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Book Review

The Essential Austrian Economics

Christopher J. Coyne and Peter J. Boettke
Vancouver: Fraser Institute, 2020. 68 pp.

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Christopher Coyne and Peter Boettke, both professors of economics at George Mason University, say, "The purpose of this book is to present an overview of the key tenets of Austrian economics. In order to do so we draw upon and synthesize the insights from the aforementioned thinkers to present and discuss a set of eight topics that capture the core elements of Austrian economics." By the "aforementioned thinkers," they mean Menger, Böhm-Bawerk, Wieser, Mises, Hayek, Kirzner, Rothbard, and Lachmann. They succeed very well in explaining the topics they cover in a way students will find easy to follow. Naturally enough, there are points of detail which other Austrians might address differently, and I shall mention a few of these in what follows. (The most questionable statement in the book, oddly enough, does not concern economics at all. In their chapter "Spontaneous Order," they say, "language emerges as people interact with one another and attempt to communicate."[p.

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34]. Chomsky would reject that, and the view is quite controversial.) But the main problem with the book lies elsewhere, and this I shall address after a summary of the book.

Before they cover their eight topics, they briefly explain the marginal revolution.

> The marginal revolution was a paradigm shift from the established labour theory of value to the marginal utility theory of value. The labour theory of value held that the value of a commodity is a function of the labour required to produce the item. The marginal revolutionists, in contrast, argued that value is not based on the amount of labour expended, but rather reflects how useful people perceive the commodity to be in satisfying their ends. (p. 1)

The new theory was able to solve the "diamond-water" paradox. Further, by proving that there are universally true economic laws, Menger refuted the German Historical School.

The first of their eight topics is "Methodological Principles." They explain in exemplary fashion the principle of methodological individualism: "Groups and organizations, which consist of people, do not engage in choice and do not have purposes and plans absent the individuals that constitute the group." (p. 5). It is precisely the purposes and plans of individuals which lie at the heart of Austrian economics, and, contrary to Alfred Marshall, the subjective nature of value determines not only the demand side of price, but costs as well.

As they note in "Economic Calculation," the allocation in a developed economy of production goods to alternative uses requires market prices, and Mises used this fact to prove the impossibility of socialism. "Mises argued that without property rights in the means of production, which the socialists wanted to abolish, there could be no economic calculation because there would be no money prices." (p. 13) The attempts by Lange and Lerner to incorporate some element of market pricing into socialism did not succeed. "The market socialists, Hayek argued, were preoccupied with a static notion of equilibrium where all relevant economic knowledge was given, known, and frozen." (p. 15)

Coyne and Boettke turn to another fundamental Austrian insight, one very much related to economic calculation. Capital is not a homogeneous "blob," but consists of a wide variety of goods, organized in stages of production. As Menger argued,

> the value of capital goods is not inherent in the goods themselves, but instead is derived from the lower-order goods in the structure of production. Raw materials do not have inherent objective value, but instead derive their value from what they contribute to the production of other, value-added capital goods in the structure of production. These lower-order goods likewise derive their value from their contribution to the production of the final consumer good. What ultimately drives this process is the expected value of the final consumer goods (the first-order goods) as determined by consumers. On the market, these subjective valuations are captured in the market prices of capital goods…." (pp. 18–19)

The chapter relies heavily on the insights of Lachmann, fortunately from his earlier work and not from his later "kaleidic" speculations.

The next chapter, "The Market Process," is Kirznerian in emphasis. Like Kirzner, the authors stress that the market allows individuals to coordinate their plans. "Markets are valuable because in order to accomplish our various goals we typically need to coordinate with others who are also pursuing their own goals." (p. 24) Is this true, I wonder? We can imagine, at each moment, an equilibrium that would be reached if all data were then frozen, but does it follow that individuals are endeavoring to reach this equilibrium? But this is not the place to pursue this difficult topic. They rightly note the importance of property rights that make possible the price system by which persons can adjust to changing circumstances. Entrepreneurs are central to their market process, and their account of this vital function follows Kirzner in his emphasis on "sheer ignorance." I am pleased to see, though, that they note the importance of loss as well as profit in their account of the entrepreneur: "The lure of profit provides an incentive for risk taking because a successful first mover can earn a significant profit by being the initial producer of a good valued by consumers. At the same time, the potential for loss makes entrepreneurs careful when making investment decisions." (p. 28)

Hayek moves to the center of attention in "Spontaneous Order." Here the key idea is that

> The systematic development of thinking about spontaneous order was achieved during the eighteenth century by scholars of the Scottish Enlightenment. Thinkers like Adam Ferguson, David Hume, and Adam Smith appreciated the idea that mechanisms existed to solve complicated problems and generate complex orders absent design or control by an individual or group of individuals. Moreover, given the nuance and complexity of these orders they could not be designed using human reason because they extended beyond what the human mind could grasp."

