IDEAS ON LIBERTY
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University Economics versus Austrian Economics

by Arthur Foulkes

Some time ago my wife asked me to define economics for her.

"Ah," I said, sensing an opportunity to sound intelligent. There was long silence. I sat up, cleared my throat, and said "Ah" again.

Truth was I wasn't sure how to answer her. Of course, I could have spouted some answer with lots of "scarcities" and "resources" (after all, years of teaching college courses had taught me how to sound intelligent without being clear), but I wanted something better for my wife. To date, I still haven't attempted to answer her, but I have, as they say in mystery novels, made inquiries.

One source I queried was, naturally, the Internet. I did a Google search of university economics department Web pages to learn how they, the trainers and certifiers of today's economists, define their science. The results are a little disheartening.

Many of the economic departments I found defined economics as the study of how *societies* choose what to produce and then how to allocate what has been produced. If definitions mention individuals at all, it is usually in conjunction with society as a whole.

Perhaps a benchmark definition for this view of economics is one by the Nobel laureate and best-selling textbook author Paul A. Samuelson. It's quoted prominently by one economics department. Samuelson writes economics is "[T]he study of how men and *society* end up choosing, with or without the use of money, the employment of scarce productive resources, which could have alternative uses, to produce various commodities over time and distribute them for consumption, now and in the future, among various people and groups *in society*."[1]

This emphasis on "society" makes sense if you presuppose the existence of interventionism and see the economist as someone who can choose for society at large whether to produce guns or butter or a little of each. Since this presupposition almost certainly *does* exist in the minds of most academics, politicians, and citizens, it makes sense that economics departments would reflect this in their definitions of economics.

One department's definition nicely sums up this perspective: "Our main motivation [as economists] is to find mechanisms which encourage efficiency in the production and use of material goods and resources, while at the same time producing a pattern of income distribution which society finds acceptable."[2]

Another department put it this way: Economics is the study of "how society provides for its material well being. It concerns the production, distribution and use of goods and services. It studies the allocation of scarce resources among alternative uses."[3]

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In addition to (and perhaps as a result of) this highly collectivist view, many departments also take a highly inductive and quantitative view of economics. They present the economist as a sort of white-coated laboratory experimenter, tirelessly seeking "a socially efficient equilibrium" where, as one department explains, "no individual can be made better off without making others worse off."[4]

One department states: "Economists are scientists. We design experiments, test hypotheses, make predictions, etc. As such, a good economist requires the same sort of skills needed by a good chemist or physicist. . . . [E]conomists work in the laboratory of everyday human and organizational behavior."[5]

Another says: "Many economists use mathematical models to explain and predict economic behavior and econometric analysis to test these models against observed data from the real world."[6]

Austrian Approach

Those two notions, that economics is about allocating *society's* resources and that it is largely an inductive and quantitative science, are both at odds with the Austrian school's approach to economics. First, Austrian economists do not focus on things (resources, goods, and services) but rather on human action. As perhaps the greatest Austrian economist, Ludwig von Mises, wrote, "Economics is not about things and tangible material objects; it is about men, their meanings and actions."[7]

Mises and other Austrians further emphasize that while human beings are certainly enmeshed deeply within society and "social entities," the focus of economics needs to remain squarely on the individual, not collectives. Mises wrote:

> A collective whole is a particular aspect of the actions of various individuals and as such a real thing determining the course of events.
>
> It is illusory to believe that it is possible to visualize collective wholes. They are never visible; their cognition is always the outcome of the understanding of the meaning which acting men attribute to their acts. We can see a crowd, i.e., a multitude of people. Whether this crowd is a mere gathering or a mass . . . or an organized body or another other kind of social entity is a question which can only be answered by understanding the meaning which they themselves attach to their presence.[8]

Ludwig von Mises (1881–1973)

The view that economics is an inductive science is also misleading from the Austrian point of view. Austrians view economic science as principally deductive, based on fundamental laws of human action, which are as real as "the laws of nature" and represent a body of knowledge pertaining to a "regularity of phenomena to which man must adjust his actions if he wishes to succeed."[9] Further, the quantitative analysis implied by an inductive approach is further suspect in the Austrian mind.

As Mises wrote: "The fundamental deficiency implied in every quantitative approach to economic problems consists in the neglect of the fact that there are no constant relations between what are called economic dimensions. There is neither constancy nor continuity in the valuations and in the formation of exchange ratios between various commodities. Every new datum brings about a reshuffling of the whole price structure."[10]

He added: "The mathematical economists . . . do not notice the individual speculator who aims not at the establishment of the evenly rotating economy but at profiting from an action which adjusts the conduct of affairs better for the attainment of the ends sought by acting, the best possible removal of uneasiness. . . . They describe this imaginary equilibrium by sets of simultaneous differential equations. . . . They deal with equilibrium as if it were a real entity and not a limiting notion, a mere mental tool. What they are doing is vain playing with mathematical symbols, a pastime not suited to convey any knowledge."[11]

It is, to me, interesting that a school of thought that (through its founder, Carl Menger) helped uncover the subjective nature of value and whose students explained and foresaw the eventual collapse of communist systems decades before the fall of the Berlin Wall is so consistently ignored by economics departments and introductory economic texts.

