Significance of the Austrian School

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9 Different Schools of Economics

from Mark Thornton on Mises Wire (2014)

Comparing Different Schools of Economics

	CLASSICAL	NEOCLASSICAL	MARXIST	DEVELOPMENTALIST	AUSTRIAN	SCHUMPETERIAN	KEYNESIAN	INSTITUTIONALIST	BEHAVIOURALIST
The economy is made up of...	classes	individuals	classes	no strong view, but more focused on classes	individuals	no particular view	classes	individuals and institutions	individuals, organizations and institutions
Individuals are...	selfish and rational (but rationality is defined in class terms)	selfish and rational	selfish and rational, except for workers fighting for socialism	no strong view	selfish but layered (rational only becaus of an unquestioning acceptance of tradition)	no strong view, but emphasis on non-rational entrepreneurship	not very rational (driven by habits and animal spirits); ambiguous on selfishness	layered (instinct – habit – belief – reason)	only boundedly rational and layered
The world is...	certain ('iron laws')	certain with calculable risk	certain ('laws of motion')	uncertain, but no strong view	complex and uncertain	no strong view but complex	uncertain	complex and uncertain	complex and uncertain
The most important domain of the economy is...	production	exchange and consumption	production	production	exchange	production	ambiguous, with a minority paying attention to production	no strong view, but puts more emphasis on production than do the Neoclassicals	no strong view, but some bias towards production
Economies change through...	capital accumulation (investment)	individual choices	class struggle, capital accumulation and technological progress	developments in productive capabilities	individual choices, but rooted in tradition	technological innovation	ambiguous, depends on the economist	interaction between individuals and institutions	no strong view
Policy recommendations	free market	free market or interventionism, depending on the economist's view on market failures and government failures	socialist revolution and central planning	temporary government protection and intervention	free market	ambiguous – capitalism is doomed to atrophy anyway	active fiscal policy, income redistribution towards the poor	ambiguous, depends on the economist	no strong view, but can be quite accepting of government intervention

Purpose

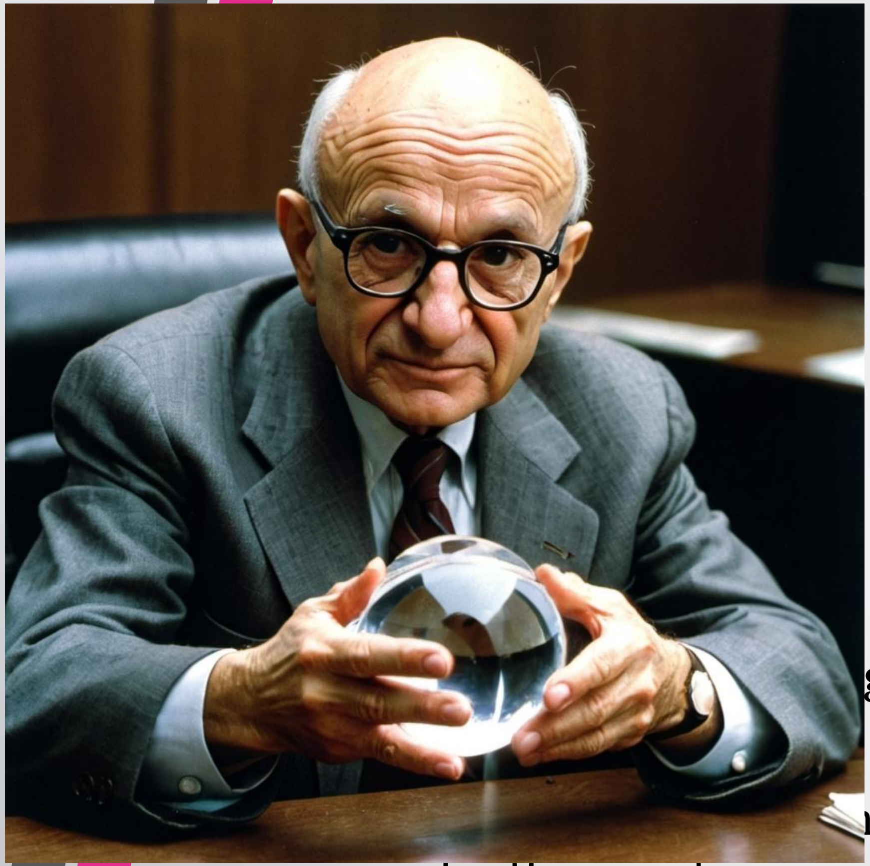
Austrians

- It is about Understanding how the world works.
- Accurate prediction is impossible to constantly repeat.

