AUSTRIAN ECONOMICS AND THE "MARKET TEST": A COMMENT ON LABAND AND TOLLISON

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While teaching my classmates and me graduate microeconomics at Auburn University in 1995, David Laband recounted a story from his first year of doctoral studies in economics at Virginia Polytechnic Institute. As he read for a class taught by Gordon Tullock, Laband came upon what he believed was an error by Milton Friedman.

The then-graduate student went to Tullock's office, where the professor, without ever looking up, replied that if an issue came down between Friedman and Laband, he would automatically side with Friedman. Tullock then dismissed his student with a curt, "Goodbye."

As one reads Laband and Tollison (2000), it seems that the authors would say that Friedman had passed Tullock's "market test," while Laband had not. Copi (1972), however, would describe Tullock's response as an instance of *argumentum ad verecundiam* or the informal fallacy of "appeal to authority." Indeed, since Tullock had not even bothered to hear what Laband had to say, one cannot know whether or not the young graduate student had actually found a mistake by Friedman.

Another incident also comes to mind. In September 1999, I attended a dinner in Greenville, South Carolina, at which Sherwin Rosen, then the president-elect of the American Economics Association, was the speaker. I was especially gratified when Rosen began his talk by saying he would be speaking about Austrian economics. However, as the speech went on, it became clear to me that Rosen had no idea what Austrian economics was and certainly had no grasp whatsoever of the praxeological paradigm.

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Fortunately for him, hardly anyone else in the audience (which consisted mostly of economics professors from local colleges and universities) seemed to know anything about the Austrians, so Rosen was able to speak without embarrassment. When one person in the audience asked Rosen about Ludwig von Mises's *Human Action,* Rosen replied that he had not read the volume because it was "too difficult."

All of this came from a person who wrote (Rosen 1997) that Austrian economics had failed the crucial market tests. In his paper, he intimated that anything that comes from current practitioners of the Austrian paradigm is illegitimate scholarship unless it is published in a mainstream journal. However, if his speech that night in Greenville was an indication of Rosen's actual knowledge of Austrian economics, then it is clear that he was not qualified to comment on the Austrians, and certainly not in a scholarly journal.

Coase (1977) writes, "Economists treat their heroes well." No doubt, there is much truth to that statement, and Tullock's laconic dismissal of an inquisitive graduate student eloquently bears out Coase's point. It is one thing to lionize an economist for his or her work; it is quite another to accept a statement from a prominent economist as gospel truth just because the words emanated from that person's mouth. To do so would be to elevate a person from scholar to cult leader.

I make such remarks because this is precisely the charge that Rosen (1997), Laband and Tollison (2000), and others have leveled at the Austrians on many occasions.[1] According to the critics, holders of the praxeological paradigm simply are blind followers of Mises, with *Human Action* serving the same purpose for them as the *Bible* does for Christian believers.[2] Thus, someone like Rosen can dismiss *Human Action* out of hand without ever having read it. Like the critic who rejects a scientific theory without ever having examined its claims, many in the economics profession do the same with Austrian economics. It is deemed illegitimate thinking not because of the falsity of its claims, but rather because someone of prominence in the economics profession has said it is bad. It is time to answer some of these accusations.

Block (2000) addresses a number of the charges levied by Rosen and Laband–Tollison, and I don't want to plow the same ground. What I attempt to do

[1]I recall a conversation with Gary Becker in 1998 on Mises and the Austrians, and he remarked that while the profession had "treated Mises very badly," modern Austrian economics really was little more than a cult.

[2]While in graduate school at Auburn, professors from the economics department referred to events hosted by the Ludwig von Mises Institute, including the Austrian Scholars Conference, as "prayer meetings."

here, however, is to more fully deal with some of the accusations that Rosen, Laband and Tollison make. I also wish to examine their claims that the paucity of Austrian-oriented papers published in the profession's most prestigious journals designates a "failure to meet the market test" by Austrian economists.

EXAMINING THAT "MARKET TEST"

Ignoring the current criticisms of Caplan (1999) it has been six decades since the Austrian paradigm had any real hearing within the economics profession, at least from the major mainstream journals.[3] In the late 1930s, Mises and Lange (1938) engaged in the famous "socialist calculation debate" in which Mises argued against and Lange argued for socialism.

