A TALE OF TWO SCHOOLS: MARK SKOUSEN'S *VIENNA & CHICAGO: FRIENDS OR FOES?*

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Vienna & Chicago: Friends or Foes? A Tale of Two Schools of Free-Market Economics
Mark Skousen
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While both the Austrian and Chicago schools are commonly associated with free-market ideals, there have been rivalry and lively discussions between them. In *Vienna & Chicago: Friends or Foes?*, Mark Skousen asks whether the two schools are separated by an unbridgeable difference or if, rather, they can become closer allies. After providing an overview of the history of the two schools, Skousen compares the schools' positions on four subjects, namely methodology, the ideal money standard, macroeconomics, and the proper role of government. After describing the positions of both schools on a particular subject, Skousen concludes with a judgment about which school has the stronger position in that regard. After declaring a 2:2 tie, in the last three chapters Skousen writes about the view of both schools on other economists, about their faith in capitalism, and about his strategic recommendations concerning the advance of free-market economics and a possible alliance of both schools.

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A TALE OF TWO SCHOOLS

The subtitle of the book is honest and clear: *A Tale of Two Schools of Free-Market Economics*. So those who do expect a tale will not be disappointed. Those, however, who look for a scientific and rigorously argued comparison and in-depth study of the Chicago and Austrian schools will not find what they expect, since Skousen, indeed, sets out to tell a tale from his personal perspective. Unfortunately, his tale is loaded with contradictions, misunderstandings, inconsistencies, inaccuracies, and erroneous conclusions. However, the tale is an easy read, since Skousen is an entertaining narrator. He mixes his analysis with numerous interesting anecdotes. So, for instance, we learn that Joseph Schumpeter «...engaged in outrageous behavior, was an infamous womanizer, and once declared his personal goals to be the world's best horseman, best lover, and best economist. He said that he accomplished two out of the three.» (p.39)

Interestingly, Skousen dedicates a subchapter to Schumpeter as a member of the Austrian school, leaving out his contemporaries Fritz Machlup, Richard von Strigl, or Oskar Morgenstern. While Schumpeter was, by virtue of his nationality, Austrian, his membership in the Austrian school must be disputed. Curiously, Skousen even cites Schumpeter praising Léon Walras as the «greatest of all economists» for discovering general equilibrium analysis. But that does not lead Skousen to question his classification of Schumpeter as a member of the Austrian school. Arguing with Schumpeter's positivist methodology, set out in 1908, and later adopted by Milton Friedman, one might even make the case that Schumpeter was more a pioneer of the Chicago school than an Austrian economist.

Another anecdote concerns the rumor that Ludwig von Mises supported state subsidies for operas which Skousen throws light upon with the help of his private correspondence with Bettina Greaves. In fact, Mises was asked if he would have

> favor[ed] government subsidizing anything at all?' Mises answered something along the lines, 'Well, the voters should be free to vote for anything they want. And if the pros and cons of subsidies are fully explained to them, and if they still want to subsidize something, I would suggest they subsidize the opera, because I like to go to the opera. (p. 267)

The personal correspondences are another point that makes the book an easy read. Skousen has many friends among both Austrians and Chicagoites and weaves his personal correspondence with them into his tale. When Skousen shares the treasures of his insights on the profession, he is certainly at his best. The opinions of the economists about each other can be very interesting for historians of economic thought. However, the advantage of having friends in both schools might also involve the disadvantage of not being as critical as is necessary when it comes to judging their theoretical positions. Another ingredient in this tale is Skousen' intellectual autobiography, since he mixes his own experiences with both schools into it, telling his readers how he started as an Austrian economist and became ever more open to the Chicago school.

SOME PROBLEMS OF THE BOOK EXAMINED

After naming the merits of the books for historians, tale readers, and lovers of biographies, we must discuss and show some more of the shortcomings that we mentioned above. To name an inaccuracy, Skousen maintains that the Habsburg Empire was partly located in what is today Yugoslavia, obviously escaping him that Yugoslavia no longer exists (p. 22). Also, there are some inconsistencies in the tale. Skousen seems to contradict himself when he maintains that Habsburgs ruled their empire for 400 years with «an iron fist» (p.22) while on the following pages he tells how enlightened Empress Maria Theresa abolished serfdom and torture and how in 1867, economic and political freedom was expanded by establishing a new constitution. Inconsistencies also lie in his treatment of Adam Smith, when he admits in a footnote (p. 16) that there were predecessors of Smith who advocated a free market and provided a more consistent exposition of economic theory like Juan de Mariana, Richard Cantillon, A.R.J. Turgot, and Etienne Bonnot de Condillac. However, instead of devoting more in-depth analysis to these predecessors, Skousen seems to spend an inordinate amount of his analysis on Adam Smith who is presented as a great classical liberal and economist leading to a revolution in economic theory of the good. Even though Adam Smith might be important for the intellectual tradition of the Chicago school, Skousen seems to get side-tracked from his original goal by his treatment of Adam Smith in a book intended to analyze both the Austrian and Chicago schools (According to the index Mises appears on 39 pages, while Smith on 44 pages). One is inclined to think that Skousen prefers to show off his knowledge of the history of economic thought in general, and Smith in particular, rather than to provide an in-depth theoretical analysis of Chicago and Austrian schools.

