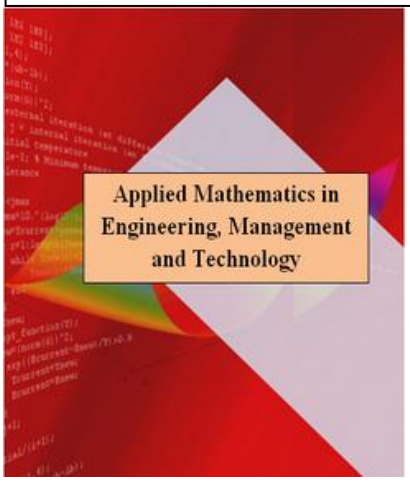
Applied mathematics in Engineering, Management and Technology 2014
The special issue in Management and Technology (Jun. 2014):1622-1626
www.amiemt-journal.com

Austrian Economics School as one of the Schools in Free Market Economy: A Critical View

Mohammad Taher Ahmadi Shadmehri[1], Gholam ali Rahimi[2], Ali Fathani[3]
[1]Associated Professor, Department of Economics, Ferdowsi University of Mashhad, Mashhad, Iran, shadmhri@um.ac.ir
[2]Ph.D. Student of Economic, Ferdowsi University of Mashhad, International Campus, Mashhad, Iran, alirahimigh2000@yahoo.com
[3]Ph.D. Student of Economic, Ferdowsi University of Mashhad, International Campus, Mashhad, Iran, fathani_ali@yahoo.com



Abstract

Studying an economic school, its principles and rules must be identified. Each school is based on specific principles and rules which they, in turn, are divided into other fundamentals and awards. For example, base of wealth in mercantilism school is precious metal, in physiocrat school is agriculture, and in classic school is agriculture and industry. This subject, namely identification of main factor of wealth yields other problems. Each economic school has its special view toward basic economic subjects.
Austrian Economics or Austrian School, which is known as Vienna School, too, is one of the economic schools out of the main stream that emphasizes automatic organization by price mechanism. Methodological individualism and non-neutralized money are other mental specifications of it. This school in nominated by its primary founders and advocators, which were citizens of Habsburg, Austria, including Carl Menger, Ludwig von Mises, and Friedrich Hayek, the winner of noble prize.
Austrian school has always encountered problems in justification of economic academies, and, despite of significant developments of advocators of this school in propounding himself, many faculties and scientific academies encounter obstacles in acceptance of Austrian approaches and criticizing it. Undoubtedly, Austrian thinking pattern is out of the common flow system. Researchers familiar with common flow equations hardly can understand Austrian economics, unless they reconstruct their mental structure. In this research, we study fundamentals of Austrian economics school and we evaluate fortes and foibles of this school in demonstration of economic phenomena.

Keywords: Economic school, Austrian Economics, free market economy, Carl Menger, Friedrich Hayek, individualism, subjectivism, processism

1.Introduction

Austrian Economics School was founded in 1871 by publication of “Economics Principles” by Carl Menger. Manger, William Stanly, and Leon Walras created marginalist revolution in economic analysis. Manger, in his book, had claimed that economic analysis was universal and human and his selections were a suitable unit for this analysis. He wrote that these selections were formed based on mental priorities of individual and final results of his decisions. He believed that understanding the logics behind these selections is the main element to develop a universal economic theory.
This is while historical school claims that economics principles are not universal, thus scientific researchers must be concentrated on interpretations of historical details. By historical school, beliefs to economic laws further than time and national borders are large mistake fostered by classic English economists. Manger used marginalist analysis in “Economics Principles” to protect universality of economics. Pupils of Rosher, specially Gustav Schmoller, objected with this manger’s defense and called the works of Manger and his advocates, namely Bohm Bawerk and Friedrich , disesteem of Austrian School, because they all taught in University of Vienna. This name remained for Manger and his colleagues.
After 1930s, no other economist from university of Vienna or other universities of Austria has not become famous in Austrian economics. During 1930s and 1940s, Austrian school was transferred to England and USA and its important economists mainly taught in London’s Faculty of Economy (1931-1950), University of New York (1944), University of auburn (1983), and University of George Mason (1981). In the middle of 20th century, views of famous Austrian economists, including Ludwig von Mises and friedrich august von hayek,

