

AUSTRIAN ECONOMICS AND ITS IDIOSYNCRATIC IDEAS FOR THE DIGITAL AGE

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Abstract

The intellectual tradition of the Austrian School of Economics has a vivid history for more than two centuries. Generation by generation, the 'Austrian' economists slowly distanced themselves from the prevailing neoclassical paradigm, explaining the world they lived in and showing the paths to the prosperity. But what can be said about the analysis of the main forces driving the digital era? Would the ideas of the 'Austrian' forefathers have still something to say? The purpose of this paper is to explore in what respect the Austrian's heterodox ideas could explain the recent technological evolution and guide its the future development.

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JEL classification: *B13, D40, E14, L26, O30*

1. Introduction

The intellectual tradition of the *Austrian School of Economics* has a vivid history that can be traced back to more than a few centuries ago. Great minds of economic thinking have emphasised that the basic tenets of Austrian Economics could and should be found in the teachings of the Jesuits and the Dominican scholars of the Spanish Golden Age (Kirzner, 1994; Rothbard, 2006; Schumpeter, 2006; Huerta de Soto, 2011). They also found the roots of these first ideas of economic liberalism in the ancient Greek philosophy and in the thoughts of the Roman statemen. The Humanism and the Natural's law philosophy preserved these ideas of the vital role of individual entrepreneurial creativity as the driving force of civilization as we know it (Rothbard, 1998).

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One of the many timeless achievements of Carl's Menger *Principles of Economics* (Menger, 1871) was his fruitful insights that reinforced the scholastic ideas about economy and society. Economic historians recognized Menger's work and placed it besides the penetrating analysis of yet another two giants: Leon Walras and William Stanley Jevons. The 'trio' marked the cornerstone of the early *neoclassical economics* (Boettke and Coyne, 2015). But Menger's vision was essentially different from the beginning. Its uniqueness comes from the fundamental belief that the nature of value is subjective. The key to the understanding of the economy are to be found in the ordinal decisions of the individual who is constantly acting in a means-ends framework.

Thus, generation by generation, the Austrian economists 'guarded the temple' and slowly distanced themselves from the prevailing neoclassical paradigm. On the grounds laid by Menger, Eugen von Böhm-Bawerk or Friedrich von Wieser, the *Webberian wert frei economics* was carried on by Ludwig von Mises and Friedrich A. von Hayek, followed, from the other side of the Atlantic, by Murray N. Rothbard and Israel Kirzner. They created a real alternative to *mainstream economics*, profound and idiosyncratic in its fundamentals, i.e. subjectivism vs. objectivism, action vs. decision, entrepreneur vs. *homo aeconomicus*, tacit vs. codified knowledge, entrepreneurial coordination process vs. general equilibrium.

Moreover, when Menger wrote his first thoughts, the world was on the verge of some tremendous transformation. The real effects of the technological progress stemming from the First Industrial Revolution, irreversibly changed the entire socio-economic landscape. History had to acknowledge the unprecedented growth of life expectancy, an unimaginable fact just by few decades before. It seems like Menger's *Principles* are speaking about the forthcoming era of prosperity, one nascent from the principles of the market process.

A few decades after, Mises also spoke and wrote about the world he lived in. By directly attacking the central-banking issue, at the time of its emerging as governmental interventionist method (Mises, 2009), or by strongly rejecting the collectivist and socialist ideology (Mises, 1951), his work stood up as guiding light for the next generation of 'austrians'. In addition, one needs to remember that it was just one line from the thoughts of Hayek that meant to explain the business's cycle nature and formation in the times of the *Great Depression* (Hayek, 1931, 1933).

Then came the penetrating *Rothbardian* analysis of the state's control over currency and its constant violation of private property, in a time of political crisis when the trust on central powers were dissipating, the omniscient myth of its endless abilities began to intake serious counterarguments, and the prevailing *Keynesian* paradigm stopped to deliver its macroeconomic outcomes (Rothbard, 2009). After all, just few decades before, it was Hayek and Mises who warned on the fallacies and on the unwanted consequences of such economic policy.

