

COMMENT ON SALIN'S "THE MONETARY ECONOMICS OF THE AUSTRIAN SCHOOL AND THE CHICAGO SCHOOL"

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Professor Pascal Salin has embraced the ambitious project of reconciling the Austrian and the Chicago fundamentals of monetary theory. His in-depth knowledge of the most relevant doctrinal aspects of both schools and his acute awareness of the related stakes account for the very dense exposé of a question that could be treated at book length. His presentation may prompt occasional questions,¹ but it shows a certain sympathy for the Austrian approach, which is articulated and referenced with relatively greater care than the Chicago approach.

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¹ For instance, Salin states, without the support of a quote, that Ludwig von Mises considers the concept of the quantity of money as "useless." The lack of praxeological certainty in the notion of money, defined as the most common medium of exchange, does not imply, however, that the stock of money is irrelevant. The many attempts by the Austrians to find the most adequate measure of the money supply suggest the exact opposite. Similarly, with no explicit reference, Salin suggests that because of the real cash balances effect, the Chicago school economists admit that any aggregate nominal quantity of money is sufficient for the economy. Yet the endless quest for an optimal monetary policy, in particular as undertaken by Milton Friedman himself, offers evidence that non-Austrians do not endorse this most fundamental theorem of monetary theory.



Salin proposes two complementarities that would be conducive to a reconciliation of the Austrian and Chicago schools. First, he suggests that openness to some of the other school's key concepts in both schools would contribute to theoretical consensus. For instance, acceptance of the notion of a general price level in the Austrian school could foster mutual understanding on such issues as the validity of the quantity theory of money, price stability, and money neutrality. Second, a stronger interest in each other's research agendas could promote cross-fertilization of ideas between the schools.

Well-intended and richly argued as Salin's proposal for reconciliation is, it eschews a discussion of one aspect of the two schools that is also relevant to their respective monetary views; namely, their analytical method. The remainder of this short comment aims to clarify why the specific praxeological approach of the Austrian school makes its monetary theory unique. By implication, as long as methodological differences between the Austrian and the Chicago traditions persist, no reconciliation will be within reach. The comment concludes that this is the decisive, though unintended, contribution of Salin's article.

The praxeological approach is rooted in the axiom of human action—i.e., the fact that individuals use limited means to achieve unlimited ends. The systematic rational analysis of the general structure, specific aspects, and concrete conditions of purposeful human action reveals the logical implications that apply to all instances of human action, whenever and wherever they occur. These time- and space-independent regularities related to and implied by human action constitute the laws of economics. Their deductive discovery comes through the progressive unveiling of ever more elaborate conclusions about human action itself. Built in that way, economic theory is necessarily true, unless errors have been committed in the logical chain of thinking, and realistic, as it derives from our direct comprehension of reality. It is also concrete insofar as it applies to instances of actual human action. This praxeological method of building economic theory, which is the distinctive mark of the Austrian school in the Misesian tradition, is fundamentally different from an abstract analysis of arbitrarily simplified synthetic versions of reality (models).

The consistent application of the praxeological method led Ludwig von Mises to make many great contributions to economic theory.

One of his achievements was to clarify the necessary conditions for cooperative action in society. For social cooperation to occur, it must be more rewarding, including in terms of higher physical productivity, than individual action in isolation. The theorem of comparative advantage, properly understood as a general law of association, proves the superiority of social cooperation. Yet Mises emphasizes that the actual coming into being of society based on division of labor requires two further conditions: private property in the means of production and the use of money for intermediating exchanges. Rational decision-making in society needs a tool for economic calculation—i.e., for comparing incurred and expected costs to expected revenues. Mises has proved that monetary calculation based on market-determined monetary prices for the factors of production is the only possible solution to the problem of organizing social cooperation on rational grounds. In other words, the monetary capitalistic economy is the only functional form of society.

This major conclusion, in addition to explaining the key social function of money, has analytical implications that account for the uniqueness of the Austrian monetary theory. Because money is foundational to the economy and to the actual market process, it is no longer permissible to discuss the market process in isolation, without an explicit reference to the monetary aspect that all transactions have. The realism and concreteness of the praxeological method command the economist to keep in mind that any supply of good A or B is, at the same time, a demand for units of the medium of exchange M, and vice versa. The recognition that money is an integral and constitutive element of the market process implies that, analytically, monetary considerations should permeate the theory of market exchanges. This significantly broadens the scope of the Austrian monetary theory, as opposed to alternative approaches, such as that of the Chicago school.

Thanks to its broader scope, the Austrian monetary theory avoids the limitations and difficulties of alternative mainstream approaches to money. For the Austrians, there is no issue of integrating money into the analysis of individual consumption and investment choices—i.e., of an allegedly independent “real” economy. Subjective valuation at the margin applies directly to individuals’ holdings of monetary units relative to units of other goods and services. This allows for a coherent explanation of monetary prices, as they really

occur in the market process, based on the subjectivist value theory. Indeed, this is the superb "monetary integration" that the Austrian school of economics has achieved, and which finally removed the veil of money that plagued classical economics for so long and raised such a mathematical challenge to neoclassical economics. For the same reason, the Austrian monetary theory does not face the standard mainstream problem of lacking microeconomic foundations for its macroeconomic findings.

