

AUSTRIAN ECONOMICS

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She is the author of *India: Progress or Poverty* (London, IEA, 1971), *Underdevelopment and Economic Growth* (London: Longman, 1970), and articles in the *South African Journal of Economic and Management Sciences* and other journals, as well as book chapters.

She is also the editor of *A Tiger By the Tail: The Keynesian Legacy of Inflation* by F.A. Hayek (1972, 1978, 1979).

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An Interview with Sudha Shenoy

THE GLOBAL PERSPECTIVE

AEN: You were part of the South Royalton conference, which is considered a founding meeting of the modern Austrian movement.

SHENOY: Most certainly. That was 1975, before the modern Austrian movement had really taken shape. Many of us had come very long distances. None of us could believe the surroundings in which we found ourselves. We were driving and driving to get to the conference center. We found ourselves in a tiny village in the midst of this huge forest, in an ancient dilapidated hotel. Finally, halfway through the week none of us could stand it anymore, and we went into town where there were people, activity, lights. Civilization!

Murray Rothbard made the whole affair fun, but the facilities really were horrible. The chap who organized the conference, who shall remain nameless, owed the owner of the hotel some money, so the conference killed two birds with one stone. But aside from the facilities, it was a very good conference. Ludwig Lachmann came from South Africa. At that time, I was teaching in my first position in Australia. It was very exciting to find colleagues and imagining that our ideas might have a future.

AEN: It's remarkable how far back your personal connection to the Austrian School goes.

SHENOY: I've had the longest connection to the Austrian movement of anybody ever. My father, B.R. Shenoy, was a graduate student at the London School of Economics in January 1931 when F.A. Hayek delivered his lectures on prices and production. My father said that Hayek

still had a thick Viennese accent at the time. He was uncertain about his English: “Money he does this, money he does that.” My father couldn’t really follow because of the accent, but he could tell that there was something there. After studying the Austrian theory, he said that he was immunized against every other framework.

After teaching in Ceylon and India, he joined the Reserve Bank of India. He was sent to Washington as the Indian representative for the World Bank and the IMF from 1951 to 1953. He could have become the governor of the RBI but he couldn’t stand it anymore. So

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he took a cut of half his salary and went back into academic teaching. They made the mistake of leaving him on a panel of economists for the planning commission. In an appended dissenting report issued in the early 1950s, he predicted that if the Nehru plan went into effect, India would face a foreign-exchange crisis and inflation and there would have to be cuts. Nehru got very upset.

AEN: These views were quite uncommon then, and probably extremely uncommon in India.

SHENOY: Certainly. When he died in 1978, he had been virtually the only liberal economist between Athens and Tokyo. Peter Bauer took notice of him in 1955, when he came to India on a research visit. Bauer had seen my father’s articles, and asked the economist at the British High Commission about him. The economist replied, oh, don’t pay any attention to him, he’s a madman. Bauer’s thought: well then, I must get in touch with him!

After that, the Mont Pelerin Society invited him to speak at the Oxford meeting, and the people there couldn’t believe what they were hearing. I was just reading in the archives a letter from Hayek to Lachmann, in which Hayek reports having met a liberal economist from India named B.R. Shenoy! My father did indeed become quite well known.

AEN: And what about your academic choice?

SHENOY: I never thought I would be an economist. I thought I had had enough, and I would go into English. In the second year of college, I took a course in economics—the alternative was mathematics—and I quite liked it. Henry Hazlitt had sent my father some books and among them was the *Free Man’s Library*. This provided a good reading outline for me. For some reason, Gujarat University (in Ahmedabad, north of Bombay) where my father was teaching, had copies of some Mises books. I read them and was hooked. Hayek and Mises were household names in the family. I eventually attended the LSE, University of Virginia, and finally ended up teaching at Newcastle (in Australia).

AEN: Tell us about your collection of Hayek articles, *A Tiger by the Tail*.