Menger, Mises, Hayek and Rothbard offered their arguments in the times of the ink pen and of the typing machine. The almost instantaneous electronic duplication of the document was considered, if thought about, miraculous. One could hardly imagine a world of ubiquitous availability of information that travel at highspeed internet networks, *intelligent* devices and satellites, owned by the rich, the poor and those in between. The markets are, nowadays, digital and interconnected, defying, for some, even the limits of scarcity (Mason, 2016; Peters, 2020).

The contemporary Austrian economists are delivering robust analysis of the present economic, social and politic realities, and the digital evolution made them worldwide available. But what can be said about the analysis of the main forces driving the *digital era*? Would, with the same persuasive power, the ideas of the forefathers have something to say about this phenomenon? Instead of reviewing the recent literature on Austrian economics, as there are many great efforts made in this area (Holcombe, 1999, 2014; Boettke, 2010; Boettke and Coyne, 2015), the purpose of this paper is to explore in what respect the fundamental 'austrian' concepts and core idiosyncratic ideas could explain the digital transformation of the economy and guide its the future development.

2. Methodology

The Austrian methodological approach to economic science, from Menger on, argued on the existence of three levels of economic discourse (Boettke, 1994). The *pure theory* seeks and finds the universal tenets of human action and stands at the core of the economic science. The second level, *applied theory*, is using these discovered principles within specific institutional and social contexts of human purposive action. The final level consists in *historical and public policy research*, where the concepts of the first two levels are employed to the real phenomena of the real world. Thus, the main purpose of theoretical research is to help the understanding of real

phenomena. In addition, research should be conducted by the use of logic deductions based on general accepted knowledgeable evidences, though an open dialog inside the ‘free market of ideas’ (McCloskey, 2017). As we are fully resonant with the Austrian methodological approach, this paper will use qualitative narrative analysis trying to shortly explore the forefather’s world of ideas, in order to test if and how the theoretical concepts from the core of Austrian economics can explain the recent development of the digital (intangible) economy, emphasizing some of its uniqueness differentiating the Austrian economics from other schools of thought.

3. The market process

Since its beginnings, the focus of the economic science was the production of wealth and the identification of the elements that generates it (Smith, 1776). Besides the errors made along the way, i.e. *mercantilism* or the *labor theory of value*, classical economists discovered two of them: trade and capital accumulation. Through trade and the division of labor, Adam Smith and classical economists – from the magnitude of Say, Ricardo or Marshall, understood the economy as driven by *the invisible hand* of markets – *places* for different exchanges. From this perspective, Walras, Knight or Debreu thought the market as not being a physical space, but saw it in a metaphorical manner (Sautet, 2010). In their construct, markets were mere *metaphors* suggesting the supply and demand equilibrium that had to be attained. Although the market is vital to the understanding of economics, it was shown that, paradoxically, following this line of thought, the markets became somehow mysterious, black-boxed and certain (Lie, 1997).

For the Austrians, by contrast, markets are central to the understanding of economics and should be analyzed thoroughly. For Mises, Hayek and Kirzner, the market represents *a process* made up by a multitude of complex trades among many individuals, generating prices and allocating resources, finally conducting to social order and harmony. Markets, seen as processes, *inter alia*, are main themes of an Austrian origin which had little impact on mainstream economics. Markets are living organisms, constantly changing and developing, complex matrixes with an indestructible evolution, essentially uncertain and hard to predict.

