Austrian Economics Rising

Austrian economists predicted the Great Depression and America's present troubles, but are only now gaining recognition.

by Thomas R. Eddlem

"Peter, you have been mocked on all of these financial shows going back to 2005. Going back to 2005! Not only did you predict problems, you actually explained what was going to happen. Why didn't anybody listen? You were Cassandra!"

— MSNBC commentator Joe Scarborough to "Austrian school" economics adherent Peter Schiff on *Morning Joe*, March 25, 2009

Scarborough's reference to Cassandra — the character from Greek mythology given the gift of prophecy and the curse that nobody would believe her predictions — was particularly apropos to the Austrian school of economic theory until the latest economic crash. The name of this free-market economic school acknowledges the fact that many of the school's "founding fathers" were Austrian nationals and disciples of the Austrian economist Karl Menger. Of course, the "Austrian school" is not a school in the traditional sense of the word denoting a physical structure; the term defines those who believe in pure free-market economics and *laissez-faire* principles. The Austrian school has a long history of amazingly accurate economic predictions while at the same time being completely ignored by the political establishment and virtually ignored by the mainstream media.

The one-penny bet: Back in 2006, Austrian economist Peter Schiff (left) took a one-penny bet suggested by supply-side economic guru Arthur Laffer (right) that a crash would come by the end of 2008, but Schiff's knowledge of real economics took any risk out of the wager. Laffer told Bill Maher he has yet to pay the penny.

Prescient Predictions

But that lack of credibility to the public faded entirely once the Austrian school's predictions again came true. One of the few exceptions to the media blackout against the Austrian school before 2008 was Euro Pacific Capital President Peter Schiff, now a candidate for the U.S. Senate in Connecticut, who had given a number of television interviews in advance of the current recession. Schiff repeatedly pointed out with astonishing accuracy what would happen and — more amazingly — *why* it would happen. Among the more famous of these interviews was an August 28, 2006 CNBC-TV debate with Reagan-era "supply-side school" economist Arthur Laffer. Laffer, a famed economic advisor to President Reagan, is perhaps the most prominent of the supply-side theoreticians and best known for the "Laffer curve" that explains how government can extract the most taxes from taxpayers without choking economic activity. After hearing Schiff predict a severe recession in 2007 or 2008, Laffer replied:

> What he's saying is that savings is way down in the United States, but wealth has risen dramatically. The United States economy has never been in better shape. There is no income tax increase coming in the next couple of years. Monetary policy is spectacular. We have freer trade than ever before.... I think Peter is just totally off base, and I just don't know where he's getting his stuff.

Schiff replied: "When you see the stock market come down and the real estate bubble burst, all that phony wealth is going to evaporate and all that is going to be left is the debt we accumulated to foreigners."

Laffer next bet Schiff a penny in the same interview that Schiff was wrong. Laffer claimed he hadn't paid Schiff the penny on HBO's October 24, 2008 *Real Time With Bill Maher* show.

Schiff was not the only Austrian to accurately predict the current recession. Congressman Ron Paul made virtually identical predictions. Interviewed on February 23, 2010 — shortly after Paul won the Conservative Political Action Conference (CPAC) presidential straw poll on who conservatives would like to run for the next presidential election — on MSNBC's *Morning Joe*, Scarborough noted:

> Here's what Ron Paul predicted in 2003 about … the bubble that was growing through Fannie and Freddie and the banks: [Video clip] "Ironically, by transferring risk of a widespread credit default, the government increases the likelihood of a painful crash in the housing market. Like all artificially created bubbles, the boom in housing prices cannot last forever. When house prices fall, homeowners will experience difficulty, their equity will be wiped out. The more people who will be investing in the market, the greater the effects across the economy when that bubble bursts. Even Fed Chairman Greenspan has expressed concerns that government subsidies make investors underestimate the risk of investing in Freddie and Fannie." You called it right. That was in 2003, Congressman. 2003, five years and five days before the crash. How did you know?

Actually, Rep. Paul had also said essentially the same thing a year earlier than that, in a July 16, 2002 speech before the U.S. House of Representatives.

How did he know? Representative Paul explained to Scarborough that he was

> just trying to understand economics from an Austrian free market perspective. It sort of goes to show that with a little perseverance sometimes you can come as a winner in the end. And I think we are winning on arguing the case for free markets over government intervention.... It isn't me that makes these predictions, it's the predictions made by good Austrian economists, people like Mises and

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> Hayek and Rothbard and Sennholz. They taught us this, it's available, and the young people especially are responding to this and studying this school of thought.