SHENOY: I was at the IEA, and I was pestering people about all the great anti-Keynesian ideas in Hayek’s work, and how it ought to be brought into print. They agreed. It came out at the right time. We were in the midst of stagflation, and it was just before Hayek’s Nobel Prize. I was surprised by the reception, but Arthur Seldon was not. For months after, we had “tigers” running through the financial press. Keynes’s unassailability died between the first and second editions, and I realized while preparing the second edition that I could now say anything I wanted. The first had to be very cautious because Keynes was still very much alive.

Stagflation, which is the combination of inflation and unemployment, was the cause of Keynes’s decline. Apart from the Austrian theory, there was no intellectual way of dealing with it. So this was a big moment for the Hayekian theory.

AEN: Rothbard also had a certain influence on you.

SHENOY: His *Man, Economy, and State* is another book that came out at the right time. I recall that in 1963, I bought the original two-volume hardback version in a secondhand London bookshop. I couldn’t afford it, but I bought it anyway. I would sit through lectures thinking “I don’t believe this,” and then I would rush home and read Rothbard to strengthen an alternative position that made more sense. For the ideas I was getting at the LSE, this book was hugely important. These

days, Austrians can get formal training. But in those days, all Austrians were self-taught. Rothbard's book was excellent for this purpose. It was the starting point for all of us.

There can be no question that Rothbard has had a substantial influence on the modern Austrian School. We must remember that there was a huge gulf between the older Austrian generation of Mises, Hayek, and Lachmann, and the next generation, which began with Rothbard and Kirzner. The modern Austrian School is an Austro-American School. Rothbard is very important here. Kirzner is also crucial.

AEN: What other books were crucial for you?

SHENOY: Certainly Hayek's *Constitution of Liberty*, which I read when it first came out.

AEN: Was there surprise at how un-liberal that book was in places?

SHENOY: It wasn't un-liberal in those days, and if you look at what people are recommending for government to do now, it is still not un-liberal. The more one looks into the workings of the market, the more one can see much of his program can be compatible with a complete market framework. When he says that there should be a minimum below which people should not fall, he is merely invoking the old Victorian principle that people should not be permitted to starve. This means nobody is going to find life easy on the dole either. Also, charities would play a major role.

In any case, Hayek's recommendations were principled and constantly related to an existing market order, in a way in which others are not. The market, not the state and its programs, forms the central core of his social theory.

Most discussions of these issues start with the presumption that the state precedes the market. The reverse is in fact the case. Hayek was part of this great common-law tradition. Once you realize this, you begin to recognize the significance of his proposals, that they do not compromise his market stance.

AEN: Do you accept the view that *Constitution* draws from a British intellectual tradition to the same extent that *Law, Legislation, and Liberty* draws from a Continental tradition?

SHENOY: No. In *Constitution* he extends the analysis to customs, traditions, and society at large, and in *LLL* he discusses the common law. Both books work from this framework. The important point about all the older Austrians is that they all belong in this common-law tradition. That is especially true of Menger, who drew clearly from Burke. His book, *Problems of Economics and Sociology*, contains an appendix in which he points out that the Younger German Historical School and Burke are *opposed* in their analysis. It is quite clear that Menger was in some ways a Burkean.

The older Austrians were examining institutions and social forces that had *already developed* in people's actions. Then they were trying to work out the principles that are implicit in how people are acting. The point is that they realized that there was already a market economy out there working. They began to see that people were acting on rules that were first manifested in people's actions and then articulated. This is like language. It is a way of understanding the origins and background of Austrian analytics. The "something" they are analyzing is preexisting, not created by one mind or one generation but over a long period of

time. The older Austrians were the latest in this analytical line.

AEN: Didn't the classical economists recognize this as well?

SHENOY: They did but they didn't go far enough. As Mises said, they looked at the businessman but they didn't consider human action generally. That is why their analysis was limited in so many respects. What the older Austrians saw was that commercial activity was only one dimension of a general pattern of human engagement that is managed by rules and norms scarcely known even by the participants themselves, any more

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than they "know" the rules of the languages they use. To provide the analytics for understanding how this worked was the method of both Mises and Hayek.