Without rehashing the details of this debate, suffice it to say that the profession at the time declared Lange the winner (Landreth and Colander 1994). Mises was seen as hopelessly out of date and his arguments deemed irrelevant. Fifty years later, as the socialist economies and governments came crashing down, events proved Mises to be correct, something that even a Marxist critic like Heilbroner would at least partially admit.[4]

In the lexicon of Rosen (1997) and Laband and Tollison (2000), Lange's theories dominated the profession because they passed the "market test." While they might argue today that, in the long run, what happened in the real world vindicated Mises, it is also clear that Misesian ideas on socialism are hardly popular among mainstream economists.[5] There was no *mea culpa* in *American Economic Review* or in any of the other "A-level" journals. No prominent economist was willing to admit that Mises's arguments had withstood the ultimate "market test," that is, being vindicated by real events.[6] This being the case, perhaps we need to further examine what the critics of Austrian economics mean by the "market test" in the analysis of economic theories to see if these observations are valid.

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[3]There have been a number of exchanges outside of Caplan between Austrians and their mainstream critics, including Block (1980), Cowen and Funk (1985), and running debates between Block and Harold Demsetz, the latest being Block (2000). However, it is safe to say that these arguments have not taken the center stage in the economics profession that the Mises–Lange debates once did.

[4]This was the subject of Heilbroner (1990).

[5]A check through the numerous economics textbooks I receive as desk copies shows that almost none of them refer to Mises in their discussions of socialism. While I agree that this is anecdotal evidence, it still demonstrates that even though Mises's theories turned out to be true, they still have not passed any "market tests" as far as the economics profession is concerned.

[6]Even with real-world events staring them in the face, Landreth and Colander (1994) continue the fiction that Lange was the winner in this debate and offer no updates other than to say the socialists' arguments were so convincing that they still cannot be challenged.

I teach my beginning college economics students that markets are the arenas in which economic exchanges are made. There are rules we must follow, however, as we examine market behavior. The first is that when individuals engage in trade, they are exchanging *scarce things.* For example, if I wish to exchange my watch for someone's belt, both the watch and the belt must be scarce, or what we call economic goods. Second, both the person with whom I am engaging in exchange and myself must have ownership of, along with possession of, the goods in question. In order for the exchange to occur, the other party and I must believe that we will be better off after the trade happens.

Although economists like to speak loosely of the "marketplace of ideas," it is not clear whether or not such a market exists, at least in the form that other markets may take. During my discussion with Professor Becker, he and I both "exchanged" ideas in that I said what I believed and he said what he thought to be true. That is not the same, however, as Becker and myself trading a watch for a belt. He did not give up an economic good in his possession to gain a scarce idea from me. Rather, we were simply voicing our opinions in a conversation.

The "market" for economic theory is not the same as the real market for information, and I believe that Laband and Tollison (2000) are in error at this point. One may try to make the analogy of what is published in an economic journal to what happens daily in commodities and securities markets, but it is not a good one.

The perfect market hypothesis states that all relevant information is expressed in the price of an item. For example, when Iraq's armies invaded Kuwait in 1990, the price of oil and its subsequent products increased immediately, as suppliers and consumers correctly anticipated that less oil would soon be supplied on the market. In markets such as the ones for oil or shares of stock, information travels quickly and having the correct knowledge can mean the difference between profits and losses. Thus, as information becomes available, traders immediately convert such knowledge into prices.

Laband and Tollison attempt to give "prestigious" economics journals the same characteristics as the markets for oil or securities. In their view, scholars examine new views and incorporate those that are true into the existing lexicon and reject those ideas that are false. While there may be some bumps along the way (just like traders occasionally may fall for rumors), over time correct ideas are accepted and wrong ones are weeded out.[7]

[7]Laband and Tollison admit that at times the "top" journals fail to accept papers that are then placed elsewhere and ultimately accepted as "classics." See Gans and Shepherd (1994).

