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The Austrian School

by **Jesus Huerta de Soto**

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In his book *The Austrian School* Jesus Huerta de Soto took as his goal to explain both the fundamental principles of the Austrian Economic School and to show its superiority compared to the other competitive economic teachings, above all the dominant neo-classical school. It is a difficult and brave task that deserves respect, irrespective of the way it has been carried out, as it is well known that the Austrian School does not belong to the mainstream of economic theories today and, as such, many economists treat it as obsolete and old fashioned, making this work even more intriguing and interesting.

According to de Soto, two main features of the Austrian teachings contain its inner core: its peculiar understanding of market dynamics and its perceiving of economic science as a theory of action. Both of these two characteristics can contain all other aspects of the theory: the denial of the idea of market equilibrium as the main concept of economic science and the adoption of the theory of action, as the wider and more comprehensive notion than the decision theory of the neo-classic school. Initially, Carl Menger introduced the concept of human action as the main object of inquiry of all social sciences. At the same time human action is perceived primarily as a complex economic activity. It means that decisions, as the key notion of the neo-classical school, have become just a part of a more complex process. Namely the decisions, as de Soto points out, are embodied in human actions. Human action includes a series of acts, shifts of the point of view, taking into account new information, permanent new adaptive acts and coordinating activities. All these various activities were missing in the narrow concept of the decision theory. Correspondingly, starting from such a complex understanding of human behavior, the Austrian school refused to reduce the economic theory to fit within the decision theory, but insists it to be a theory of the process of human interactions. Ludwig von Mises introduced a name for it – praxeology.

The main feature of the neo-classic paradigm, de Soto claims, is that it reduces economic problems to the purely technical problem of allocation of available resources, i.e. to the problem of optimisation and maximalisation. The further consequence of such a narrow view is that the theory reckons that the knowledge of available resources and posed goals already exists. Therefore the only thing left is the question of right decision. In contrast to this, the Austrian school perceives the problem quite differently: people do not engage themselves so much in allocation of the means towards the chosen goals, as to discovering new means and projecting new ends. This dynamic aspect of economic action could be seen most clearly if it is perceived through the main actors of economic activity – the entrepreneurs.

The second chapter of the book is entitled "The knowledge and the entrepreneurship". It shed more light on the concept of entrepreneurial activities. The interest of the author is focused on the epistemological activity of entrepreneurs in the market process. It clarifies how the entrepreneur obtains relevant information, how he combines it in the process of seeking the best solutions for achieving his plans, how he corrects his own activities on the basis of acquired experience in that process, etc. It is obvious that for Austrians the entrepreneurial activity is synonymous for human actions in general. In that sense every human being who modifies reality and pursues some ends could be seen as an entrepreneur. To corroborate that claim de Soto develops an extended etiological explanation about the very meaning of the notion of entrepreneurship. "Indeed the Spanish word *empresa* and French and English word *entrepreneur* derive etilogically from the Latin verb *in-prehendo-endi-ensum*, which means "to discover, to see, to perceive, to realize, to capture; and the Latin term *in prehensa* clearly implies action and means "to take, to seize".

Therefore within the epistemology of entrepreneurship is a creative activity, similar to the activity of a scientist or an artist, it is a contemplative act that leads to the discovery of some new possibilities that were hidden by now. Therein lies the fundamental difference between the Austrian and neo-classic school. The Austrian paradigm insists on the momentum of creativity and invention, of bringing new ideas in the spheres of productions and distributions. In that sense human action is conceived as permanently seeking new ideas and new combinations; it is not so much about rational decisions within the already defined possibilities, but about constant searching for new means and new ends.

This is the basis upon which these innovative activities and the dynamics of market activities came about. New products, new use of technical skills, new ways of exploitation of nature, new technical inventions, new needs and preferences – all this permanently produces "market disturbances" and forces the actors of the market game to change their plans and adapt to new circumstances. In other words, the capitalist mode of production bears within itself a powerful dynamic element that is inherent to its own nature.

What are the findings of the entrepreneur? In the epistemological sense it is new information. This information is of a subjective nature: as Ludwig von Mises has pointed out, it is something that only the acting person knows. The content of the new information could be entirely different – new resources, new technological knowledge, discovery of the future preferences of the costumers, etc. – but what is important is that that kind information is basically of a practical nature. It is dispersed among thousands of actors and can hardly be linguistically articulated or in some way formalized. Most often it is practical knowledge bonded to a specific place and time.