The digital technological progress showed an entire history of bankruptcy and displacement of big market players by younger and smaller enterprises that are facing the same fate if they fail to successfully compete. For example, it is a notorious fact that the dominance of web browser *Internet*

Explorer was to be replaced by its much younger competitors like *Chrome*, *Firefox*, *Opera* or *Safari*. Then, the powerful *Yahoo*, *Ask* or *AOL* partially lost the fight against some young competitor with a strange name called *Google*. By the 2001's summer, when *Facebook* was starting to win battle after battle, *Google* proposed its own social networking digital platform, reinventing himself and giving *Facebook* his first serious challenge.

Can anyone just imagine and then try to act in order to freeze, even for a moment, this living process aiming to evaluate its current state by reference to some general rules or norms stemming from the neoclassical paradigm of pure and *perfect competition*? But what can be said about the dominant perception on efficiency, inequality, or unjustly market power? The market process is *dynamic* and unceasingly *intense* by its Austrian definition. These fundamental characteristics are easily observable and relevant nowadays, when the economy is transforming, literally, on a daily basis. We find it important to emphasize not only the fact that the market process does not permit for the digital developers to delay their plans, but, more important, it encourage them to build their source-code and software starting from the premises that development can never be stopped. And this is because change is not only a simple feature of the market process, it is its defining vital force.

4. Competition as voluntary cooperation

The classics developed a theory and a rhetoric defending *competition* seen as an essential institution for market functioning. For them it was vital to emphasize it as key counterarguments against mercantilism and governmental privileges. The Austrian tradition has always held a much wider perception. In the Austrian approach, competition is just a component for the societal *cooperation process*, defining the mere existence of civilization. The subjective theory of value is grounded on the individualistic and subjectivist judgemental decisions for *value creation*. A value expressed ordinally that could not and should not be compared among people (Menger, 1871).

It is from this reasoning that market exchanges create mutual gains, maximizing utility through minimizing them marginally, all being interpreted from the point of view of every individual in the market. Here it can be noticed one of the constant *Misesian* themes at work: free markets are both cooperative and competitive (Mises, 2018). Cooperation takes place not only between buyers and sellers, but also among those who engage themselves in diverse and complex structures of production formed by the extension of the division of labor. Moreover, the *Misesian law of association*, measuring the

extension of division of labor through the entire society, has the same value with the one measuring the development of the market process serving more and more individuals.

For the first time in the history of humanity, digitalization has opened the door to voluntary cooperation at all levels and worldwide. This kind of collaboration can transcend not only geographical and political barriers, but also cultural and linguistic ones, i.e. increased complexity and availability of translation and voice recognition software. Other examples could be found in the concepts motivating the social networking developing activities. Individual beliefs, attitudes and the propensity to associative behaviour are at the core of commercial entrepreneurial initiatives like *eBay* or *Overstock*, and even at those pertaining to the private life or friendship relations, i.e. Facebook or Instagram.

The Austrian School of Economics is an ideal position if it tries to explain the current technological evolution, due to its emphasis on the economic agent as an acting goal-seeking individual. These ends are everchanging the contours of human competitive action which is, in the final analysis, cooperative.

5. Entrepreneurship

Almost alone among many schools of thought, the Austrian School understood entrepreneurship as the driving force of the market process, therefore of the entire economy. Market functioning and competition (rivalrous or cooperative) are explained through the *entrepreneurial function*. This function, in the *Kirzenerian* and the *Misesian* approach, represents the individual's propensity to discover the hitherto unknown (Sautet, 2010). Neither markets in the classical or neoclassical sense could be the locus of the entrepreneurial discovery or creation function, as they are perfectly coordinated or automatically equilibrated. Starting from Menger, Austrian economists have always understood that it is a non-sense to assume profits and gains as known and *ex-ante* exploited. These are some of the reasons that gave birth to the *alertness's concept* (Kirzner, 1973, 1985) or to the solution concerning *economic calculation* and *price coordination* (Rothbard, 1985; Salerno, 2008).

Moreover, entrepreneurs confront the uncertainty of the future as they imagine it cognitively. They produce *ad-novo* tacit knowledge (Polanyi, 1959) indispensable for the relentlessness of error correction in the market process.

