises and its mathematical formalism. These concepts are easily disproven through the Austrian sui-generis method, praxeology, devised early in the 20<sup>th</sup> century by Ludwig von Mises in his monumental treatise *Human Action*.

### **Knowledge and entrepreneurship**

The second chapter tackles the economic issue of entrepreneurship, a basic concept for the ASE and a pivot of Austrian economic analysis. De Soto examines the essence of entrepreneurship and the economic role played by the knowledge of the entrepreneurs when they act in the market. In de Soto's opinion, this is the only way one can comprehend the coordinating tendency of dynamic market processes.

Unfortunately de Soto falls short on his explanations and a careful reader easily notices the inherent contradiction of his arguments: he rejects the neo-classical mathematical model with mathematical derived results.

### **The *salamanticenses***

The third chapter is probably the most exciting. De Soto presents a comprehensive view of the ASE going back to the School of Salamanca. The author captures the essence of libertarianism following the continental Christian tradition of the Spanish and Portuguese intellectual and pedagogical work. The precursors of the ASE were a group of theologians and jurists who undertook the reconciliation of the teachings of Thomas Aquinas with a new political order. The themes of study in the School of Salamanca were morality, jurisprudence and economics.

On this very same school of thought much attention has been drawn by Joseph Schumpeter in his *History of economic analysis*. Although the Salamanca School did not elaborate a complete doctrine of economics, the theologians have nonetheless established the first modern economic theories. In de Soto's opinion, the *salamanticenses* are proto-Austrians because they have provided the core of von Mises' argument on the theoretical impossibility of socialist planning.

### **The four fathers**

The following three chapters describe the main theories of Carl Menger, Eugen von Bohm-Bawerk, Ludwig von Mises and Friedrich Hayek and their contributions to the foundation of the ASE.

As professor of economics at the University of Vienna, and then tutor to the young but ill-fated Crown Prince Rudolf of the House of Habsburg, Menger restored economics as the science of human action based on deductive logic, and prepared the way for later theorists to counter the influence of socialist thought. Indeed, his student Friederich von Wieser strongly

influenced Friedrich von Hayek's later writings. Menger's work remains an excellent introduction to the economic way of thinking.

Bohm-Bawerk's *Positive Theory of Capital* demonstrated that the normal rate of business profit is the interest rate. Capitalists save money, pay laborers, and wait until the final product is sold to receive profit. In addition, he demonstrated that capital is not homogeneous but an intricate and diverse structure that has a time dimension. A growing economy is not just a consequence of increased capital investment, but also of longer and longer processes of production.

De Soto emphasizes on Bohm-Bawerk's battle with the Marxists over the exploitation theory of capital and other theories which depict interest as rooted in the marginal productivity of capital. Though Böhm-Bawerk's contribution is not absolutely perfect in terms of explaining interest, and in the end, almost without realizing it, he partially fell for the theory of the marginal productivity of capital, to Böhm-Bawerk goes the credit for laying the essential foundations of a theory of capital and interest which would later be refined and carried to its logical theoretical conclusion by authors like Frank A. Fetter.

But the ASE doesn't reach its climax until Ludwig von Mises, the economist which, in de Soto's opinion, perfectly distilled the essence of the paradigm Menger introduced. In von Mises' own words:

*What distinguishes the Austrian School and will lend it everlasting fame is its doctrine of economic action, in contrast to one of economic equilibrium or nonaction.*

Von Mises did a better job than anyone else of applying this dynamic conception of the market to new areas where the analytical Austrian view had not yet been applied and, in doing so, he furthered its development within the theory of money, credit and economic cycles, built a sophisticated theory of entrepreneurship as the coordinating, driving force in the market, and refined the school's methodological foundations and the dynamic theory as an alternative to conceptions based on equilibrium.

The last of the four fathers is Frierich Hayek, a leading intellectual figures of the twentieth century, a multidisciplinary philosopher, a great classical liberal thinker and the only Austrian Nobel Prize winner in 1974, the year following the death of his teacher, Ludwig von Mises. Hayek produced a very extensive collection of works, which now exert a strong influence in the most varied spheres, not only in economics, but philosophy and politics as well. Alongside von Mises, Hayek authored many studies on the business cycle, warned of the danger of credit expansion, and predicted the coming currency crisis.

### **The radical Austrian School of Economics**

De Soto attributes the resurgence of the ASE to Israel M. Kirzner and especially to Murray N. Rothbard, both students of Ludwig von Mises. In the tradition of many Austrian scholars, Rothbard was uncompromising in his views and was ostracized from many influential political bodies because of his perceived radicalism, even within right-leaning conservative groups that would normally have been sympathetic to his views.

Rothbard's *Man, Economy, and State* was patterned after *Human Action*, and in some areas, mainly monopoly theory, utility and welfare, and the theory of the state, tightened and strengthened von Mises's own views. Rothbard's approach to the Austrian School followed directly in the line of Late Scholastic thought by applying economic science within a framework of a natural-rights theory of property.

Rothbard extended and "radicalized" the Austrian School, taking von Mises's insights and pushing them to their logical conclusion. Unlike Mises's view that there was a role for the State (in providing public goods and services such as law and order and basic infrastructure) it was Rothbard's view that all goods and services could be and should be produced by the private sector. He viewed many regulations and laws ostensibly promulgated for the "public interest" as self-interested power grabs by scheming government bureaucrats engaging in dangerously unfettered self-aggrandizement, as they were not subject to real competition. Rothbard held that there were inherent inefficiencies involved with governments providing commercial services and asserted that real competition would eliminate these inefficiencies, if those services could be provided by the private sector.

### **Future prospects**

De Soto's monography ends with the rebirth of the ASE. Ushering a new millenium, dozens of younger Austrian scholars are working on a variety of topics and tackling myths in the current economic mainstream. The current themes of the ASE and how entrepreneurship affects multiple angles (competition, monopoly, institutional coercion, and welfare economics) are well described. Furthermore, de Soto replies to the comments and criticisms against the ASE.

As a conclusion, the book offers a concise historical perspective to the Austrian ideas and entices the young reader to supplement and deepen the study of a better and free society.