Thus, at any time, the most prestigious economics journals reflect the best knowledge the profession currently has to offer, according to Laband and Tollison. Even if the profession is currently chasing down a rabbit trail, it won't be long until truth-seeking scholars and scientists will find their way back to the right path. That is why no heterodox journals are necessary. Editors and referees who seek truth above all else direct the most prestigious mainstream journals and are always open to new discoveries even if they eclipse their own views. Everything we need to further our economic knowledge is contained in the latest issue of *American Economic Review*.

Yet, even an example that Laband provides for his microeconomics students casts doubt upon the veracity of applying the perfect market hypothesis to scientific theories, and especially to economics. As Stewart (1986) points out, for many years scientists believed that in ancient times the various continents were linked by land bridges. However, when Alfred Wegener published his theories of continental drift, others scientists reacted violently to his work. It took many years for Wegener's theories to be accepted by the scientific community, which reluctantly accepted what later turned out to be obvious.

Stewart's analysis centered upon the fact that most of the original critics of continental drift theory had a vested interest in keeping the intellectual *status quo*. All of their studies had been geared in the direction of land-bridge theories, and future prestige (not to mention income) would depend greatly upon those explanations continuing to dominate the profession.

Wegener did not change the direction of land mass studies by having early papers accepted by leading journals. Instead, as Stewart writes, he ultimately won by fighting what in essence was intellectual guerrilla warfare. In fact, it is quite rare for dissenting ideas to receive much play in leading journals of any profession.

Using Public Choice's "median voter model," Vedder and Gallaway (2000) explain that editors are loath to publish anything that their referees might reject, and if something disagrees with current mainstream thought, that surely is a strike against such a paper seeing the light of day. That is why heterodox journals like *Public Choice* exist, and why they are important. As Block (2000) points out, had James Buchanan and Gordon Tullock simply depended upon mainstream publications to present their ideas, Buchanan most likely would not have won the Nobel Prize for economics in 1986.

Critics might concur, except they will also point out that Austrian ideas have been around as long as neoclassical economics itself. Rosen's "market" thesis has been that the profession long ago accepted the good ideas from the Austrians and rejected the bad ones. Yet, if Rosen's Greenville performance was an indication of his knowledge of Austrian economics, it is difficult to know what Austrian ideas he believes to be good and which are deemed unacceptable. Indeed, Rosen's failure to articulate even the most basic of Austrian concepts during his speech demonstrates that he lacks the academic understanding to make any judgments regarding the particulars of Austrian economics.

It is true that Austrian economics fell out of favor during the 1930s, as it, along with many other schools of thought, was overshadowed by the Keynesian Revolution. One of the great career misfortunes for Mises was that he came to the United States at a time when one either had to accept the Keynesian paradigm or be banished from most "prestigious" academic positions. By the end of the 1930s, both macroeconomic and microeconomic scholars came to accept the view that a free-market economy is unstable without government and that a socialist system would function as efficiently and productively as a private-enterprise economy. In fact, economists like Lange would argue that a socialist economy would be even more efficient. Those who dissented often were left out.[8]

There are two ways to view the events of the 1930s. The Rosen-and-Laband and-Tollison approach is that Keynesian theories represented the best and most advanced thinking of the times and that Keynes and Lange won the market test. That real events would discredit both Keynes and Lange do not negate the market approach, in their view.

Furthermore, the "market test" Laband and Tollison wish to impose upon the economics profession differs greatly from other markets. According to the authors, there can be only one version of economic thought, and anything outside that realm is illegitimate. Yet, when one engages in any formal study of economic thinking, one finds numerous interpretations of economic events.

It is agreed that the vast majority of economists (including Austrians) agree on a few core items, including scarcity, opportunity cost, what occurs when governments attempt to fix prices, and the existence of gains from trade. Furthermore, most economists agree that individual utility is *ordinal,* not cardinal

[8]One important exception to this trend was Hayek (1945), which was the lead article in *American Economic Review*. At the same time, however, Hayek had a very difficult time finding an American publisher for *The Road to Serfdom* precisely because of its antisocialist stand. Furthermore, given today's anti-Austrian climate, it is doubtful that "The Use of Knowledge in Society," a classic paper, would pass the current "market test" at *AER.*

in scope and that interpersonal utility comparisons are incorrect, even though many economists proceed with cardinal utility measures in order to allow them to apply calculus to their models.[9]

However, Laband and Tollison fail to point out that there are numerous positions that economists take, even when nearly all are in agreement with the core principles of economic thought. One can liken their position to someone who complains because there are literally hundreds of different makes and models of automobiles instead of just one "standard" car.