have rooted in views of classic economists such as Adam Schmidt, David Hume, or famous faces of early of 20th century such as Knut Wicksell , Manger, Bohm Bawerk, and Friedrich von Wieser. This various composition from enlightenment traditions in economists of this school are more brilliant between contemporary economists that were affected by new faces of economics. Among them there are Armen Alchian, James Buchanan, Ronald Koz, Harold Demsetz, Axel Leijonhufvud, Douglas north , Mancur olson, Vernon Smith, Gordon Tullock, Oliver williamson, Israel kirzner, and Murray rothbard. Although some today believe that Austrian school has a bold role in economy area, but it can be claimed that "Austrian" logo has no meaning now.

2.Principles and fundamentals of Austrian economics

This section studies principles and fundamentals of Austrian economics and evaluates fortes and foibles of this theory. Thus, fundamentals of Austrian economics are:

1. **Methodological individualism:** Austrian economics emphasizes on individual, because an individual is the origin of human action and can provide exclusive actions. Thus, there are various selections as equal as individuals. On other words, there are always a wide spectrum of distinct individual priorities that are no necessarily parallel and sometimes they are opposite of each other. Thus, aligning different human actions and asks is the most important problem of economy. another approach of Austrian economics towards complexity and variety of human action indicates not use of mathematical tools to demonstrate and analyze economic realities. When some economists construe economic theory synonym to mathematical economy, Austrian economists believe mathematics is unable to understand complex human actions. In fact, in its optimistic case, mathematics can only describe occurrence of phenomena, and cannot anticipate future.
2. **Methodological subjectivism:** In Austrian economics, human actions are very important. But what is the origin of human actions? In other words, how do those who are actors of human actions, invoke to distinct selections? In response to this question, Austrian economics propounds to the role of human mind in accomplishment of actions. Human actions take place based on value scales of individuals and these values come from minds of individuals. Subjective thinking is very important in minds of Austrian economics thinkers. In fact, in this school, no only values, but designs, expectations, and perceptions of individuals from realities are subjective.
3. **Processism:** Not only actions differ from one individual to another, but actions of an individual differ over time. Each individual decides based on his last needs every moment and selects tools to achieve his goal, and finally acts to achieve the goal. Uncertainty due to different actions cause all not to reach their real demands, and sometimes an action is stopped by another. Therefore, real results of an action are not assured up to before accomplishment of them. By Austrian economics, movement toward equilibrium condition is a learning process that produces a new recognition and changes expectations, and finally the equilibrium condition changes. Therefore, Austrian economics believes processism instead of accentuation to a final equilibrium situation; a process by which individuals act to attain the most favorable option by reviewing their goals.

In continue, we introduce beliefs of Austrian economists. In public policies, these theorems imply that there are many doubts towards abilities of official authorities to interfere in economic system, so they cannot manage economy intellectually. Market economy is formed from natural trend of individuals to improve their conditions through discovery of useful transactions for parties. Adam Smith expressed this message for the first time in "Nations Wealth". In 20th century, Austrian economists were the most non-compatible and the most non-flexible advocates of this message. However, this persistence of Austrian economists in defense of market is not the result of an ideological obligation, but is due to their logic.

3.Theorem 1: Only individuals proceed for action. Human is at the commence of his economic analysis with all his goals and programs. Only individuals select and society cannot select. The main duty of an economic analysis is making economic phenomena understandable through individual goals and plans. The second function of an economic analysis is drawing unwanted outcomes of individual selections.