Austrian school economics received a massive national hearing during Rep. Paul's presidential race in 2008, though — like Cassandra — his predictions of an economic crash were not accepted by enough Republican Party primary voters to win him the presidential nomination. That has all changed since the crash, Rep. Paul told THE NEW AMERICAN in an interview for this story. He sees a rising interest in the Austrian school: "There has been a dramatic change with the collapse in the economy because the Austrians predicted it. They've been right before."

He's right on both counts. The media is covering Austrian economists more than ever. Rep. Paul has been a frequent guest on national television and enjoyed two national best-selling books, *The Revolution: A Manifesto* and *End the Fed*, since losing the Republican presidential nomination. His "Campaign for Liberty" — a non-political interest group founded to continue the grass-roots activism of mostly younger 2008 campaign volunteers — received more than $4 million in donations in just the first few months after President Obama was elected. Rep. Paul acknowledges that "the campaign lit a match." But he's quick to add that "the work was done many many years ago," by Ludwig von Mises and others.

Found to Be Fundamentally Sound

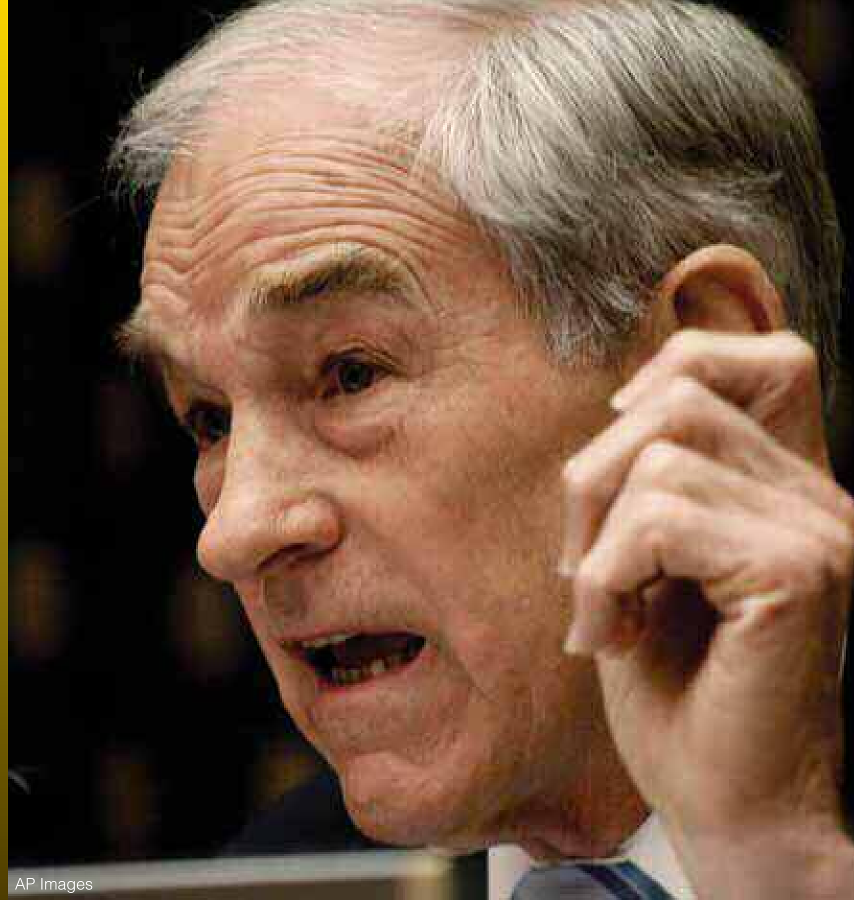
Rep. Paul is correct about the Austrian school making accurate forecasts in the past in addition to analysis of the most recent recession. Austrian school economist Friedrich A. von Hayek predicted the Great Depression years in advance of the infamous 1929 Wall Street stock market crash. Hayek's *Monetary Theory and the Trade Cycle* — first published from Austria in 1929 — predicted the Great Depression. Hayek was granted a Nobel Prize in Economics (much later, in 1974) for his pre-Depression and Depression-era related work in the study of economics. The Nobel committee explained in a press release about the award:

> Perhaps, partly due to this more profound analysis, he was one of the few economists who gave warning of the possibility of a major economic crisis before the great crash came in the autumn of 1929. Von Hayek showed how monetary expansion, accompanied by lending which exceeded the rate of voluntary saving, could lead to a misallocation of resources, particularly affecting the structure of capital. This type of business cycle theory with links to monetary expansion has fundamental features in common with the postwar monetary discussion.

