

## Chapter 10

# Austrian Economics Yesterday and Today

The body of economic knowledge is an essential element in the structure of human civilization; it is the foundation upon which modern industrialism and all the moral, intellectual, technological, and therapeutical achievements of the last centuries have been built. It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not annul economics; they will stamp out society and the human race.

—Ludwig von Mises (1949), *Human Action*: 885.

The Austrian School of economics has a long and distinguished history. Members of this school have been awarded the Nobel Prize in Economic Science, recognized as Distinguished Fellows of the American Economic Association, elected to the British Academy, served as President of the major scientific associations in economics, edited the major academic journals, and taught at some of the most prestigious universities in the world. Beyond this rich history, the central elements of the Austrian School have contemporary relevance for economic understanding and for public policy.

Economics is fundamentally a human science, meaning that the study of all economics phenomena must be traced to the purposes and plans of individuals. People are embedded in an array of formal and emergent institutions, and Austrian scholars have shed light on the arrangements that advance the human condition. By clarifying the delineation of mine and thine, property rights are

a prerequisite for exchange that is at the foundation of broadening the extent of the market and increasing the creation of wealth. These ownership rights motivate individuals to use their resources in productive manners. The beneficial exchanges that are pursued because of the recognition of opportunities for mutual gain result in settled terms of exchange that are expressed in market prices. These prices, in turn, allow economic actors to engage in economic calculation to determine how to allocate scarce capital goods to produce outputs valued by consumers. Profit and loss serve as crucial feedback to entrepreneurs, informing them whether their judgments about the use of scarce resources reflect the wants of consumers. By enabling economic actors to sort through the array of alternative uses of scarce resources, the market process allows for the complex coordination of economic activities through time that delivers generalized material progress.

Even the most well-intentioned and limited government interventions into the market are troublesome because they distort the market process. By distorting prices and profit and loss, interventions distort the signals sent to entrepreneurs that, in turn, adversely affect the capital structure and the outputs ultimately produced. One example is bank-induced credit expansions, which reduce the interest rate and change the production plans of entrepreneurs by distorting the perceived profitability of more roundabout production processes. Because this intervention distorts the economic signals sent to entrepreneurs, it results in an allocation of resources that does not align with the underlying preferences of consumers. This malinvestment eventually results in a bust because of the disjoint between entrepreneurial decisions, as a result of the artificially low interest rate, and actual consumer preferences. As the Austrian theory of the business cycle illustrates, interventions into the market process have real effects that can adversely affect human welfare.

Another issue with government intervention is that it grants significant power to policymakers. While this power can potentially be used for good, it can also be used to engage in opportunistic behaviour that benefits a few at the expense of the many. When this happens, the desirable consequences of the market process are dampened, if not altogether eroded. Cronyism, the entanglement of private and political actors, is perhaps the most relevant contemporary example of this logic: where private actors can partner with the

political elite, they are able to establish barriers that undermine the competitive market process. This weakens the ability of the market process to generate widespread improvements in human welfare.

The central mystery of economics is how the market society achieves social cooperation and economic coordination without central command. The answer to this mystery can be found in the main tenets of the Austrian School of economics, which remain as relevant today as when they were first introduced.