4.Theorem 2: Study of market order includes transactional behavior and the organizations in which these transactions take place. Prices system and market economy can be construed as a catallaxy. Therefore, a science that studies market order is in catallactic area. These words come from the Greek work "Katallaxy" that means transaction and making a friendly relation with a stranger through transaction. Catalectic concentrates on relations in markets, haggling, and organizations in which these transactions take place.

5.Theorem 3: Realities are those that people think. In spite of natural sciences, human sciences deal with goals and programs of individuals. While separation of goals and programs in natural sciences caused progress by overcoming anthropomorphism, but in human sciences, deletion of goals and programs cause separation of human actions science form its main subject. In human sciences, all of realities of world are thoughts and beliefs of actors. The meanings people imagine for objects, actions, places, and humans have deterministic roles in their decisions. The goal of human sciences is understanding these actions, not anticipation of them.

6.Theorem 4: Desirability and costs are subjective. All economic phenomena pass through mind filter. From 1870s, economists agreed upon this relation that value is a subjective affair, but many of them, obeying Alfred Marshal, claimed that cost side of this equation is determined by objective conditions. Marshal emphasized that as the blades of a scissors cut a paper, subjective value and objective costs determine price. But Marshal couldn't understand this point that costs are subjective too, because they are also determined by values of rare resources.

7.Theorem 5: Prices system saves information that must be process by individuals for decision-making. Prices express transaction conditions of market briefly. Prices system sends necessary information to market actors and help them recognizing their common benefits. Hike, in his famous example, says "when people know increment of tin price, they don't need to know whether this price increment was due to increment of demand or decrement of supply. In any case, increment of tin price obliges people for less consumption. By changing conditions, market prices changes and people reconcile with new conditions.

8.Theorem 6: Private acquisition of production tools is necessary condition for logical economic calculations. For a long time, economists and social thinkers have found that private acquisition provide many incentives for optimal assignment of rare resources. However, advocates of socialism believed that socialism can overcome incentive problems by changing nature of human. Ludwig von mises showed that even if socialism could change nature of human, it encountered defeats due to disabilities of economic planners to calculate replaced resources.

9.Theorem 7: Competitive market includes an explorative process that results entrepreneurship. Many economists view competition as a special situation. But word "competition" includes a kind of activity. If competition was a special situation, then entrepreneurship had no role. But since competition is a kind of activity, an entrepreneur has an important role and makes market moving in new paths as a change factor. Prices system and market economy provide tools that guide people to discover common benefits and use rare resources efficiently.

10.Theorem 8: Capital structure includes dissimilar goods with various applications. These applications must comply with each other. Production always encounters uncertainty towards future demand. A production plan aligns different goods with capital structure so that final goods are produced ideally and efficiently. If capital goods were homogenous, we could use them to produce any final good that consumers wanted. Then, when there was a mistake, resources were reassigned to final goods with more desirability. But, in reality, capital goods are dissimilar and specialty.

11.Theorem 9: Social organizations are result of actions of human, not designs of human. Social organizations are not often result of a direct design, but are lateral products of activities to achieve other goals. Market economy and its price system are samples of similar processes. Individuals don't seek to make a complex set of exchange rates and price signals. Their goal is only improving their lives, but their behaviors conduce the market system.

12.Critiques to Austrian economics

Austrian school has always encountered problems in justification of economic academies, and, despite of significant developments of advocators of this school in propounding himself, many faculties and scientific academies encounter obstacles in acceptance of Austrian approaches and criticizing it. Undoubtedly, Austrian thinking pattern is out of the common flow system, unless they reconstruct their mental structure. Such a problem has somehow been obviated by some Austrians such as Roger Garrison from Aberdeen University. He was ready to introduce Austrian economics in the frame of drawing models and was damned by many Austrians who thought he had asked holiness of Mises. He proved that Austrian thinking pattern can by expressed simpler and near to the common economic flow. It should be remembered that if common flow economists used charts to express their economy, it was because they showed their forms better and simpler, therefore, why did Austrian economics should do this tool? The point is that drawing analysis must not be replaced for non-drawing one, otherwise, using drawing tool cannot contradict Austrian school.