Originally written during 1928 — and published in the German language in 1929 — *Monetary Theory and the Trade Cycle* provided the theoretical models that proved an economic crash was coming in the United States and other countries. The June 1932 preface to the English edition explained more specifically that the Federal Reserve had continued an inflationary, easy-credit policy under the Hoover administration (further continued and accelerated by the Roosevelt administration) that was bound to drag out the Depression: "Far from following a deflationary policy, central banks, particularly in the United States, have been making earlier and more far-reaching efforts than have ever been undertaken before to combat the depression by a policy of credit expansion — with the result that the depression has lasted longer and has become more severe than any preceding one." The acceleration of that easy-credit policy under the Roosevelt administration guaranteed that the Great Depression would last until the end of World War II (though the war

Compliments of the Ludwig von Mises Institute, Auburn, Alabama

Austrian giants: Austrians Ludwig von Mises (left) and Friedrich von Hayek are the most famous Austrian-school economists, and their economic models helped to predict the Great Depression, as well as the current "Great Recession." Von Mises was a contributor to *American Opinion*, a predecessor of THE NEW AMERICAN.



They're listening now: Rep. Ron Paul's 2008 presidential race aired Austrian economic analysis on a national scale, though many Republican primary voters in late 2007 and early 2008 refused to believe the crash Rep. Paul accurately predicted.

itself "cured" the unemployment part of the depression). And for many Austrians, today's Federal Reserve policies are mirroring those of the early 1930s.

Hayek's "trade cycle" is today called the "business cycle" by most Austrians, who use a term called "praxeology" to describe their approach. Praxeology is simply a word of Greek derivation employed by the Austrian school that means "the study of human action." The action being studied in this case is economic action of a people. Austrian school economists understand the common-sense principle that nations — like people — build wealth from savings and investment and not from borrowing and spending.

The seminal work in Austrian economics is *Human Action,* authored by Hayek's tutor (and Menger's student) Ludwig von Mises. Von Mises was an Austrian who emigrated to the United States just before the Second World War, served as a member of the editorial board of *American Opinion* (a parent magazine of The New American), and lived the Cassandra complex that Scarborough said Schiff had endured. Despite Mises' brilliance, the Austrian crown denied him a full professorship at Vienna University. Mises instead found work as an economist for the Vienna Chamber of Commerce and Industry from 1909 though 1934. Although von Mises was denied full political recognition for his substantial economic accomplishments in his native country, his staff (which included Hayek) at the chamber of commerce attended regular economic sessions in his office, and spread von Mises' influence across the globe.

Von Mises argued that government can't make accurate judgments in the complex human marketplace because government officials don't have the knowledge to make millions of economic decisions every day better than the consumers themselves:

> Starting from purely arbitrary assumptions concerning allegedly eternal and absolute values and perennial justice, they arrogate to themselves the office of the supreme judge of earthly affairs. They misconstrue their own arbitrary value judgments derived from intuition as the voice of the Almighty or of the nature of things.

Arguing that big-government arguments for intervention in the marketplace would not really replace *laissez-faire* chaos, von Mises' logical critique of state planning was withering against socialism and fascism/Keynesianism. Von Mises wrote in *Human Action*, "The alternative is not plan or no plan. The question is whose planning? Should each member of society plan for himself, or should a benevolent government alone plan for them all? The issue is freedom versus government omnipotence." Von Mises explains that "*laissez faire* does not mean: Let soulless mechanical forces operate. It means: Let each individual choose how he wants to cooperate in the social division of labor; let the consumers determine what the entrepreneurs should produce. Planning means: Let the government alone choose and enforce its rulings by the apparatus of coercion and compulsion."

Von Mises championed the *laissez-faire* theory that government should not interfere in the economy because it is not competent to make the people happier or more prosperous than the people can do for themselves by making their own economic decisions. "Government is in the last resort the employment of armed men, of policemen, gendarmes, soldiers, prison guards, and hangmen," von Mises noted. "The essential feature of government is the enforcement of its decrees by beating, killing, and imprisoning. Those who are asking for more government interference are asking ultimately for more compulsion and less freedom."

This is not to say von Mises, or any particular adherent to the Austrian school, must necessarily think the state is an evil (though some do). Von Mises acknowledged that sometimes force is necessary, although he distilled the essence of the state as force rather than a positivist actor in the economy. The Austrian school is often associated with the libertarian movement, though one need not be a libertarian to accept the economic realities that the Austrian school explains. As von Mises argued:

> Economics is not dogmatic, as the self-styled "unorthodox" advocates of government omnipotence and totalitarian dictatorship contend.