This is to be proved by the increasing number of *digital entrepreneurs* animated by anticipated profit gains.

6. Economic planning and knowledge

The idea of the impossibility of governmental or central planning is one the most famous and distinctive tenets for the Austrians. The rational allocation of resources is absolutely bounded to the existence of monetary calculus over the expected profit and losses. The authorities are incapable of doing such a simple task due to even a simpler cause: the lack of instruments and data to input in the calculus. They just extract resources from the private sector and spend them, not having to confront the validity of their action through the only objective mean available: the market process. Thus, the rationality of the economic calculus and planning is dependent on the information and on the knowledge provided by the system of relative prices formed inside markets as results of the voluntary exchange of property rights and means of production.

The realities of the *intangible economy* stresses one more time the validity of the above truths. Nowadays, the system of prices is global, instantaneous and everchanging. In this medium, the statist organizing means and methods seem to be simple unfunctional *anachronisms*, gigantic machineries functioning on old methods of production gathered around rigid national strategies. What relevance would have the actions of such a *leviathan*, a decrepit creature in a digitalized world?

The corollary of this point of view comes the *Hayekian spontaneous order* concept (Hayek, 1988) – a social order unplanned in advance, resulted from the actions of billions of individuals. We argue the fact that Hayek would be fascinated to observe the way through which information technology companies are unable to precisely forecast the future usage of their own digital innovations. However, the main point is that firms developed and prospered by trial and error processes, using unique and specific knowledge.

Knowledge diffuse and dissemination is another unneglected concept in the Austrian paradigm. The dominant paradigm defines competition in terms of ‘runners’ at the starting line. However, this is not the hole truth. ‘Runners’ must be aware of the competition they face, the method of running, and also to possess the knowledge that they are not the only ones who compete. All this knowledge is equally important in the digital age. The entrepreneurs use and improve their knowledge thus gathered, they discover

and create value by *acting on the opportunities* offered by the worldwide market process.

7. Conclusion

The Austrian school of thought can give many insights in the context of the Digital Era. Reading Mises in the light of recent technological development, one can observe that every word is at its rightly place. Understanding Hayek, the worldly digital landscape seems more orderly than ever. The Austrians are explaining, once more, how the digital revolution saved humanity from being crushed by central powers. Through voluntary cooperation, competition and opportunity discovery in an open-market globalised context, the creative entrepreneurial human spirit is the key to future development.

From the founders to the contemporary, the Austrians placed entrepreneurship at the core of their understanding, offering a unique explanation for the real economic phenomena. Mainstream economics, neoclassical in its nature, could not fully grasp the entrepreneurial dynamic character of society, unintentionally and spontaneously ordered by the market process. These core principles and the ones that follow organically from them (competition, cooperation, coordination) give to the contemporary proponents of the Austrian thoughts the strength to resist and refute the mechanistic explanation of economic and social phenomena, as mainstream economic theory often claims. The Austrian economist should be intellectually visited in order to better understand the Digital Era and see how their theories sheer light on the main trends of nowadays' realities.

In the line of *Misesian* thinking, *everything that happens in the social world in our time is the result of ideas. Good things and bad things. What is needed is to fight bad ideas. We must fight all that we dislike in public life. We must substitute better ideas for wrong ideas* (Mises, 2010). In the final analysis, what drives creativity, the cognitive or intellectual process driving innovation, are the ideas, or at least, the mental representation of what can be done. The understanding of the historical evolution of humanity and the economic development could not be separated from its dependency to the role of ideas (McCloskey, 2017). Modernity and civilisation were always grounded on a paradigm of ideas stemming from the values of classic liberalism. They argued for an economising behaviour, for capital accumulation and for freeing the functioning of the fundamental economic institution. Open competition of ideas in a market context, personal freedom and open exchange are the

premises for economic development in the Digital Era and key principles of the Austrian School of Economics.

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