By view of many of its advocates, Austrian economics has distinct specifications from neoclassic flows. On the other hand, some (kerzner) believe that, despite the critiques of Austrian school to neoclassic flow, it develops scientific neoclassic scope. From this angle, Austrian school is not opposite to neoclassic and its development is a score for development of neoclassic thinking. Also, the father of Austrian school, Manger, was a member of marginalist revolution in 19th century and was one of the neoclassic revolutionists. Austrian cannot no longer deny this reality that they have no historical and intellectual affinity with other advocates of Austrian economics as a school advocating market economy. Perhaps this is the reason that kerzner believes that neoclassic economy at first emphasized mental approaches, as same as Austrian school, but it was forgotten over time and by excess notice to equilibrium.

Emphasizing these common aspects between Austrian school and neoclassic economy, Austrian principles can be better transferred to audiences. Although the dominant sense in Austrian economics is separation from neoclassic economy, and persons such as Lakshman deny thinking to Austrian school as complementary of neoclassic economy, but this approach is accompanying with other free economy schools, and minds are ready to receive complementary elements of neoclassic economy than an opposite economy against neoclassic economy. Another noticeable point is that it seems that there are significant affinities between Austrian and neoclassic interpretations. For example, while Austrians speak about market process, neoclassic emphasizes equilibrium. However, when they want interpret equilibrium, they discuss about a market process; or when Austrians emphasize methodological individualism, neoclassic persist Austrian approach by opening subjects of minors in major economy.

13.Conclusion

Today, advocates of Austrian school are known as Austrian economists and their works are known as Austrian economics. Austrian school was developed at the end of 19th century and the early of 20th century. Austrian economists developed neoclassical value theory and subjectivism theory, on which the main flows of contemporary economic thought are based, and propounded economic calculations that defense non-concentrated free market economy against assignment of resources in a concentrated planning economy.

Economists of Austrian school emphasize voluntarily contracts between economic agents and believe that trade transactions must have little constraints and government interferences. By their thinkers, John Lock, libertarian economists in Austrian school believe that these constraints must be based on individual freedoms and equal rights. The main shaft of theories of Austrian economists is constraining government power: "If you want stable peace among nations, you must constrain power of governments. Governments always were origins of largest embitterment, deviations, and disasters. The largest evil that human encountered up to now was governments".

At the end, because of non-accompany of common flow and little economists, Austrian school couldn't breed its economists indirectly and the main face of Austrian school was professor-pupil tradition. If market followers groups in common flow can breed economists directly without a professor, and books and papers were the only incentives, why do Austrians cannot? The remedy of leaving this tradition is using tools of common flow.

References

1- Craver, Earlenr.1989. "The Austrian economist". History Of Political Economy22(1):21-42
2- Samuels, Warren J.1992 " .Austrian and economics" .Researches in History Of Economic thought and methodology (12): 21-54
3- -walker,A1998." Austrian economic." www.hayek.org
4- -Yeager,Leland.1987."Whay subjectivism? "Review of Austrian economics 5 : 1-31
5- Boettke, P., Ed. The Elgar Companion to Austrian Economics. Brookfield, Vt.: Edward Elgar, .1994
6- Dolan, E., Ed. The Foundations of Modern Austrian Economics. Mission, Kans.: Sheed and Ward, 1976.
7- Vaughn, K. Austrian Economics in America. Cambridge: Cambridge University Press, 1994.
8- Boettke, P., And Peter Leeson. "The Austrian School of Economics: 1950–2000." In Jeff Biddle and Warren Samuels, eds., The Blackwell Companion to the History of Economic Thought. London: Blackwell, 2003.
9- Hayek, F. A. "Economic Thought VI: The Austrian School." In International Encyclopedia of the Social Sciences. New York: Macmillan, 1968.
10- Machlup, F. "Austrian Economics." In Encyclopedia of Economics. New York: McGraw-Hill, 1982.