For his part, Hayek was trying to ride two horses at once and didn't quite realize it. If you exclude all that he said about testability and falsifiability, and just put it to one side, the rest of Hayek's method is quite coherent and completely an extension of the praxeological tradition. In fact, in a footnote in the *Counter-Revolution of Science* he says that it would be a good idea to adopt the term praxeology.

Hayek had read *Nationalökonomie*. A copy did reach him from Geneva in

1940, and the insights from that book show up at once in Hayek's work. His discussion of economics and knowledge was merely an expansion on what Mises had said earlier. Mises said the market order is based on a division of knowledge which parallels the division of labor and the division of property.

AEN: What about political divisions between Mises and Hayek?

SHENOY: This is interesting. Mises was quite clear that he believed that government was a praxeological necessity. He wrote again and again that a society needs an institution that

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enforces the law, and therefore you need government.

Hayek, on the other hand, says that we owe loyalty to government only and to the extent that it maintains the economic order and the laws on which we all depend. If it does not do that, we do not owe it any loyalty at all. He wrote this in "Confusion of Language in Political Thought." When the IEA published this, I pointed out to Arthur Seldon that he was promoting anarchy. This quite startled Seldon.

Hayek further says, in *LLL*, that if all government activity ceased, society

would continue. So the political implications of Hayek are, in some measure, more extreme than Mises. In a late interview, he admitted that were he a younger man, he would probably be a libertarian anarchist.

AEN: You said in your lecture that economic science took a wrong turn long ago and hasn't recovered.

SHENOY: I'm prepared to say that nearly every economics department in the world could be shut down without having an ill-effect on the world of ideas. The wrong turn was taken in the 1930s or perhaps earlier, when economists began to adopt what the philosophers of science said were the methods of the natural scientists. The latter at least have an objective object of study. Economists follow whatever the philosophers of science say is the latest scientific procedure.

So economics is three or four steps removed from the real world, and, on top of that, it is the natural world. Hence, economists are following a scientific recipe but have no real object of study. They are not interested in examining the social world, which requires specific analytical tools.

This means economists today aren't even interested in studying the real world. If you told economists today that it is their job to study the world of human action, and that "applied" work consists of studying economic history, they might all decide to move on to some other profession. This is why I believe that neoclassical economics is a dead end. And this is just a symptom of a larger problem. The university as we know it has lost its way, no longer sure of what it is doing. This is not surprising. State institutions cannot adapt to change.

AEN: You are doing some work on trade right now, and you believe that

Austrians might have something to contribute to the discussion.

SHENOY: As an economic historian, and an Austrian one, I've long been interested in questions of trade, and I became furious at what Paul Craig Roberts and others were putting out on the issue of trade, and I didn't see it being countered effectively. Roberts has written many good essays and books—but on trade he is just wrong. He says that the problem isn't free trade; it is the mobility of capital which is driving U.S. production for American consumption overseas.

Capital mobility is nothing new. It is only part of the global division of labor and a reflection of rising capital accumulation, i.e., prosperity. It is not for nothing that Mises wrote that the world is the sphere of the market economy. He was, in a real sense, a nineteenth-century liberal. In the nineteenth century, you had for the first time a worldwide economic order. You had free trade, free movement of people, free movement of capital, a gold standard, falling prices in the latter part of the century, peaceful development, and no major wars between 1815 and 1914. The world's armies and navies did not know what to do. Yes, there were aberrations like the American Civil War and the Franco-Prussian War, but mostly it was a period of peace. Forty million people moved peacefully because they wanted a better life. There were no expulsions, no wars, no genocides, nothing. They were just looking for a better life. There was a real expectation that the world could go on like this. World War I came as an incredible shock to this generation. You can read it all throughout Mises's writings. He never really recovered from it.