Mainstream

- It's all about Prediction.
- Assumptions are not as important as how well the model predicts.

Purpose



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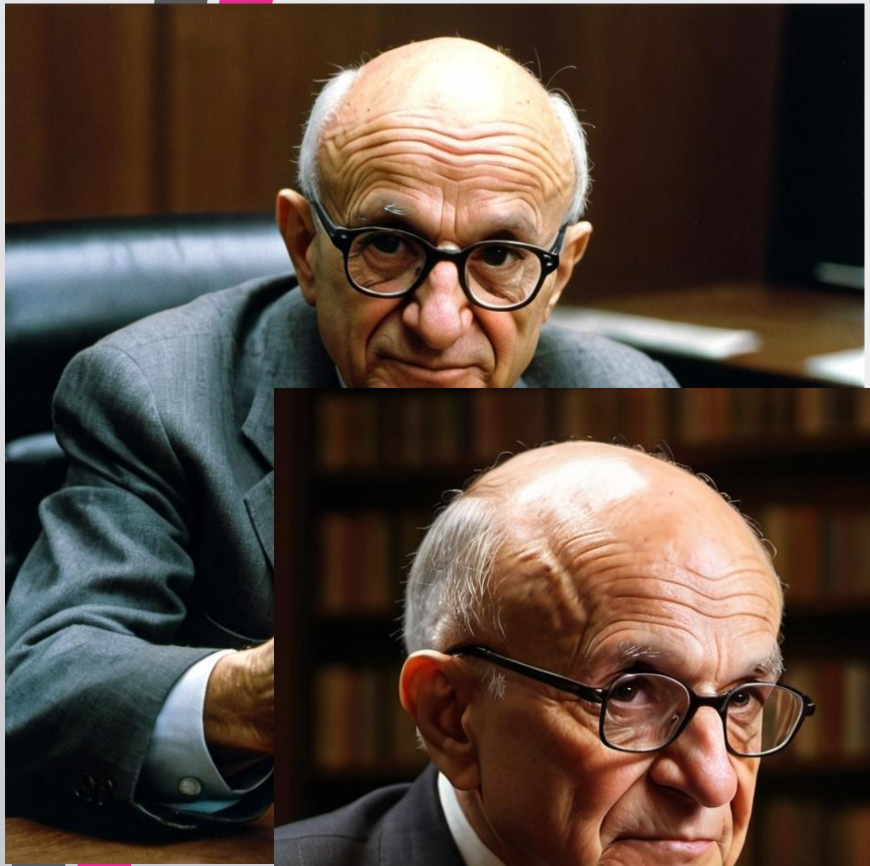