Yet, even in what appears to be his strength in this work, history of economic thought, there are other errors and misleading conclusions in Skousen' tale. For instance, he states that the socialist calculation debate was initially lost by the Austrians. However, this has been shown to be a myth by Jesús Huerta de Soto (2005). Moreover, Skousen believes that it is possible to reconcile the opinions of both schools on the Classical school. Yet, it seems that the Austrian school has become ever more critical towards Adam Smith and the classics while the Chicago school continues to admire Smith. This interpretation also runs against another thesis of Skousen' that the difference between Chicago school and Austrian school is diminishing. But with respect to the appraisement of Smith it seems to be the other way around, especially since Murray Rothbard's critical treatment in his monumental *History of Economic Thought*.

Along with errors in fact, inconsistencies, and misleading conclusions, the results of Skousen's theoretical analysis are sometimes dubious to say the least. One error concerns the assessment of Friedman's monetarist rule, i.e., the automatic increase in the money supply between 2%-4%, which Skousen regards as anti-inflationary (pp. 76). He claims the rule to be a positive restriction of monetary policy. That might even have been Friedman's intention when pronouncing it. However, one must look deeper on the real significance and effects of that rule. First, it gives the control of the money supply ultimately to the government. Second, this rule serves as a final legitimation for a constant increase in the money supply, which from an Austrian point of view is constant inflation. In comparison to a gold standard proposed by the Austrians, the monetarist rule is therefore highly inflationary.

Another point of concern is Skousen's giving primacy to academic and political approval over theoretical rigor. Skousen recommends that those in the Austrian school use empirical methods to convince people of free-market ideas, because he thinks that people are more easily convinced by statistical data than by pure logical reasoning. However, in the process of persuading others to accept a particular view point, a coherent theory should win over an opportunistic strategy. Science always must tell the truth. If Austrians believe that it is unscientific to use empirical data to prove a proposition, how can they be expected to use an inappropriate methodology, i.e., empirical data, to convince «non-believers» (p.11)? That would be an intellectual vice. One should not overthrow principles, tell an untruth, or lie just to persuade others to a particular point of view. Such a strategy is not ethical.

Furthermore, doing so will destroy one's consistency and undermine one's argumentative basis, so much so, that in the long run this strategy becomes self-defeating. In the long run, it thwarts the one's own aims as a theorist, to make compromises in theory, as Skousen seems to recommend. He says that the Chicago school has had more influence in academics and politics through making compromises and adhering to some interventions. However, what is important for an economist or an economic school is not to have influence but to tell the truth. *Fiat veritas, et pereat mundus* to change a famous Latin phrase.[1] Ultimately, compromises in theory cannot strengthen the influence of a particular school of thought. Nothing is more attractive in theory than a coherent, consistent, and stringent position. It will attract a hard core of followers and students strongly committed to the cause of truth. By sticking to the truth one will not need rhetoric that makes compromises to convey a position since the truth seekers will find the truth. Neither will one need to approve of others' inconsistent, compromising, and socialistic positions. One must even pronounce their failure. In contrast, an inconsistent theory will lead to false conclusions and will attract those with shallow reasoning that will easily abandon the cause of truth. At this point, one loses respect for his own position. Moreover, once having started with compromises, there is no logical end in continuing with compromises until the whole original theory is abandoned and falls apart. Skousen unfortunately fails to understand all that. Therefore, he is baffled by the apparent success of the Ludwig von Mises Institute (p. 274). It is no wonder, that he denounces Mises for leaving a Mont Pelerin Society meeting and for announcing «'You´re all a bunch of socialists'» (p. 274). Again, Skousen fails to see how important it was that Mises defend his coherent position as others opted for interventionist ideas instead.

[1] The original phrase is: *Fiat iustitia, et pereat mundus*. There shall be justice even if the world perishes. This was the motto of the Habsburg Emperor Ferdinand I (1503-1564).