In any case, the beneficent trends you see today began in the nineteenth

century. They are merely a continuation of the growing division of labor on a global basis, reflected in the growing prosperity of ever more regions of the world. Today, as then, countries are really regions in the world economic order. Political boundaries are merely political markers, which economic activities cross and re-cross all the time. That is the background you need to really understand what is happening.

AEN: So the mistake is merely looking at it from the point of view of one nation's short-term interest.

SHENOY: The outlook of today's U.S. protectionists is incredibly narrow. The perspective is that everything that matters happens in the U.S., and that we foreigners just sit around doing nothing until the Americans make a mistake, and then we suddenly jump in and seize the moment. Their view is based on complete ignorance.

What's completely lost here is that we have continued industrial development taking place in the developed areas. Japan is even more a major industrial power now. There is major industrial growth taking place in South Korea, Indonesia, Malaysia, and many other nations. China is benefiting from Hong Kong and Taiwanese investment and making products at competitive prices. That these projects are not as commercially viable within the U.S. setting reflects the fact that resources are growing elsewhere and so it makes more economic sense to produce some goods elsewhere. That fact frees up capital and labor at home to be employed in other lines.

This is a wonderful thing. Every other part of the world has already adjusted to it. The U.S. is only now having to adjust. What you hear in the U.S. today are the same sentiments heard in

Britain, Australia, and Europe 15 and 20 years ago. The claim was that the developing world lives on the smell of an oil rag—they will undercut everything we do—we won't be able to sell them anything—our industries are being destroyed.

The truth is that none of this happened. Instead, we saw an adjustment on the part of other nations, and they are better off for it. The U.S. faces the choice of making that adjustment now, or delaying it and in the meantime imposing the massive costs of so-called "protectionism" on its own consumers. But either way, the adjustment cannot be avoided. Yes, some people will lose jobs in the short term. But this also frees up resources without which future economic growth cannot occur.

AEN: Many people blame open trade for the slow decline in real income in the U.S..

SHENOY: Whatever the indices show, a careful look can show good things are happening nonetheless. We've all heard about how awful the Great Depression was but the truth is that the interwar period also saw real technological advances taking place in a wide range of areas from communications to transportation. So I would want to look further before concluding that the American standard of living is somehow falling. Indices don't tell you much.

AEN: So you see no downside to this development for the U.S.?

SHENOY: The continued expansion of the division of labor is a wonderful thing for the world economy and all countries participating in it. It means continued growth, which means continued change. Many developed countries now export more developed

machinery and more sophisticated consumer goods. The less developed countries manufacture and export less developed machinery and simpler consumer goods, while some nations specialize in agriculture and resource exports. It is nothing but the structure of production expanding out over the entire world economy. The world does not stand still.

The U.S. will have to end its protectionist trade policies. They only end up hurting the U.S. in the long run. If free trade is good *within* a country it is good *amongst* many countries. If you are going to say that another country is dumping because it has lower

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prices, you should be willing to stop *any* producer who is able to produce more cheaply than any other existing producer. This logic will lead to a shutdown of all the benefits of the market economy, i.e., the division of labor. Protectionist countries harm themselves. Free trade benefits everyone.

AEN: Let's talk about U.S. steel tariffs.

SHENOY: Both Americans and Europeans are suffering as a result of what their respective governments are doing. You have cheaper steel coming in and so the U.S. imposes tariffs. Everybody's costs go up. Every user of steel pays more. Output goes down.

Incomes go down. That's blow number one. Blow number two comes from the reaction of Europe. Sales are lost and income goes down. Nobody wins at this game. Both populations experience a reduction in real income. People work but they do not get the results they should.

What would have been the better solution? Let the steel firms contract. If they contract, they lose capital and labor, which is precisely what they need to do. That capital and labor are transferred elsewhere within the economy, and the sooner and quicker you do it, the more firms of *other* types can

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expand elsewhere. Once they expand, they create new jobs elsewhere. The ripple eventually draws in more of those people who lost their jobs from the steel contraction. The adjustment takes place. Identically the same thing happens when domestic competition appears for any product.