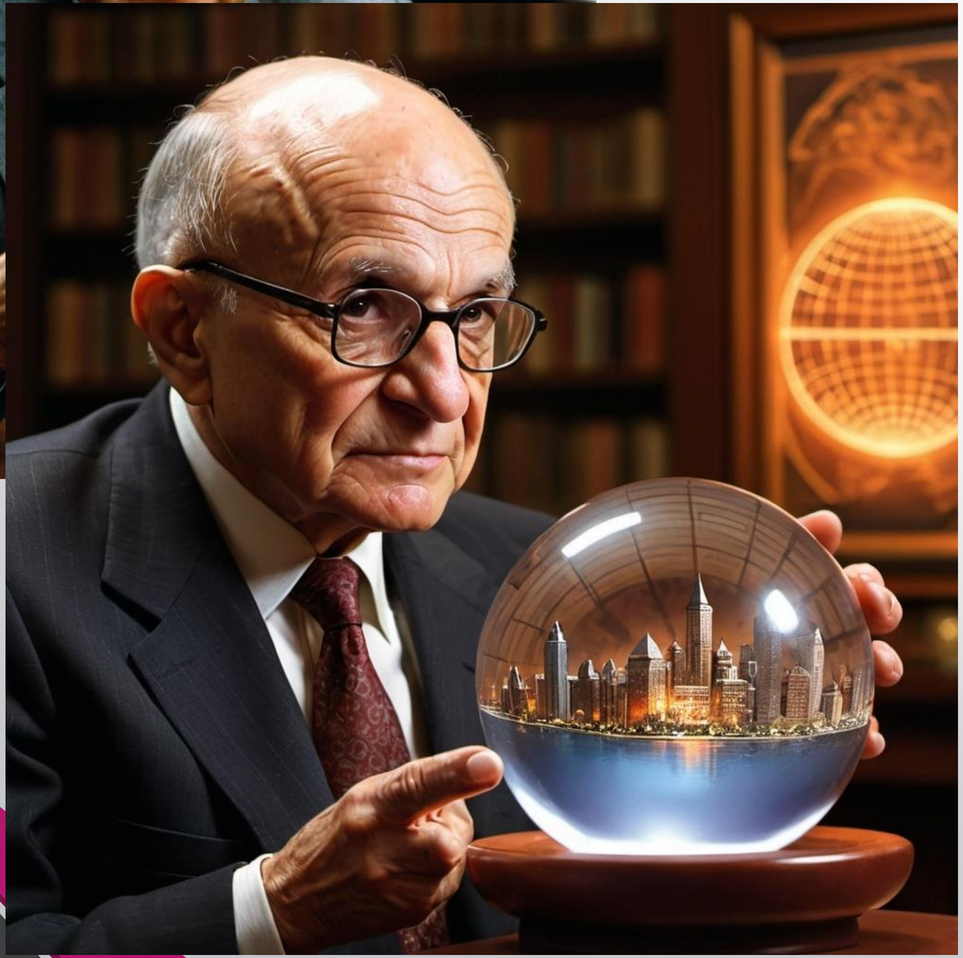

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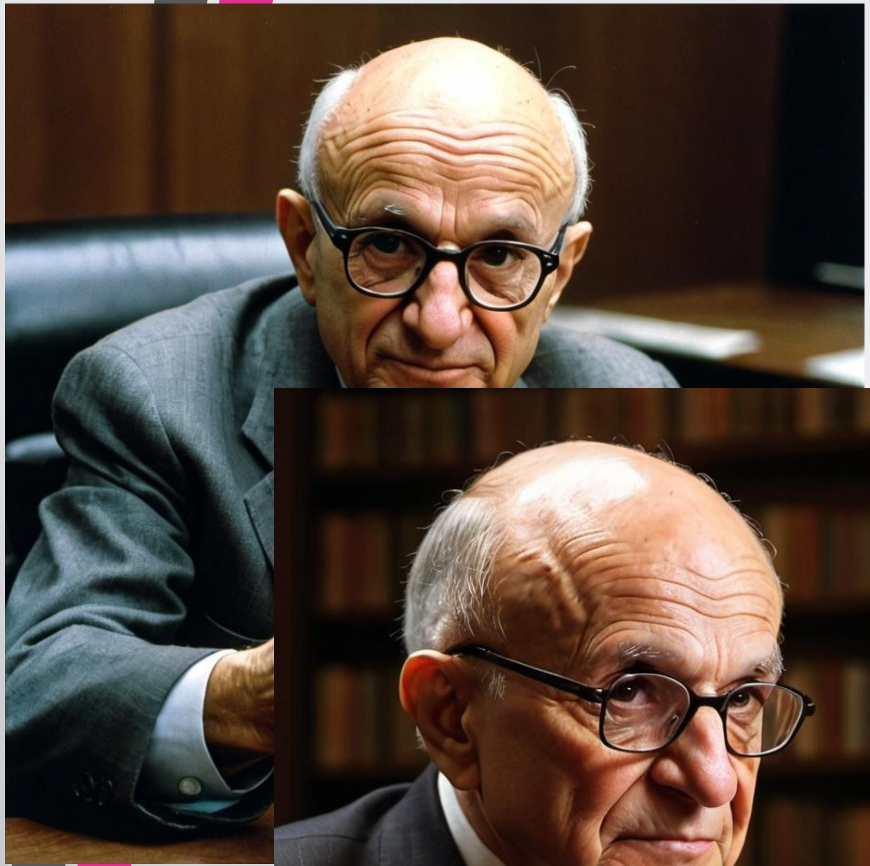