It is important to notice that neo-classical economists do not recognize such information as a discovery of a particular subject, but as an objective entity, as something that is at everyone's disposal. But, as De Soto stresses, this is not the case: that kind of information is not something that is objectively given. It is a creation of the subjective mind and at the beginning only he knows about it. It is of essential importance how this new knowledge would be used by the individual who discovered it.

Without this complementary act new information would be of no value. New information becomes an economic fact only if it enables the economic subject to use newly discovered choices and produce some benefit. The benefit is possible if this information enables him to form an alternative practice by which the hidden opportunities newly discovered alternatives are used. The profit would be the criteria of the success of an entrepreneurial activity based on the new way of using available resources.

The innovative activity of the individual and his successful use of new knowledge require a new coordination of the activities. That information of new entrepreneurial discovery would be signalized through the price mechanism of the market and the profit rise. The competitive mechanism forces the market players to adapt their plans and actions towards that new fact. The dynamical modifications of entrepreneurial behavior and swift use of new information are the agents of permanent change. Starting from that basic comprehension the interest of the Austrian school above all is to analyze the process of competition and dynamic nature of the market. Its interest is focused on the innovative entrepreneurial acts and market risks. One of the consequences of the acquired view is that the use of mathematics and statistics in economic research is inadequate, since these sciences can operate within the framework of a static model of the market process. But the market is primarily one dynamic system essentially linked to the individual's unpredictable activities and subjective judgments: in that area the formalized knowledge is of little real help. For the Austrians there is only dynamic market process towards to the equilibrium, but not market equilibrium as such. Concerning how they conceive entrepreneurial activities the achieved equilibrium would be a pure contradiction in terms.

Opposed to it the neo-classic economists have focused on the model of market equilibrium and use of comparative statistics. The model of market equilibrium has an implicate presupposition that all relevant information for the derivation of the function of supply and demand are already given. Correspondingly, it is only about successful or unsuccessful operationalisation of available data.

From this fundamental difference come the other disputes and disagreements between the neo-classic and the Austrian schools. De Soto, as his prime goal, took to elaborate the main disputes between the founders of the school and their opponents. So, the four following chapters are devoted to the great intellectual debates through which the Austrians earned their distinguished position in economic science:

- Carl Menger versus historical school (famous *Methodenstreit*);
- Eugen von Böhm Bawerk versus Marshal, Marx and John Bates Clark;
- Ludwig von Mises versus Otto Neurath and other followers of socialist planning;
- Friedrich von Hayek versus Lord Keynes and the Chicago School.

The Austrian concept of society is based on the idea of society as a dynamic structure which spontaneously grows. It is highly complex and comprises millions of people with an infinite range of constantly changing goals, tastes, values and practical knowledge. All these interactions are driven by force of entrepreneurship that creates, discovers and transmits new information and knowledge. Through competi-

tion the economic actors are forced to adjust their plans and actions and to use their skills and knowledge in the most productive way for the whole of society.

Starting from these essential premises de Soto concludes: "Economic sciences should center precisely on the study of this social process as defined above. Austrian economists feel that the essential purpose of economics is to analyze how the spontaneous social order enables us to take advantage of a huge volume of practical information which is not available anywhere in a consolidated form, but rather is dispersed or diffused throughout the minds of millions of individuals."

De Soto's book is at the same time analytical and polemical. Its analyses are devoted to the core of Austrian teachings and the mainstream influence it produced. The polemical part of the book concerns the disputes with the representatives of the neo-classic paradigm. The whole of chapter VII is devoted to rehabilitate the school from the main accusations of the contemporary economics. There is a list of usual critical comments to which de Soto tries to answer: "Are the approaches of the Austrians and the neoclassic mutually exclusive or complementary?", "Why do the Austrians fail to formalize their theoretical proposals?", "Why do the Austrians produce very few empirical studies?", "Why are Austrians so dogmatic?", "Why do the Austrians jettison economic forecasting?", etc. As an adherent of the school the author gives convincing explanations within the framework of the main premises from which the whole teaching starts. The other problem is how this argumentation is perceived by its opponents and could it make them to change their views?

Nonetheless, the de Soto book is worth reading: it is at the same time concise and comprehensive. The work explores the fundamental ideas of the fathers of the Austrian school as well as the contributions of its contemporary representatives.