

ON THE COMPLEMENTARITY OF THE AUSTRIAN AND MONETARIST TRADITIONS

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Pascal Salin, professor emeritus of Paris Dauphine University, is one of Europe's leading experts in the field of macroeconomics, especially, but not exclusively, from the vantage point of Austrian economics. Professor Salin makes clear at the very beginning of his article on "The Monetary Economics of the Austrian School and the Chicago School" that he is in favor of the Austrian approach, but it is well known that he has not always been an "Austrian" (Hülsmann 2007). In his early career, he was influenced by, among others, the works of Milton Friedman, arguably the most important representative of the Chicago school and monetarist tradition. In Professor Salin's home country of France, the most important intellectual influence on his work probably came from Jacques Rueff, whose own outlook on economics was indeed influenced by the Austrian school. In my eyes, Rueff represents a hybrid position between Chicago monetarism and Austrian economics.¹ It is thus no surprise that Professor Salin, as

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¹ I admit that this interpretation might be considered too much of a stretch, as monetarism really evolved as a well-defined branch of monetary economics only after World War II, first with the works of Clark Warburton and then, of course, with those of Milton Friedman. Jacques Rueff had already had some of his most

one of Rueff's most important intellectual disciples, emphasizes the complementarity of these two schools of thought.²

In his article, Professor Salin focuses on two main aspects of monetary economics: first, the neutrality and stability of money, and, second, the balance of payments. I will limit my comment on the first topic, on which I agree with Professor Salin's proposition, but will add a couple of new elements and qualifications.

Professor Salin rightly points out that monetarists (or Chicago school economists) in some sense follow a more pragmatic approach by trying to formulate an optimal monetary policy rule, given the current monetary system, in which, for better or worse, monetary policy plays a major role. In this respect, they are much like other mainstream monetary economists, who very rarely, if ever, question the monetary system on a more fundamental level. In contrast, Austrians are more willing to discuss the relative merits of different monetary systems, regardless of how far removed they are from the system in place, and regardless of how likely a system's implementation seems in practice. One effect of this tendency is the Austrian school's emphasis on the potential benefits of currency competition, a topic that most other economists, including the Chicago school, typically do not discuss. This, however, does not imply that Chicagoans or monetarists would not acknowledge these benefits if they were to discuss currency competition.

productive and influential years in the interwar period, graduating from the prestigious École Polytechnique in 1919 to pursue a career as a senior civil servant and academic in Paris. As far as methodology is concerned, Rueff was mostly in line with the project of the Econometric Society, which was founded by Ragnar Frisch and others in 1930 (Rueff 1925, 1969) and whose position was essentially adopted by Friedman and the monetarists (Israel 2015, 2016). On practical conclusions related to monetary policy, Rueff was closer to Ludwig von Mises than to Friedman. It is in that sense that I consider Rueff to be a *mélange* of the two schools. I have shown some of Rueff's connections to Frisch in my doctoral dissertation (Israel 2017, 45).

² Here too, I must admit, I am speculating to some extent. Although I had the honor of meeting Professor Salin in person at the *Journée d'études en économie autrichienne*, a biannual colloquium dedicated to current research in Austrian economics, held at Sorbonne University in Paris last year, I have never asked him about his intellectual connection to Jacques Rueff. From his publications one cannot but infer a close connection and affinity. See, for example, Bourricaud and Salin (1989). At Paris-Dauphine, Professor Salin was also a close colleague of Georges Lane, who served as Rueff's research assistant and coedited his collected works.

As a matter of fact, there is some evidence that the late Milton Friedman developed a much more skeptical view of the role of governments in monetary affairs (M. Friedman and Schwartz 1986), which is a good first step toward a genuine laissez-faire position. Also, Friedman's close colleague at the University of Chicago, Gary Becker, contributed a very interesting article on "Free Banking" to the 2006 festschrift dedicated to none other than Professor Salin himself (Laine and Hülsmann 2006). Originally written in 1956, Becker's article is not a rejection of government monopoly over the issuance of currency, but it is interesting to note that in his new introduction to the paper for the festschrift, Becker made some concessions that suggest that he had come much closer to a Hayekian perspective concerning the denationalization of money. He wrote:

The paper was not published except in 1993 in a not widely circulated collection of free banking articles because I wanted to revise the analysis, but I did not get around to doing this. I was especially bothered by my conclusion that the Federal government should retain a monopoly over currency. A truly "free" banking system would permit banks to issue notes that circulate, and such a system might not even need government currency. (Becker, 2006, 227)³

We can thus join Professor Salin and confirm that at least some Chicago school economists are indeed open to a genuine free market in money. There is nothing in principle that prevents a Chicago economist from adopting a skeptical position toward a government monopoly over the issuance of money. David Friedman, the son of Milton Friedman, is another good example. He is as much of a Chicagoan as one can be when it comes to economics. As an advocate of anarchism, he rejects governments completely, including in monetary affairs. The chapter in his *The Machinery of Freedom* called "The Market for Money" contains the most important insight right at the beginning:

³ For a detailed discussion of Becker's article, see Van den Hauwe (2011). On a side note, Hayek published his more radical work on the denationalization of money after having won the Nobel Prize in 1974 (Hayek 1976). Friedman, too, came to a more radical position on money after having won essentially every award an economist could dream of. Now, Becker published his paper on free banking, which was originally written in 1956, for the first time in 1993. When did he win the Nobel Prize? 1992. Coincidence?