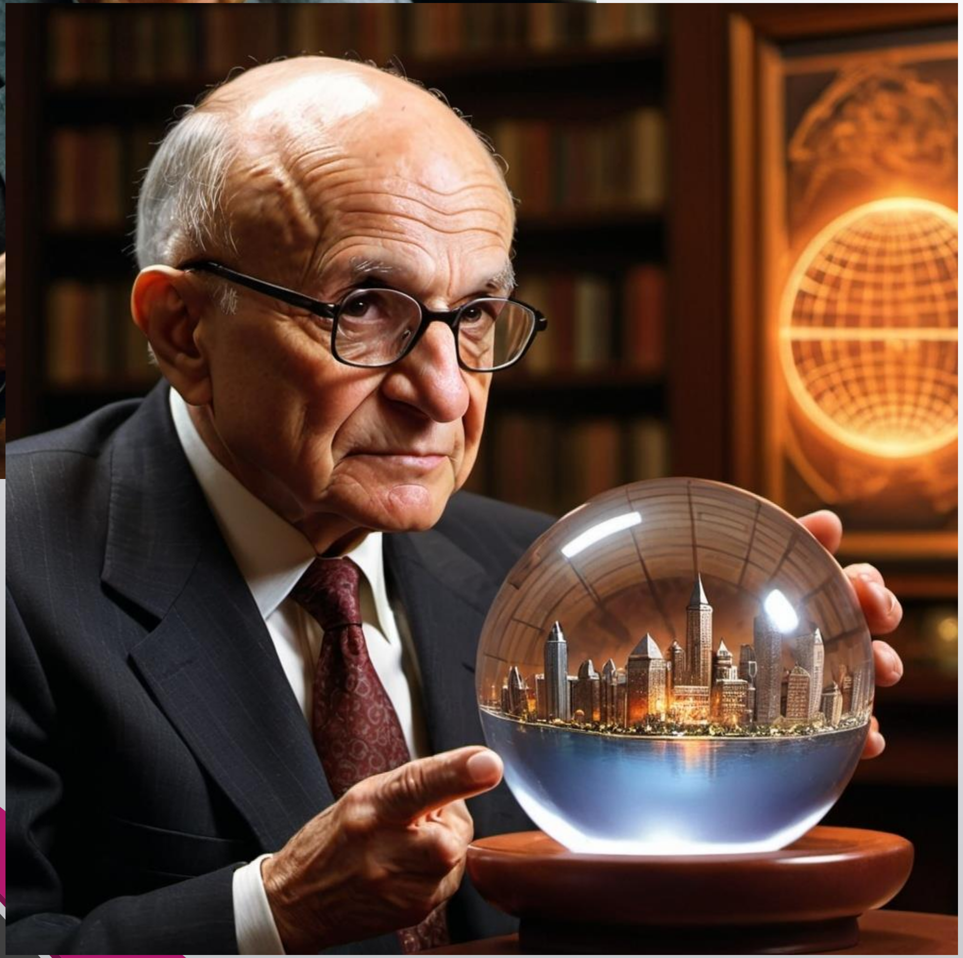

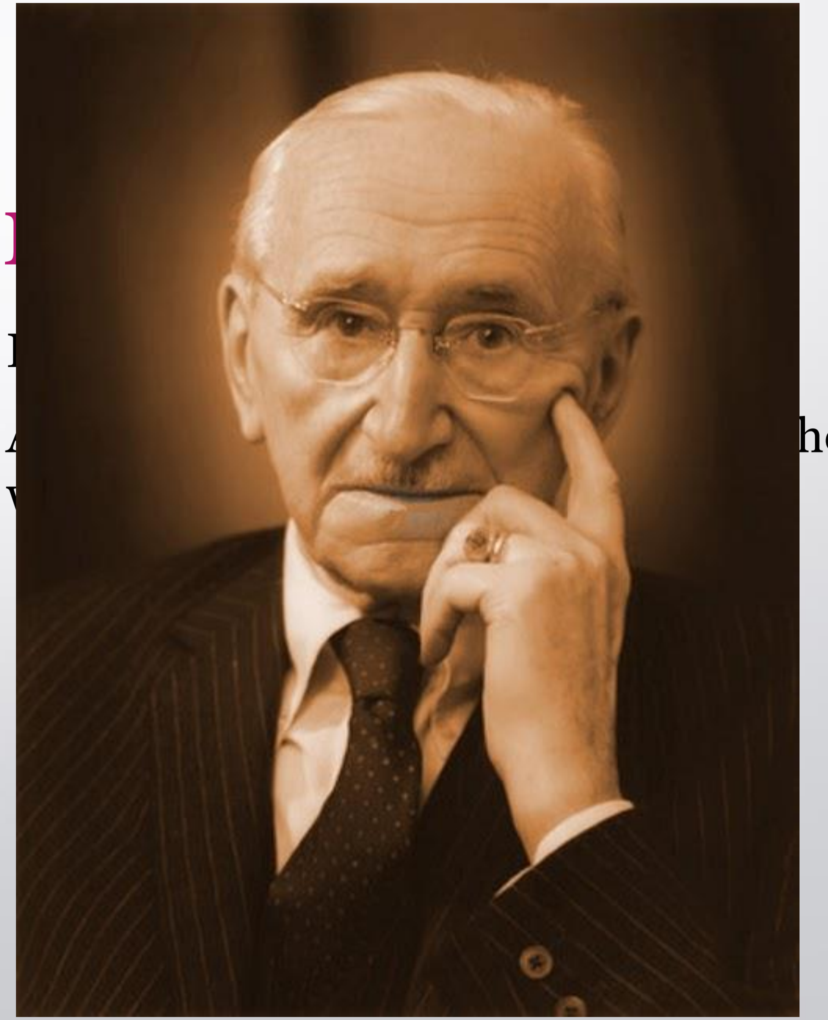

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Starting Point

Austrians

1) Axiom of Human Action
2) Assume a World of Scarcity

Mainstream

1) Data
2) Econometric Models

Starting Point

$$y_{1t} = \alpha_{10} + \sum_{g=2}^{G}\beta_{1g}y_{gt} + \sum_{j=1}^{K}\alpha_{1j}z_{tj} + \eta_{1t},$$

....

$$y_{gt} = \alpha_{g0} + \sum_{g'=1;\; g\neq g'}^{G}\beta_{gg'}y_{g't} + \sum_{j=1}^{K}\alpha_{gj}z_{tj} + \eta_{gt},$$