I once asked an economics professor whose specialization is monetary theory whether he was interested in the Austrian school. His answer was a quick and undiluted "No." At the time I didn't know that his own area of expertise is perhaps where the Austrians have made their most significant contributions, providing a comprehensive theory of the business cycle tied directly to monetary policy.

It is perhaps because the Austrian school is so clearly associated with deductive reasoning and nonintervention that mainstream economists are left unimpressed. Austrian economics does not, for example, encourage endless debates over the proper interest rate or the best rate of growth of the money supply. Austrian theory makes it clear that the best monetary policy is one that bases money on gold or some other true media of exchange, as opposed to allowing politicians and bureaucrats to manipulate the money supply, creating false signals, artificial booms, and, inevitably, busts.

It is encouraging to hear, as I do from time to time, that Austrian economics is experiencing a revival and is arousing new interest, especially in light of the current recession. Let's hope its fundamental notions can begin to penetrate our institutions of economic learning and training. □

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1. Quoted on the economics department homepage of the St. Mary's University (Halifax, Nova Scotia) website, www.stmarys.ca/academic/commerce/economic/eco.html. Emphasis added.
2. Trinity College Dublin (Ireland), www.tcd.ie/Economics/what_is_economics.htm.
3. Lock Haven University of Pennsylvania, www.lhup.edu/economics/.
4. Indiana University-Purdue University Indianapolis, www.iupui.edu/~econ/whystudy.html.
5. Franklin P. Perdue School of Business, Salisbury University, www.salisbury.edu/Schools/Perdue/EconFin/whatisecon.asp.
6. University of Nevada, Reno, www.coba.unr.edu/undergrad/econ/info.html.
7. Ludwig von Mises, *Human Action*, 4th rev. ed. (Irvington-on-Hudson, N.Y.: Foundation for Economic Education), p. 92.
8. Ibid., p. 43.
9. Ibid., p. 2.
10. Ibid., p. 118.
11. Ibid., p. 250.

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Henry Ford, Upton Sinclair, and Limits on Consumer Choice

by Richard B. Coffman and R. Ashley Lyman

Early in the twentieth century two prominent Americans, one a capitalist, the other a socialist, enunciated surprisingly similar views on the relationship between product differentiation and consumer welfare. The capitalist, Henry Ford, had revolutionized the young automobile industry, using mass-production techniques to provide cheap cars to American consumers. But Ford did not believe in offering product variety. He produced only one model, the famous Model T, and, in his typically blunt way, stated his policy on consumer choice of colors as: "Any color, so long as it's black."[1]

During the same era the socialist novelist Upton Sinclair published a popular and influential novel, *The Jungle* (1906), which stated his views on the unimportance of consumer choice. Sinclair felt variety in consumer goods was a frivolous waste of resources, which could be eliminated under socialism. One of his socialist characters says, "consider the waste in time and energy incidental to making ten thousand varieties of a thing for purposes of ostentation and snobbishness, when one variety would do for use!"[2] And another socialist speaker says, "Since the same kind of match would light everyone's fire, and the same-shaped loaf of bread would fill everyone's stomach, it would be perfectly feasible to submit industry to the control of a majority vote."[3]

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Ford and Sinclair both actively opposed variety in consumer goods. How did their ideas fare in their respective economic systems, capitalism and socialism?

Sinclair dabbled in politics, but never acquired enough power to implement his ideas. However, his socialist brethren later took control of Russia, Eastern Europe, China, and Cuba, as well as other countries. Thus while there were no socialist economies when Sinclair wrote *The Jungle,* the world since has seen many actual socialist economies at work. None used democratic votes to determine the kind of matches or bread produced, but all used government to make these determinations, and all offered consumers very limited choices within product categories.

Socialist governments adroitly rejected majority rule in consumption decisions. If everyone wants the same kind of bread, why even have a vote? Everyone knows what everyone wants, so just let anyone make the decision. Well, not just anyone: officials of the Socialist Party should make the decision. The argument that socialists with the interests of the masses at heart could easily make decisions for them was often advanced as a rationalization for the political dictatorships that dominated socialist economies in the twentieth century.

Although rejecting majority rule, the socialist elite did institutionalize the one-size-fits-all consumption doctrine espoused by Sinclair and others. Socialist governments forced consumers to all consume the same