All cars (except those powered by electricity) all have the same "core principles," including internal combustion engines, steering mechanisms, brakes, wheels, and exhaust systems. Yet, there is no such thing as a monolithic automobile. Instead, as noted above, there are numerous models built to satisfy a myriad of market demands. Ford does not fail the "market test" because not everyone wants to purchase a Taurus.

Likewise, Austrian economics has not "failed" because there are many in the profession who reject the praxeological paradigm. There is an active group of economists and other scholars who accept Misesian thinking, which demonstrates that Austrian economics has at least some appeal in this "market." No one writes that institutionalism "fails the market test" because relatively few economists call themselves institutionalists. For that matter, one can truthfully say that the theories given by Mises certainly "predicted" much better than theories given by Thorstein Veblen or even Karl Marx. If economists truly cared about applying the "market test" of having theories that accurately make predictions, the Austrians would fare far better than Keynesians and institutionalists.

DR. JEKYLL, MR. HYDE, AND THE WORLD OF ACADEMICS

Laband and Tollison also attempt to tweak the Austrians by saying that Austrians believe "market failure" exists when it comes to the placement of papers in scholarly journals. In other words, they chide Austrians, who supposedly champion free markets and abhor the term "market failure," for not having faith that an efficient market works in the world of academic ideas.

The authors further write that the use of citations provides the best market mechanism for determining tenure and promotions within academic

[9]Laband and Tollison hold that the insistence of Austrians not to use cardinal utility measures—and, hence, eschew the use of multi-variable calculus to explain utility—is a failure to recognize the mathematical "market test" of the economics profession. The use of math to explain utility may be inaccurate, and it may even be inappropriate, but since other economists do it, the Austrians should, too. However, they fail to explain why Rothbard (1993) and Mises (1998) are able to fully explain the concepts of marginal utility without the use of mathematics.

departments. They note that the alternative is to allow professors to be subject to the petty, politics-ridden world of department chairs, cronies, and unproductive academic workers.

Those who have spent time in the academic salt mines might well concur with the authors' point. However, Laband and Tollison also display some inconsistent thinking here. The public-choice paradigm, to which both Laband and Tollison subscribe, holds that an individual does not adopt one *persona* in the private sector and another one in public office. To paraphrase McCormick and Tollison (1981), Dr. Jekyll and Mr. Hyde might make for good cinema, but it is a poor tool to use in order to explain the behavior of politicians and bureaucrats.

If we carry that analogy over to the academic world, Laband and Tollison expect the readers to believe that in the relative safety of their offices, many professors and department chairs are petty creatures who are likely to reward sycophantic sluggards over productive scholars. However, place those same people behind the editor's desk of a journal, or give them a paper to referee and suddenly they become Clark Kent-like seekers of truth.

Like other professionals, economists resist change, and that is not all bad. I agree with Laband and Tollison that ideas that dissent from mainstream views should be studied with a jaundiced eye. However, one cannot divorce the behavior of editors and referees from the various incentives they face in their chosen business.

Take antitrust laws, for example. When the Sherman Act was debated more than a century ago, Boudreax and DiLorenzo (1993) point out that the majority of academic economists of that day opposed the law. However, as Boudreaux and DiLorenzo note, many economists have earned large fees consulting and testifying for both plaintiffs and defendants in antitrust cases. It is unrealistic to believe that the prospect of earning huge amounts of money does not affect how economists today may view antitrust laws. One would like to believe that all economists operate exclusively upon principle, but such a view probably would fail to win the "market test" in a roomful of economists.