The best policy for the EU would be to let the Americans do stupid things, but not retaliate against their own populations by denying them access to cheaper/better/alternate goods. We need *laissez-faire*, not because it creates the best of all possible worlds but because anything you do in the

attempt to improve on it will only make matters worse.

AEN: Do you think the World Trade Organization has been a good thing for world trade.

SHENOY: We don't need it! Throughout the whole of the nineteenth century, trade flourished the world over without such a thing. There were a few gunboats opening up markets but no government organization.

AEN: What about the claim that the industrial world developed behind high tariff walls?

SHENOY: That is emphatically not the case. Britain had a policy of unilateral free trade from 1846 to 1931. Even its own (white) colonies restricted imports from Britain, but Britain itself had open markets. This happened at the same time that population doubled and per capita income rose almost two and a half times. Germany, the Austro-Hungarian Empire, and the U.S. had internal free trade. Hong Kong is another example of unilateral free trade. How could Hong Kong do without it?

In the case of China today, the country is developing because of Hong Kong and Taiwanese investment, not because of whatever tariffs the government keeps in place. In China you have a huge labor force plus land, neither of which you have in Hong Kong or Taiwan. To cooperate is in everybody's interest. And incidentally: China is now the single largest buyer of Australian wool—*best* quality wool.

These kinds of arrangements have fascinating cultural repercussions. South Korea is the largest importer of Australian beef. During the World Cup soccer series, the cattlemen and stockmen in Queensland and the Northern

Territory cheered throughout for South Korea to win! Trade brings the world together. And again, incidentally: Britain has had a trade deficit since the end of the seventeenth century. It was also the largest single exporter of capital in the later nineteenth century—half the world total. Australia has been a (net) capital importer *since the 1860s*. Canada, New Zealand, and South Africa, too, import capital. All are developed—and continue developing.

AEN: The impression given by the breakdown of trade talks in Cancun in 2003 was that the developing world was a force for free trade.

SHENOY: That is a recent development. Poorer countries have come to realize that they have—at present—a comparative advantage in certain areas relative to other countries. They have an advantage in making available low-price labor services and a deregulated labor and environmental setting. They need to attract foreign investment, and now they understand that this is crucial to their future. They also understand their dependency on exports. So in general they are interested in bringing about a free trade environment, even as the developed world is increasingly interested in “protecting,” i.e., subsidizing, its old-line industries against the impact of global shifts in the economic landscape.

It took so long for these countries to come to this conclusion because they believed the nonsense given to them by Western economists, who said that population control, foreign aid, and industrial subsidies were the paths to development. What the developing world needs to understand is the merit of a completely unilateral approach to free trade. They should, on their own accord, drop all tariffs and restrictions on imports. Let the

Western governments hurt their own people. There is no sense in joining them in enacting self-defeating protectionist policies.

AEN: Why can't the U.S. understand the point that the unilateral approach is the right one?

SHENOY: U.S. trade is a fairly large chunk of world trade because the economy is so big. But world trade accounts for only 26 percent of the domestic U.S. economy. What this means is that the U.S. can do some pretty awful things to economies around the world without substantially affecting its own economy to a great extent. As foreign trade becomes ever more important to the domestic U.S. economy, as it will, this will no longer be true. "Protectionist" policies—subsidies—will become ever more costly.

Alfred Marshall was one of the few economists who realized that there are two ways to increase people's real income. You can increase their money income. Or you can increase the quantities of the goods they buy. John Stuart Mill said the same thing. Free trade reduces prices for the things we buy; it also increases the *range* of goods available. It increases our real income. This is the great benefit Americans can expect to gain from coming to terms with the reality that specialization and the division of labor are worldwide.

AEN: You talk as if this were inevitable, as if there is nothing the government can do to stop it.