AP Images

Tea Party Austrians: The modern-day “Tea Party Movement” began as an outgrowth of Rep. Ron Paul’s presidential campaign, beginning with a series of protests against the Federal Reserve Bank back in the summer of 2008.

> Economics neither approves nor disapproves of government measures restricting production and output. It merely considers it its duty to clarify the consequences of such measures. The choice of policies to be adopted devolves upon the people. But in choosing they must not disregard the teachings of economics if they want to attain the ends sought.
>
> There are certainly cases in which people may consider definite restrictive measures as justified. Regulations concerning fire prevention are restrictive and raise the cost of production. But the curtailment of total output they bring about is the price to be paid for avoidance of greater disaster. The decision about each restrictive measure is to be made on the ground of a meticulous weighing of the costs to be incurred and the prize to be obtained. No reasonable man could possibly question this rule.

The free-market principles of the Austrian School of Economics have become much better known, understood, and appreciated by the American people since the last presidential election — though those principles continue to be ignored and violated by the U.S. government.

Von Mises stressed that “the task of economics is to analyze and to search for truth. It is not called upon to praise or to disapprove from any standard of preconceived postulates and prejudices.” But in general, he concluded government was too blunt and inefficient a tool to make any decisions to increase human happiness in the economic sphere.

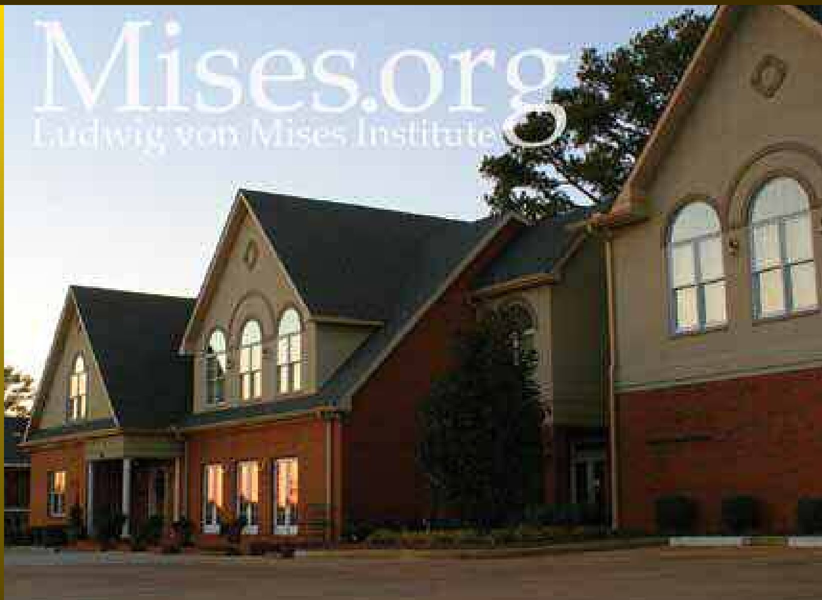
Hayek and von Mises’ work is echoed in modern Austrians, such as Peter Schiff, who argued recently: “What the government is going to do is to turn this into an inflationary depression which is going to be much, much worse.... Even President Obama will acknowledge — and Ben Bernanke acknowledges — that we got into trouble by borrowing and spending too much money. The solution isn’t to go borrow and spend even more, the solution is that we do the opposite.” Like Hayek in 1932, Schiff is making the same economic analysis: “Unfortunately, as painful as it is, the recession is what we need. The recession is the market’s way of curing the economy. And the more the government interferes with the recession, the worse we’re making the problem.”