....

$$y_{Gt} = \alpha_{G0} + \sum_{g=1}^{G-1}\beta_{Gg}y_{gt} + \sum_{j=1}^{K}\alpha_{Gj}z_{tj} + \eta_{Gt}.$$

Method

Austrians

- Methodological Individualism
- Logical Deduction

Mainstream

- Representative Agents
- Totals and Aggregates

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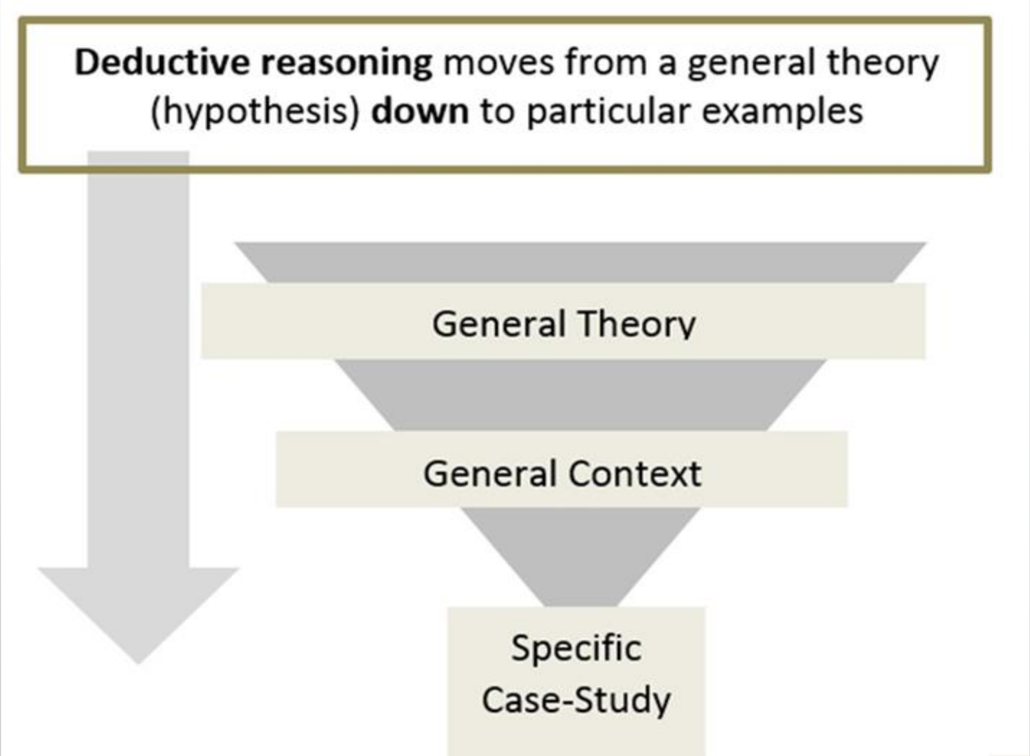
Deductive reasoning moves from a general theory (hypothesis) **down** to particular examples
General Theory
General Context
Specific Case-Study