They highlight Hayek on the limits of human reason, and in doing so, they go astray in a way I shall later address.

They return in my view to a state of grace with "Interventionism." They take up Mises's famous example of price controls for milk. Price ceilings are introduced to make milk available more cheaply to the poor. They fail to achieve their purpose, since they lead milk sellers to withdraw milk from the market. The interventionists now face a choice: they can either end the controls, returning to free market pricing, or they can institute new controls that attempt to remedy the problems of the initial set. If they do the latter, the new controls will in turn fail. If the process of intervention proceeds long enough, the result will be the end of the market system altogether.

The authors continue with another excellent chapter, "Business Cycles." Expansion of bank credit lowers the monetary rate of interest below the "natural rate," determined by consumers' time preference. This leads to malinvestments that prove unsustainable when the credit expansion stops, and the liquidation of these projects constitutes the depression phase of the cycle. As the authors say, "In addition to discussing the policy response to a bust once it occurs, Austrian economists have also explored ways of avoiding the onset of a bust in the first place." (p. 47) But one could wish that when they present the various proposals for a monetary constitution, they had been more explicit about Rothbard's proposal for a gold standard without fractional reserve banking. They say,

> A monetary constitution can take a variety of forms in practice and might include such things as a rule limiting the amount of credit created within a particular time frame, the backing of credit by hard money to limit the ability of banks to print money, or monetary competition which would limit money creation by replacing a centralized monopoly supplier of money with competition among banks. (p. 48)

They conclude the chapter with an arresting remark: "The *General Theory* was published in 1936 and Hayek decided not to respond directly. In making this decision, Hayek committed what many defenders of the free market system consider to be one of the major tactical errors of this century." (p. 48)

The book's final topic is "Planning and the Power Problem," Coyne and Boettke explain Hayek's argument in *The Road to Serfdom* that the attempt to impose comprehensive economic planning is liable to result in an end to liberty.

> As Hayek pointed out in his 1944 book, *The Road to Serfdom*, economic planning by government policymakers necessarily violates the rule of law because planners must have discretion to address unforeseeable situations that cannot be anticipated *ex ante*.... Given what planning entails, successful seekers of government office will be those who are comfortable designing plans based on their preferences and imposing their vision on others who would have pursued different activities if left to their own, voluntary choices. Hayek argued that the very desire of planners to organize life according to a single, overarching plan emerges from the desire for power to control and shape the world according to the planner's vision. (pp. 51–52)

Although the various topics are for the most part handled well, there is, as I suggested at the start, a fundamental problem with the book. The authors do not have a clear sense of economics as a separate body of *a priori* truths about human action, and it is significant that the word "praxeology" nowhere appears in the text. True enough, they say

> The theorems of economics—that is, the concepts of marginal utility and opportunity cost, and the principle of demand and supply—are all derived from reflection upon purposefulness in human action. Economic theory does not represent a set of testable hypotheses, but rather a set of conceptual tools that aid us in reading and understanding the complexities of the empirical world. (p. 6)

But they mix together praxeological theorems with other things. It is true, as they say, that we can understand a postman's activity in stuffing pieces of paper into boxes by reference to "ideal types," but, as Mises explicitly said, ideal types are not part of economic theory. Hayek's speculations on the limits of human reasoning are worth attention, but once more they are not part of praxeology. The notion that under economic planning "the worst get on top" is very plausible, but again the psychological and historical insights need to validate this stand outside of praxeology.

The authors' failure to delimit praxeology as a separate field leads to a related problem. They rightly say, "The Weberian doctrine of *Wertfreiheit*— 'value freedom'—was adopted by Mises as a foundational principle of what it meant to do economic science." (p. 9) But the book abounds in value judgments. They say, for example, and I entirely agree, that "The appropriate response to a bust is to allow entrepreneurs, through the operation of the market process, to reallocate and regroup scarce resources in the capital structure." (p. 47) This is clearly a value judgment, and the way in which one can use praxeological knowledge to attain various policy goals needs more clarification than we find here. But all in all, *The Essential Austrian Economics* is useful and helpful, if not altogether essential.