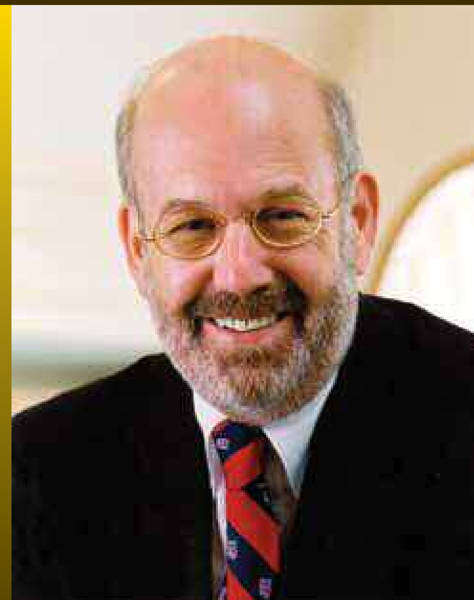
Llewellyn Rockwell of the Ludwig von Mises Institute says that the sudden increased exposure of the Austrian school can be attributed to two major factors. “I would say Ron Paul and the Federal Reserve’s latest business cycle” sparked increased interest in the Austrian school, Rockwell told The New American. “It’s still a minority, but it’s so much bigger a minority that it’s no longer in the same league.” Rockwell founded the Mises Institute in 1982 with Mises’ widow Margit von Mises, garnering the support of Hayek and fellow Austrian economic giant Murray Rothbard.

Rockwell told The New American, “When I started talking about this 35 years ago, I couldn’t get anyone interested in the Fed. It was just a name on a bill in your pocket.” He now believes “there has been a huge shift. But the main problem we have is not that bright young people are attracted to Keynesian economic theory. The problem is Keynesianism is the economics of state power. This is what you do if you want to enhance the power of the state.”

Detractors and Donations

Rockwell explains the actual lure of Keynesian economics: “Most economists are interested in working for the government and therefore they are not in free markets, but in running your life. They would never put it that way, because they are ‘helping’ you.” Rockwell adds that government economists have an interest in enriching the power of the state while at the same time preventing the total destruction of the private sector. “They learned





Compliments of the Ludwig von Mises Institute, Auburn, Alabama

Free online university: Llewellyn Rockwell of the Ludwig von Mises Institute has a physical school for students near Auburn University in Alabama, but the foundation (created in 1982 with von Mises' widow, Margit) also boasts the world's largest free online library of Austrian-school economic texts and analyses at www.Mises.org.

their lesson from communism. If you have communism, the rulers are poor too. So we have fascism." And fascism is simply an economic system that involves government intervention in the "free" market. British economist John Maynard Keynes merely put a friendly, non-Axis power face on the economic philosophy.

Austrians have also struggled against other so-called free-market economic schools. While the supply-side school popular during the Reagan administration has all but disappeared, Milton Friedman's Chicago school continues to hold many adherents. It holds many free-market beliefs similar to the Austrian school, but Rockwell notes that the Chicago school has no problem with the Federal Reserve Bank manipulating the currency and interest rates. "The Chicago school is pro-Fed," he told The New American. "They've endorsed the Fed; they love the Fed; they believe that the Fed should be doing even more of what it is doing."

Rockwell's Mises Institute has seen a dramatic uptick in interest, as have other Austrian organizations. His personal website, LewRockwell.com, is the most trafficked libertarian website on the Internet ("We have more traffic than the Fed or the UN," he says). "We've seen a significant increase in financial support, including even in this depression," Rockwell says of the Mises Institute, adding, "Of course we're still small if you compare us with the government-connected think tanks in the Washington beltway."

The uptick in donations is all the more significant because the Mises Institute gives away its publications on the Internet. "It's all available for free," Rockwell boasts. "If anyone wants to study economics in the whole world, the Ludwig von Mises Institute is where they go either on the web or in person." Online texts include the entire volumes of Mises' work (including *Human Action*), Hayek, and other Austrians in PDF and HTML formats.

"The Mises Institute has been very instrumental in doing this," Rep. Paul told The New American, who adds: "Where I find the most interest is on the college campuses. They knew all the names of these economists." While the most famous economists have passed on, Rockwell is quick to add, "If you follow physics, you don't always have Newton around." Rather than a handful of famous men in the past, Rockwell explains that "today there are hundreds and hundreds of professors" across the world teaching Austrian economics.

Asked if he thought there was increased interest in the Austrian school on Capitol Hill, Rep. Paul told The New American there may be, but adds that "I don't think there will be any action." He's not pessimistic, however, because "intellectually there are a lot of reasons to be optimistic. And the intellectual work has to be accomplished before the political progress."

And the intellectual work has received a tremendous shot in the arm over the past two years. ■

The New American has a long association with the Austrian school, beyond von Mises serving on the editorial board of our predecessor publication, American Opinion*. Its book-publishing affiliate Western Islands published* Age of Inflation *by Austrian school economist Hans Sennholz (also a longtime contributor to* American Opinion*) and has long distributed the works of Mises and Hayek through its affiliate, The John Birch Society. Lew Rockwell, founder of the Ludwig von Mises Institute, is a contributor to The New American.*