

Referee Report for “Some Fallacies Of Austrian Economics”

I do not think that this article should be published by the *QJAE*, because the author needs to extensively address and rework several issues that have been completely ignored by the author. Before the article can be publishable, extensive reexamining and readdressing of the Cambridge Capital debate is required.

That being said, I think that it is “gutsy” to submit an article attacking a school of thought to that school’s journal. I believe that debate is healthy and when issues of doubt are raised, all parties concerned are improved through debate, discussion and the subsequent refinement of arguments. Unfortunately, “gutsy-ness” is not enough to publish this article.

There are many reasons why I do not think that this article is acceptable; however I will confine myself to the top three.

First, the article is attempting to resurrect a debate that has been dead and buried for almost 30 years—reswitching and capital reversals. While there have been a few who have recently addressed this issue namely, Cohen and Harcourt (2003) and Garrison’s unpublished article in honor of Leland Yeager and maybe a few (two?) others, their articles have been more in the vein of retrospectives as opposed to debating new issues. Thus to restart the debate anew, the author must restate the open (unresolved) issues and respond to the final arguments of the debate. In this regard, the author completely fails to meet such standards. It does not “cut it” to write “...Burmeister and Yeager (1978) acknowledge Yeager’s mistakes.” and present it as that was the last word from Yeager. In fact, I find that to be extremely misleading and unscholarly, especially when, in the very next year (1979), Yeager builds upon his earlier analysis. While the author cites Yeager (1976), Garrison (200?), Lachmann (1976a, b, 1982, 1986), the author does not address the issues raised by these authors. The author should also see Robinson (1975), Yeager (1979), Garrison (1979) and, especially, Lachmann (1978 [1973]).

Specifically, the author does not address the following:

1. Yeager’s argument on “waiting” as a component in the production process;
2. Garrison’s species-reswitching parody;
3. Garrison’s observation that the reswitching differences are very small (project A in the example is barely better than B);
4. Yeager’s and Garrison’s observation that there is no reswitching, but it is merely a comparison of two static states;
5. Yeager’s observation that there is no mechanism to “move” the interest rate independently and without a causal factor;
6. Lachmann’s observation that the debate consists more between the neo-Classicals and the neo-Ricardians, not the Austrians;
7. Lachmann’s insistence that the problem is with macroeconomic formalism that ignores microeconomic foundations;
8. Lachmann’s emphasis that there is no single rate of profit or return in the real world;

9. Lachmann's observation that the neo-Ricardians do not adequately deal with expectations; and finally
10. Yeager, Garrison and Lachmann's observations that the problem really stems from the fact that the production function is presented as a relationship between physically defined capital inputs.

This last issue is of particular importance. The author creates an input/output table and shows how much steel, etc. is used in each stage of production. The author then assumes that any unit of steel is perfectly substitutable with any other unit of steel. This sort of analysis is not how an Austrian sees the Structure of Production. A ton of steel in an early stage of production is not necessarily substitutable with a ton of steel at a later stage of production. In fact, the same applies to labor and every other type of resource in the production process. Inputs and Capital, in particular, are not transferable homogeneous blobs. There are degrees of complementarity and substitutability that varies with each production process.

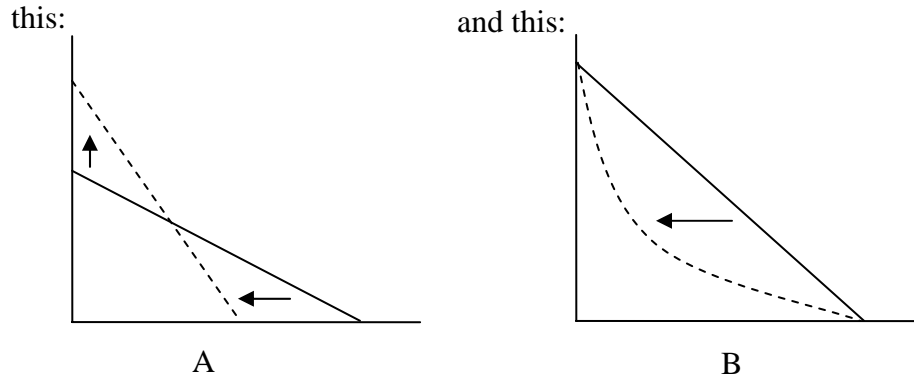
In order to bring back the debate, the author needs to respond to the Austrian replies to the reswitching debate. By simply reviewing the literature I have found 10 unanswered issues. I know that there are more. In this article, these issues are simply ignored and go unaddressed.