AREAS OF COMPARISON BETWEEN THE SCHOOLS

Let us now look at the four different subjects – methodology, the ideal money standard, macroeconomics, and the proper role of government which Skousen examines and judges. The most serious problems can be detected in the chapter on methodology. Skousen fails to point out that the unbridgeable differences between Chicago and Austrians schools ultimately stem from their opposed methodological approaches. Moreover, he maintains that Austrians have not linked theory with history (p. 100). This is simply not true. One link that Austrians have drawn between history and theory is the need of a theory to interpret and understand history. *Verstehen* needs theory. Hence, Austrians have written many books on history in which they apply Austrian theory to interpret history, like Rothbard's *America's Great Depression*, Higgs´ *Crisis and Leviathan*, Vedder and Gallaway's *Out of Work*. Another link that Austrians make between history and theory is that history directs theory to the relevant and interesting fields of investigation. In a world of barter it would only be an intellectual game to develop a monetary theory. Therefore, economists in a world of barter would probably not engage in developing a theory of indirect exchange or money. When money emerged in a historical process, monetary theory ceased to be an intellectual game and became an important theory to explain the real world.

A preposterous allegation of Skousen is to declare Mises' methodology as «quite unreal» (p. 107). Realism is exactly what characterizes Mises's methodology. Its realism lies not in the building of simplifying models, not in freezing the dynamics of reality by mathematics or graphs, not in pretending to be able to measure utility or make interpersonal-utility comparisons, not in calculating some collective social welfare, but rather its realism lies in its investigation of universal laws of human action by deductive reasoning. In contrast to Mises' realism stands Friedman's positivism and Chicago methodology. Skousen even quotes Friedman:

> In a 1953 article, «The Methodology of Positive Economics», Friedman argues that an economic model should be judged solely on its predictive power ,'the only relevant test, in general, the more significant a theory, the more unrealistic the assumptions.' A theory with 'realistic' assumptions will undoubtedly be 'useless,' Friedman contends.» (p. 115)

Albeit Friedman's disinterest in realism, Skousen names Mises' methodology as unreal instead of Friedman's. Unsurprisingly, in Skousen's opinion, Chicagoites win the round on methodology because they conduct quantitative work. This is justified not by epistemological arguments but by his opinion that it is easier to gain influence in academics and convince people by using statistics.

Another startling analysis of Skousen concerns the two school's perspectives on the ideal monetary standard. Skousen shows the advantages of a gold standard and rebuts Friedman's argument that a gold standard would be too costly. However, at the end of the chapter, he comes to the surprising conclusion that Chicago has an advantage on the subject of the ideal monetary standard with their fiat money approach. This just does not seem to follow from Skousen's theoretical arguments in favor of a gold standard. As a justification for his conclusion Skousen names pragmatism. Once again, he does not distinguish clearly between what is right in theory and what is most easy to convince politicians or the masses of. It is probably true that the Chicago monetary reforms are more easily accepted by politicians than Austrian reforms. However, Keynesian monetary reforms might be even easier to persuade politicians to accept and, therefore, more pragmatic. Pragmatism is simply not the question for a theoretician who searches for an ideal monetary standard (the subtitle of the fifth chapter is «What is the Ideal Monetary Standard?»). In theory, one must always advocate the right solution to a problem. In politics, it will then be decided how close one gets to the essential solution.

In his chapter on macroeconomics, which includes a treatment of the Great Depression, and business cycle theory, Skousen lets the Austrians win. Skousen's neglect of microeconomics implies that there are no significant differences in this respect between the two schools. Hence, he glosses over an important source of difference between both schools. Apparently, he does not see that the Chicagoite Coasian theory of social costs implies a justification of state interventions to internalize external effects and reallocate property rights virtually without a limit. By weighing the social costs and benefits case by case, property rights are not the starting points of the analysis but rather become dependent variables. This difference is ultimately caused by the fact that the Chicago school does not start (micro)economic analysis with a subjective value theory which is a core pillar of Austrian economics, but rather with a more objectivist approach of trying to calculate utility changes.

Also in the chapter on proper role of government, where Skousen deals with antitrust, public choice, and political economy, he seems to downplay deep theoretical differences between the two schools. Skousen again calls an «advantage» for the Austrian school. However, he sees the Chicago school coming ever nearer to the anti-trust position of the Austrians. It is true that the Chicago school has become less interventionist in this point; however, it must be pointed out that the Chicago school's underlying theory of «perfect competition» views all companies as automatons producing the same good at the same price. This differs greatly from the Austrian theory which regards competition as a dynamic process with the innovating and competing entrepreneur as the moving force. Skousen fails to emphasize that the Chicago school's theory of competition can be used to deduce very interventionist conclusions concerning anti-trust, i.e., the state should always intervene when reality differs from the perfect competition model.