Process

Austrian

- Step-by-Step Analysis
- Incomplete and dispersed knowledge

Mainstream

- Perfect knowledge
- Surveys the whole board.
  - (It is outside of time.)
- Comparative Statics Analysis

Process

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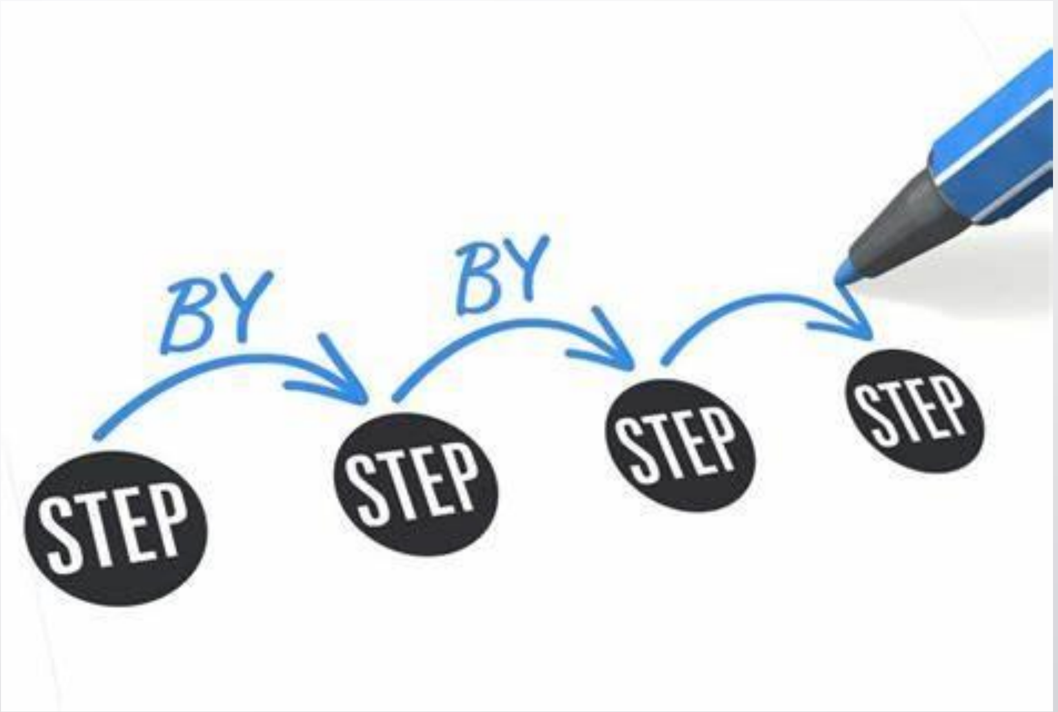
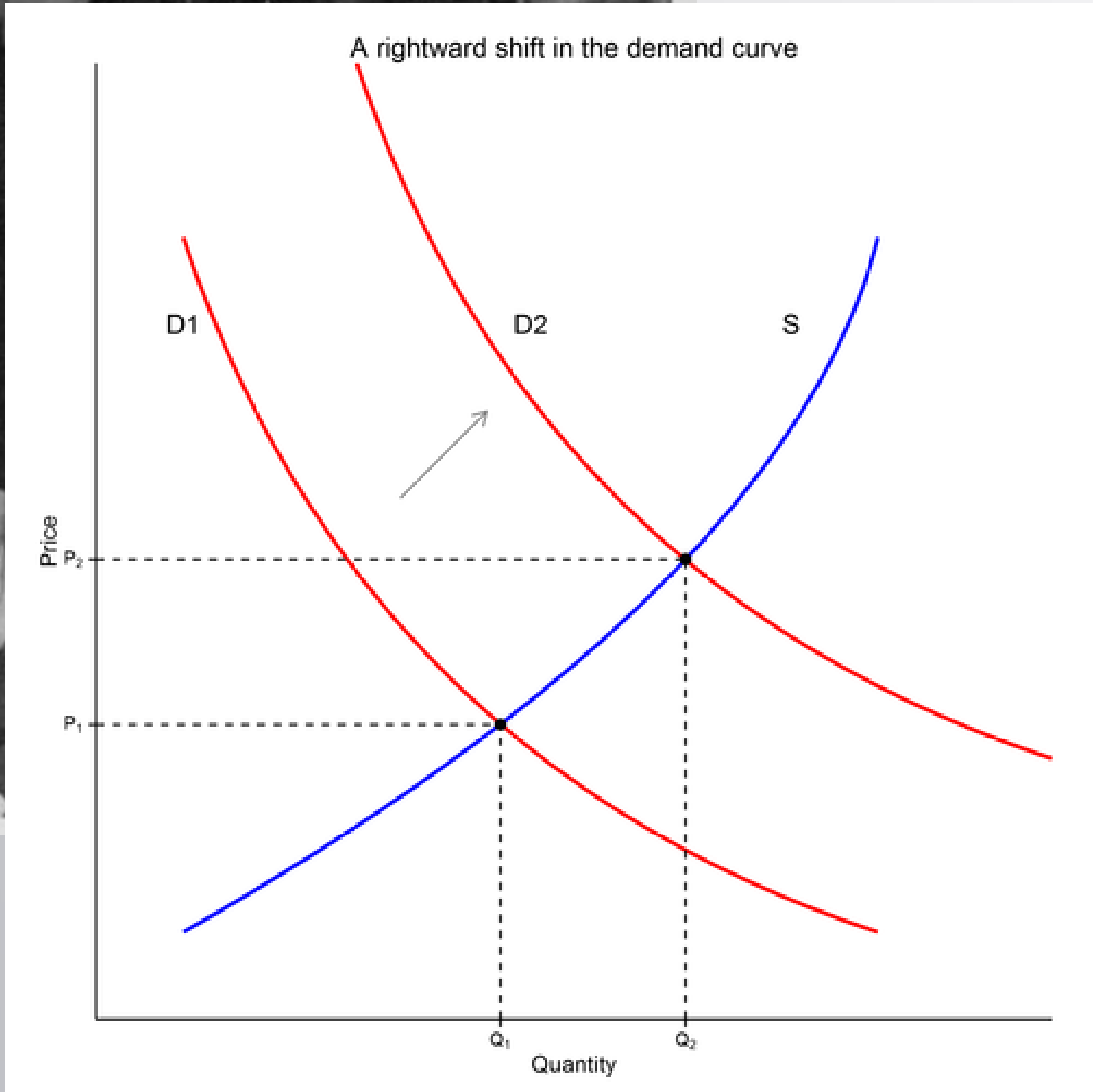