BAD PAPERS AND "CRYBABYISM"

Laband and Tollison state that the real reason that journals like the *QJAE* exist is that most of the papers accepted by that journal are either badly written or are so devoid of real content that they could not be accepted anywhere else. Thus, the *QJAE* is created by and for "crybabies" who have nowhere else to go. To answer that charge, I will begin with this article, then relate a personal experience of my own regarding another article.

I admit that if I were to submit this article to a publication such as the *Journal of Economic Perspectives,* it would most likely be rejected out of hand. Since I am probably not the best judge of the quality of my work, I am the wrong person to ask whether or not such a journal should at least give this work consideration. However, I do not think that I am wrong to believe that this paper, if sent to the above journal or other well-established publications, immediately would have two strikes against it because it would be deemed an "Austrian" paper.

The experience of Walter Block and Guido Hülsmann in attempting to reply to Caplan's (1999) attack on Austrian methodology should give one pause. The editors of *Southern Economic Journal* permitted Caplan to fire away at the foundations of Austrian economics, but refused to allow two of the better-known economists of the Austrian camp to reply to Caplan's claims in that same journal. Whether this was due to the fact that Caplan had written a superior work and Hülsmann and Block wrote inferior essays or perhaps some other reason is not known. I, like others who consider themselves Austrian, believe that at the very least the editors of *Southern* held Hülsmann and Block to a different standard than they did Caplan.[10]

My own experience in placing a paper, this one a non-Austrian piece that applied Becker's theories on the family (1991) to postwar divorce rates, tells me that referees can be swayed by things other than the alleged quality of the paper. The first stop for this paper was *Social Science Quarterly,* which reviewed and ultimately rejected the piece on recommendation of one of the referees. The empirical work on the paper, admittedly, was subpar, something that I would later "fix" by bringing in a co-author who was better versed in statistics than I. The paper was ultimately placed elsewhere (Anderson and Tittle 1999).

What I found interesting about my rejection from *SSQ*, however, was that the dissenting referee attacked what I interpreted as coming from Becker, namely that division of labor is useful in a household. Specifically, Becker writes in his well-known *Treatise on the Family* (1991) that a family wishing to experience benefits from division of labor would have the husband work and the wife stay home with the children. Becker clearly draws that conclusion, and states it in a way that no one can dispute that Becker holds to that belief.

The referee, however, insisted that I had thoroughly misinterpreted Becker on this point. In fact, the comments on my paper made clear that the referee

[10]It should be noted that the *QJAE* did run both papers. They are Hülsmann (1999) and Block (1999).

objected to my paper being published because he or she believed that such a view was anachronistic and morally intolerable. In the end, it was not the merits of the paper or my economic conclusions that mattered, but the particular political and social views of the editor.

CONCLUSION

While criticizing the behavior of Austrian economists, Laband and Tollison assert that their purpose is not to "knock" Austrian economics. However, even though they assert that Austrian economics has failed the academic "market test," they never explain just what it is that makes the Austrian paradigm such a pariah. At the same time, one can easily charge that they make no appeal to any meaningful "market test," but rather commit the informal fallacy of *argumentum ad verecundiam*.

Vedder and Gallaway (2000) write that many journal editors dislike not only the emphasis upon verbal logic favored by Austrian writers, but also the free-market conclusions that one often reaches in examining events from an Austrian viewpoint. Such rejection does not mean that the Austrians are wrong, however. It only means that the editors do not like free-market economics, an attitude that dominates not only the economics profession but nearly every other academic discipline, as well.

One might also present another argument regarding a "market test." Each year, more than 100 students from around the nation attend Mises University in Auburn to gain exposure to Austrian economics. Likewise, dozens of students also attend Austrian-oriented seminars at the Foundation for Economic Education (FEE) in New York. In their evaluations of Mises University, students consistently write that these sessions were much more interesting and informative than the mathematics and geometry-based neoclassical teachings they have received in their own college classrooms.

To put it another way, Austrian economics passes the market test given by those who must actually study this discipline. Austrians not only challenge the existing neoclassical paradigms, but they make economics more interesting than do many of those who reject Austrian thinking out of hand. In other words, modern neoclassicals flunk the "market test" that matters with students.

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