SKOUSEN'S AIMS

With this book Skousen wishes to show that the Austrian and Chicago schools are both free market schools that have more in common than what separates them. However, Skousen is not able to attain that aim. First, there are some aspects which make it difficult to call the Chicago school a free market school at all. Its proponents advocate a nationalization of money and the control of the money supply by the government. Their practical views on competition might be more or less free market but their underlying theory of perfect competition can be used to justify interventions into the market. Coase´s theory of social costs can be used to justify a virtually indefinite array of state interventions to improve social welfare. Friedman's negative income tax guarantees welfare income. Moreover, Chicagoites have proposed several other measures proposed to make the state more efficient while Austro-Libertarians want rather an inefficient state, i.e., a state that is not efficient in achieving its understood aim to exploit a productive economy. All this leads to the conclusion that only in comparison with other schools does the Chicago school look relatively free market.

Second, there seems to be more that separates the two schools than what they have in common. Skousen, himself, names many of the differences between the two schools. The methodological abyss between the realism of the Austrian school and the positivism of

Chicago school seems to be especially unbridgeable. For this reason, Skousen wants the Austrian school to adopt the positivist methodology. However, this would be the end of the Austrian school, since its methodology is its most important characteristic. Moreover, due to the large differences between Vienna and Chicago, the case even could be made that the Keynesians and Chicagoites have much more in common than Austrians and Chicagoites. Keynesians and Chicagoites both share some justifications of state interventions and the belief that the state is needed for macroeconomic management. Moreover, both schools lack an elaborate theory of capital, use aggregates in their macroeconomic analyses, and make frequent use of mathematical formalism and econometrics. Skousen himself indicates that when he tells the reader how Keynesian Friedman was, for instance, in noting Friedman's Theory of the Consumption Function or in quoting Friedman's statement that he considers Keynes a greater economist than Mises. (p. 241)

Furthermore, Skousen fails to provide evidence that the two schools move towards each other as he claims (p. 291). It is true that the Chicago school, for instance in its practical view on anti-trust lead by George Stigler, has become more free market, but the Austrian school is not moving at all towards the interventionist camp of Chicago, nor is it abandoning its realist approach. A sign that the schools are drifting apart rather than bridging their differences is the intent of some Austrian members of the Mont Pelerin Society to found the Mount Ararat Society. They want to continue theoretical discussions on free-market without the pragmatic Chicagoites.

Skousen´s ultimate and well-intentioned aim is forging an alliance between the Chicago and Austrian schools to work together more efficiently for a free-market. He states that «[i]f Austrian economists will recognize the powerful tools they have at their disposal to generate a new economic way of thinking, they will join the ranks of the Chicago economists as accomplished performers in modern economics. To do so will require Austrians to advance their model building and empirical work to a new level» (p. 290). However, this equalizing of both schools does not even make sense considered from a strategic level. Even if we regard Chicago as a free market school, both schools should stay independent and follow their respective paths. May a thousand flowers of liberty blossom. A strict separation line makes it easier to differentiate the positions and improve on them, make them more coherent and powerful. The equalizing approach Skousen follows will lead to intellectual sloth, stagnating debates, muddled positions, and compromises – an unappealing potpourri. If Skousen seeks liberty, a merging of both schools is not the road he should recommend.

CONCLUSION

In *Vienna & Chicago* Skousen fails in two respects. First, he misses a wonderful opportunity to provide a proper in-depth theoretical comparison of the Chicago and Vienna schools, which indeed, are commonly regarded by the general public as free-market schools. He might have explained in detail how the two schools arrive at sometimes similar free-market positions even though they start from irreconcilable theoretical and methodological bases. However, he passes up this opportunity by glossing over significant differences. Second, Skousen fails in his strategic recommendations, as well. A united front on the free market, achieved through Austrian pragmatism, as well as compromises on and betrayals to their methodological foundation, would not foster the cause of truth and liberty.

In sum, if the reader enjoys anecdotes, or is interested in the opinions which famous economists have about each other, or is searching for an intellectual autobiography of Mark Skousen he will find it in *Vienna & Chicago*. However, the reader should be aware of inaccuracies, contradictions, misunderstandings, inconsistencies, erroneous conclusions, and unwise strategic recommendations. He, who seeks a scientific, in-depth theoretical study of the differences and similarities of the Austrian and Chicago schools, should look elsewhere.

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