Process


A rightward shift in the demand curve
D1
D2
S
Price
P2
P1
Q1
Q2
Quantity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Implications / Applications

Money

Austrians

- Money evolved from the market.
- The same economic rules apply to money.
- Non-neutral effects occur when new money is injected into the market.
- Inflation causes some to win and others to lose.

Mainstream

- It exists. Who cares where it came from?
- $M \cdot V = P \cdot Q$
- Neutral Money
- Increasing the Money Supply ONLY affects the Price Level.

Markets

Austrians

- The Market is a PROCESS.
- We are NEVER in equilibrium.
- Entrepreneurs are critical to coordinate buyers and sellers.
- Buyers and sellers cooperate.

Mainstream

- Markets are assumed to be in equilibrium.
- Markets are automatic.
- Entrepreneurs and money are not important in microeconomic models.
- Competition is a state. It is NOT an action verb.

Welfare Analysis

Austrians

- Interventionism distorts relative prices.
- Distortions create FALSE information.
- False information disrupts efficiency.
- Interventionism makes total welfare worse, although a small group may benefit at everyone else's expense.

Mainstream

- Markets do not always generate the best results.
- Government intervention (by experts) is necessary to correct market imperfections and market failures.
- We assume government officials are saintly and omniscient.

Economic Calculation

Austrians

- To allocate capital and intermediate goods efficiently, we need to know relative scarcity conditions.
- The source of this knowledge is the market.
- Only when there is private property can the market generate relative prices, which contain this knowledge.

Mainstream

- Once all the variables have been specified, then finding the correct solution is a matter of number crunching.
- As supercomputers become better, scientific planning will improve.
- Property rights are irrelevant and unnecessary.