SHENOY: We do need to get rid of the assumption that government officials are omnipotent or omniscient and can thus change history to their liking. Many things are, in the long run, outside of their control, and trends in world trade are among those things. Ultimately, when we talk about government, we are talking about a

bunch of ignorant bullies, looters, and plunderers. They can cause plenty of trouble but they cannot reverse long-term global economic trends on their own accord or even steer them very far in one direction or another.

AEN: Might this trend toward the globalization of manufacturing, and increasing U.S. dependency on the world, also make the U.S. a more peaceful country internationally?

SHENOY: We can only hope so. What the U.S. really needs is a greater presence of alternative sources of information about the world. From what I've seen here, almost everyone believes what the government says. If the government says the U.S. needs to go to war, the American population says: go! This is a serious problem. As Hayek says, our greatest problem is the taming of large organizations and, especially, the largest organization of all, government.

AEN: How do you account for anti-Americanism abroad?

SHENOY: Much of it stems from the U.S.'s ignorant interference abroad. The U.S. government is so enormously powerful, and it must answer to an electorate that literally knows nothing about the outside world except that which the government feeds it. So in a sense the whole world just sits and waits nervously to see what this ignorant giant is going to do next.

Everyone knows that when it comes to U.S. officials speaking about international affairs, 9 times out of 10 they are perfectly ignorant. So everyone wonders: what do you do with an ignorant chap with lots of money and power? What do you do? It creates quite a problem. American public opinion isn't interested either, because

people are understandably interested in only those things that affect them directly.

I don't think the world resents U.S. prosperity. Many countries in the world are prosperous but you don't see worldwide protests against Japan or Canada, for example.

We really do need to insist on the point that Mises made again and again, which concerns the interdependence of everyone on everyone else in a market order. The market order really is a project of the global community and an ongoing process. No "heroic" individual can even make a pencil.

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AEN: What about in the Islamic world?

SHENOY: During this last war with Iraq, the importers of dried fruit and nuts in Egypt were terribly worried. This is the traditional food during Ramadan. They were concerned that they weren't going to get their supplies, which came from the U.S.! So here you have a window into the solution: trade does develop and grow between two countries with radically different cultures. There is no problem here. People have a good reason to get along and cooperate.

AEN: What about anticapitalistic attitudes among fundamentalists?

SHENOY: There is the problem of anti-Western feeling among Islam's mullahs, the semi-learned clerics who spout anti-Western hatred. But for most people, there are more important things to worry about.

Now, to promote liberal ideology to intellectuals in the Islamic world is going to be very difficult; however, Islamic intellectuals need to find a way to connect with the history of Islam, which was once *the* major world civilization. It was the Muslims who saved the Latin and Greek texts during the European dark ages. This led to the Renaissance in due course. The Italian merchants learned their business methods from Islam. There is a commercial

history, and a history of tolerance, that needs to be recaptured.

In the West, the intellectual world adopted liberal ideas in the same period when there was rising prosperity. In Islam, intellectuals have to battle on *two* fronts: the unfortunate "closure" of their own intellectual tradition *and* the anticapitalism learned from the Western academies. I might contrast this with the East, where some Buddhist sects are now adapting themselves to be more relevant in a world of prosperity. In any case, the change in the Muslim world will have to come internally. It cannot come externally and it certainly can't be imposed by military conquerors.

AEN: What projects do you have in mind for the future?

SHENOY: I'm still working on the Hayek biography I began so long ago. I'm pleased that I shelved it for a while. In the meantime, his thought has taken a more mature shape in my mind. I would like to continue writing on British economic history through 1914 showing the intertwined growth of common law, market order, and the capital structure. I would like to write more on Japanese economic development, and also concentrate some energy in looking at the role of black markets in the old Soviet Union.

I'm pleased to be working at the Mises Institute right now. It is clear to me that the Austrian School has grown enormously in the last 10 years. I only hope we can keep the momentum. But assuredly if we do not all hang together, we will hang separately. **AEN**

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