Discussions of alternative monetary systems usually focus on what kind of money we are to have—gold coins, pieces of green paper redeemable for gold coins, or pieces of green paper redeemable for other pieces of green paper. This is, I think, a mistake. The most important issue is not how the money is produced but by whom. (D. Friedman 1989, 219)

And it should not be the government. He continues: “The fundamental problem with government money is not that government cannot provide stable money but that it is not always in its interest to do so” (D. Friedman 1989, 219). Interestingly, the book is dedicated to both his father and Friedrich A. von Hayek—a testimony to the complementarity of the Chicago and Vienna perspectives, at least in some respects.

This complementarity is of course not perfect. There is an important element that makes economists of the Chicago-monetarist tradition more prone to opting for government involvement in the monetary system than Austrian economists. This element lies in the schools’ opposing views on methodology. The Chicago economists stand for an instrumentalist position, whereas Austrian economists stand for a realist position. The instrumentalism of the Chicago monetarists requires the formulation of a well-defined goal that is much narrower than the discovery of truth (which is the goal of any scientific enquiry). Their economic theories are primarily regarded as instruments to the attainment of that narrower goal. In monetary economics that goal can be summarized by the notions of *neutrality* and *stability*. Money ought to be stable and ideally neutral.⁴ In practice, this very often translates into the policy goal of a stable price level, a stable growth rate of the money stock, or a stable and modest rate of price inflation. But it is not even important how exactly one tries to attain the goal of stability in practice. Given any measurable specification of the goal, a free market in money is most likely to deliver imperfectly; that is, there will not be a stable price level, a stable rate of price inflation (or deflation), nor stable growth in the money stock in a competitive monetary system. The outcome might be relatively stable, but certainly not perfectly stable. And in

⁴ For a discussion of the neutrality of money within the Austrian tradition, see Salerno, Dorobăț, and Israel (2020). The paper suggests that the Wieser-Hayek branch of Austrian economics is closer to the monetarist position as described above than the Menger-Mises branch.

that sense, whatever the free market brings, there is always room for improvement with respect to the specified goal.

The realist position of the Austrians leads in another direction. Economic theory is not an instrument for attaining a narrowly defined goal, because there is no such goal. Rather, economic theory ultimately serves one broad and overarching goal, and that is the discovery of truths about reality. Austrians, and above all Ludwig von Mises, have thus concluded that *stability* or *neutrality* of money is essentially impossible and thus an untenable policy goal from the outset (Mises 1953, 236–38).⁵ Not only is there no way of objectively measuring the overall price level and the corresponding rate of price inflation over time, but there is also no stable causal connection between any monetary policy tool and the best approximation of such a price level. There is, then, no such thing as an optimal monetary policy. A free market in money would not deliver optimality or perfection either. There is no such thing in real-world economics. But a free market opens up a competitive process through which gradual improvements become possible and bad alternatives are exposed and sorted out. The ultimate judge in this discovery process is the complex interplay of subjective evaluations by market participants (Hayek 1969).

That being said, Professor Salin is quite right in pointing out that Austrians could make use of price indices in spite of their imperfections. But this is exactly what they tend to do when they engage in economic history. Historical analysis and illustrations of economic phenomena are built upon observable and measurable approximations of abstract theoretical notions. For example, the abstract notion of the purchasing power of money can be approximated by the inverse of some measurable price index in historical studies. But this remains an imperfect representation. Any empirical developments and statistical regularities identified in historical contexts, as interesting and thought-provoking as they may be, are not a substitute for theoretical explanation of economic phenomena (Mises 1985).

Finally, Professor Salin briefly mentions business cycle theory in his conclusion and suggests that the monetarist and Austrian theories

⁵ Carl Menger was admittedly somewhat ambiguous on the issue of monetary neutrality. For a detailed discussion, see Israel (2022).

can be reconciled. I think he is completely right, mainly because the monetarist theory is very thin. Many monetarists engage in economic history in the Austrian sense, rather than theory building properly understood (M. Friedman and Schwartz 1963; Schwartz with M. Friedman 1987). The statistical regularities that they uncover seem perfectly reconcilable with the Austrian explanation of the business cycle. In fact, I have always regarded their work as a strong empirical reason to believe that money matters in the business cycle. A convincing explanation of why it matters and what its mechanisms are is found in Austrian business cycle theory (Rothbard 2000). This area of economic research not only nicely illustrates the methodological differences that I briefly outlined above. It is also an area in which the complementarity of monetarism and Austrian economics is commonly underestimated. A more in-depth analysis of this area would have only strengthened Professor Salin's overall thesis.

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