This fully integrated explanation of monetary prices and the market process is the cornerstone of the Austrian monetary theory. It sets a consistent framework for the relentless revision of economists' findings as regards money, its role, and its consequences. The classical quantity theory, the specie-outflow equilibration mechanism, the parity theory of exchange rates, the monetary stimulation of economic activity, and central bank policies, among other questions of theory and practice, can all be reexamined, and their respective deficiencies corrected, in a coherent manner. This process of reconstructing prior findings ensures internal consistency in the conclusions of the Austrian monetary theory and in this sense is an integral part of its formation. Moreover, the Austrian monetary theory is indifferent to disagreements or complementarities with other schools of thought.

One specific issue that the Austrian school has reexamined with particular care concerns the consequences of an increase in the stock of money. With respect to this question, and based on their realistic approach to economic phenomena, Austrians emphasize that the additional monetary units enter the economy at a specific point; namely, the monetary holdings of the first receivers of the new money. Because of decreasing marginal utility, the first receivers of the additional monetary units will exchange at least some of them for some units of other goods and services that they value more. This additional demand for other goods, which is the other side of the higher supply of money, implies an increase in these goods' prices. This price increase serves to transfer those additional monetary units that the first receivers did not wish to retain to the second receivers. Depending on the latter's own value preferences, they retain part of them and offer the rest in exchange for other goods, the prices of which in turn increase. This sequential process of partial retention of some of the new money and of spending the rest results in successive

price increases. It stops when the last receivers prefer to hold all extra monetary units in their balances due to the new structure of generally higher prices. In the transition to the new final equilibrium, the first and earlier receivers of the additional money are affected positively by the income and wealth redistribution driven by the unfolding new price structure, while the later and last receivers are affected negatively. Some are better off, and others are worse off than they would have been if the change in the money supply had not occurred. This is why the Austrian monetary theory concludes that money is not, and never could be, neutral. This demonstration of money's nonneutrality also shows that 1) the concept of a price level has no analytical role to play and 2) the distinction between short-term and long-term effects has no heuristic content.²

Professor Salin goes to great lengths in his attempt to reconcile the Austrian and the Chicago school approaches to money nonneutrality. Characteristically, he starts his argument by clarifying the analytical method that he intends to follow. This method is based on "a simplifying temporary assumption in the first step of a chain of reasoning." This approach is a recurrent theme in Salin's article, which openly invites Austrians to accept mainstream concepts "at least as first steps in a chain of reasoning." Professor Salin implies that such simplifying assumptions and abstract concepts are part of the scientific method: "A scientific attitude consists in extracting some main features from reality at the expense of a comprehensive description of it." However, as argued above, the praxeological method offers a realistic alternative that does not suffer from a tradeoff between simplification and comprehension. Moreover, what is the exact "simplifying temporary assumption" when the question of the neutrality of money is analyzed? It postulates that "demand and supply for all goods are stable" or that "the real determinants of demand and supply are not changing."³ Such a starting position,

² One could consider the short-term effects as the income and wealth redistribution related to the first and early receivers of the additional money, while the long-term effects would also include the income and wealth redistribution related to the later and last receivers. Yet this would only emphasize that as long as the analysis refers to the short-term effects, it will remain incomplete. Moreover, this does not get us any closer to any "quasi-" or "long-term" neutrality.

³ Notice that this assumption boils down to the analytical dissociation of changes in monetary cash balances and changes in individual valuations. This is tantamount

which is tantamount to assuming that money does not matter for price determination in a monetary economy, does not simplify the analysis of reality. It distorts it by removing its most essential feature. If one starts an argument by assuming that money is neutral, then money is neutral for the sake of that argument. Yet it is an entirely different question whether money is neutral in reality, a question to which only the praxeological method can provide a satisfactory answer.

In sum, Salin's article contributes to a better understanding of the limits of all attempts at interdoctrinal reconciliation. First, his reasoning makes it clear, though implicitly only, that persistent differences in the theoretical views of the Chicago school and the Austrian school are ultimately attributable to differences in the analytical methods the schools have adopted.⁴ Hence, to bring different schools of thought closer, it is first necessary to bridge the methodological gap. Second, the results of this reconciliation effort speak for themselves. Salin is careful to avoid misrepresenting the Austrian and Chicago views. Consequently, the attempted reconciliation boils down to an exhaustive catalogue of their many differences and nuances. The strategy of suggesting multiple complementarities *de facto* admits that no reconciliation has taken place. Finally, Professor Salin remains silent on the reasons for and the expected benefits from such efforts to evaluate possible avenues of convergence between the Austrian and the Chicago monetary theories. He expresses his belief that the identification of areas of convergence is a fundamental task for present-day economists. His motivation stems from the generous intention to find intellectual allies of "the Austrian approach to economic problems." Yet the only indefectible ally of the Austrian approach is the truth of the conclusions reached by its praxeological method of analysis.

to excluding money from the consistent application of the subjectivist value theory, and therefore to the return of the money veil, at least analytically.

⁴ Such methodological differences are themselves rooted in divergent epistemological views.