Second, the article is unevenly researched. For example, the second footnote states, "Recent literature..." where the latest reference is 14 years old. If this was truly the latest reference in the literature to the Austrian Business Cycle Theory, it would be one thing, but to ignore Garrison's book *Time and Money* (2001), Horowitz's book *Microfoundations and Macroeconomics: An Austrian Approach* (2000), Lewin's book *Capital in Disequilibrium* (1999), plus the articles in the *Review of Austrian Economics* and the many articles found in the *Quarterly Journal of Austrian Economics* itself, is another thing entirely. Furthermore, presenting the Structure of Production as a Leontief Input/Output function has been done before, see for example Smithies (1935).

The author spends an inordinate amount of pages (the whole paper is far too long! and with three Appendices!) on the Austrian conception of the Structure of Production; there are far too many unnecessary quotes and distinctions that are irrelevant to the article, e.g., footnotes 7 and 9; the author clearly does not know his audience, see page 6 where the author states, "...Hayek, an exemplar of Austrian economics." (Anyone reading the QJAE should at least have heard of Hayek.) And then the author is downright demeaning and insulting when stating, "Austrians are hostile to mathematics." (page 3.)

Third, the author's model is not clearly explained in its original setup. If the author believes that Austrians are "hostile to mathematics" and then presents a mathematical model, one would think that the author would take care to clearly define terms, provide examples, not skip steps and make implicit assumptions. When the author returns to the model (Equation 9) on page 17 (after a 7 page hiatus), it is an abrupt jump. Why are we returning to the formal model at this point? And finally, the author is presenting the Austrian model incorrectly (it is not the "narrowness" of the triangle (page 18) per se that means a production method is more roundabout) and does so in a condescending manner. Take for example the author's statement on page 13, "In support

of these claims, I also cite Rothbard (1962), thereby demonstrating their [Hayekian Triangles] lack of novelty to Austrian economics.” Actually, Hayek’s triangles *were* novel in 1931 in that they significantly differed from Böhm-Bawerk’s concentric circles. Anyway, the author is assuming that the Structure of Production has a fixed amount of stages, in this case eight stages. No capital deepening is possible; it’s assumed away. There is a fundamental difference between:



A is the Austrian Model while B is what the author uses in Figure 3 on page 19. Model B is not showing a more roundabout production process. I don’t actually know what it’s showing, but it isn’t the modern Austrian conception of the Structure of Production.

Lastly, let us suppose that all of the author claims are true. How does a very narrow example, with highly specific assumptions show that “typical Austrian generalizations are unfounded in economic theory.”? (page 26) Even if reswitching is on occasion true, it does not deny the generalization. The author would have to show that the conditions for reswitching are typical in the economy.

This paper needs to be rethought and reassessed. I am appreciative that this article crossed my desk so that I could revisit the Cambridge Debates; it has been a long time. If this paper was written 50 years ago, it would be one thing. However, to ignore the debate over the years and, in particular, the Austrian criticisms and responses during these debates are issues that are not overcome in this paper.

Sources to Examine:

- Garrison (1979) “Waiting in Vienna”, in *Time, Uncertainty, and Disequilibrium*, edited by Mario Rizzo.
- Garrison (2001) *Time and Money: The Macroeconomics of Capital Structure*.
- Lachmann (1978 [1973]) “Macro-Economic Thinking and the Market Economy”, *Studies in Economics* No. 6, Institute for Humane Studies.
- Robinson (1975) “The Unimportance of Reswitching”, *Quarterly Journal of Economics*, 89(1), pp. 32-39.
- Smithies (1935) “The Austrian Theory of Capital in Relation to Partial Equilibrium Theory”, *Quarterly Journal of Economics*, 50(1), pp. 117-150.
- Yeager (1979) “Capital Paradoxes and the Concept of Waiting”, in *Time, Uncertainty, and Disequilibrium*, ed by Mario Rizzo.