Business Cycle Theory

Austrians

- B-Cycles have a definite cause: an expansion of the money supply.
- As the money supply expands, interest rates are falsely lowered.
- Following these false signals, an artificial boom is created.
- The recession is a painful, but necessary phase.

Mainstream

- There are no cycles. There are only economic shocks.
- Shocks are positive or negative.
- They come from outside the economic model and are unpredictable.
- The BEST we can do is manage the economy to meet these challenges.

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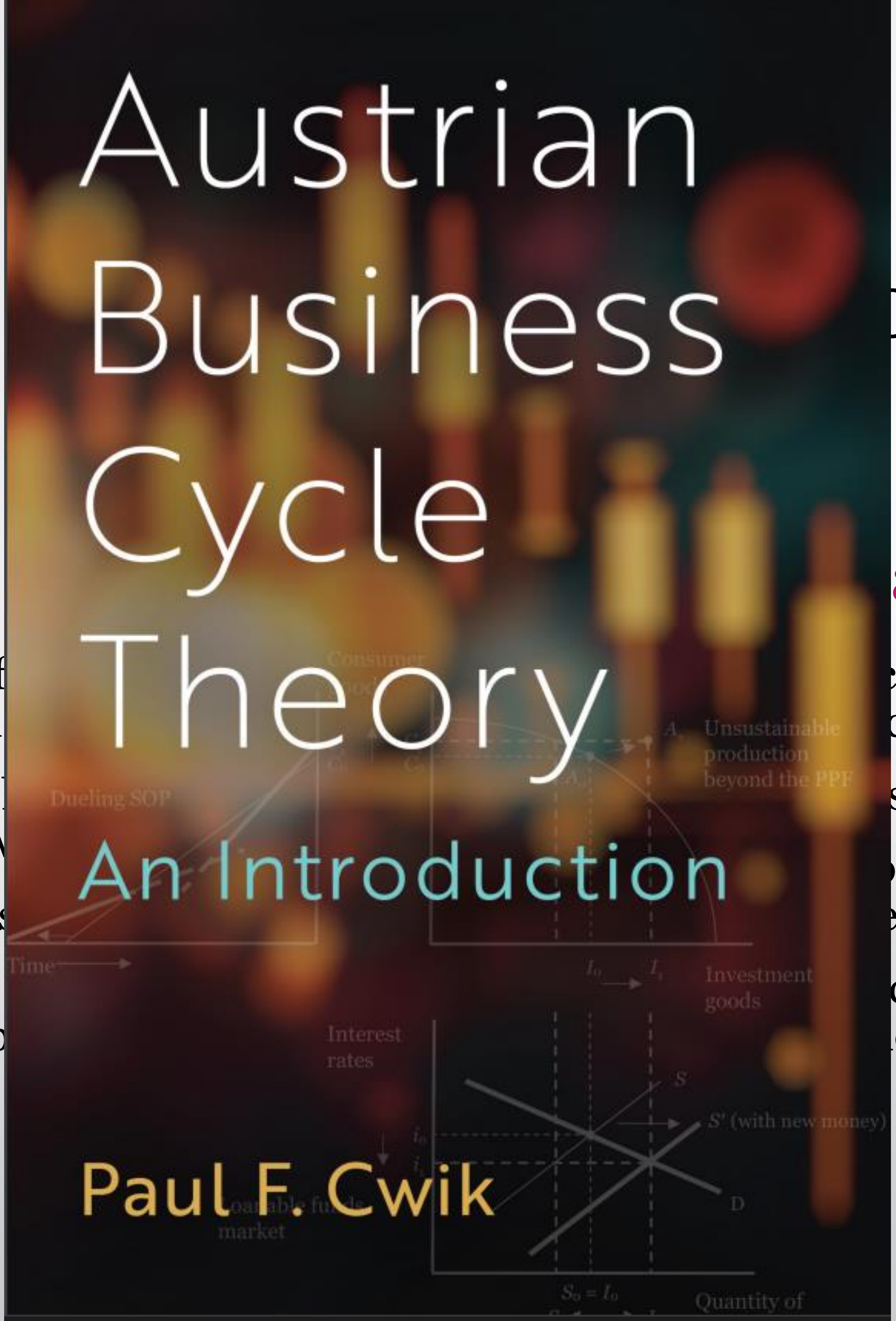

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Thank You!!!

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