

IN SEARCH OF EMPIRICAL CONTENT – THE AUSTRIAN WAY TO GO BEYOND PURE THEORY

Tereza Šimová*,
Josef Šíma**

Abstract

The Austrian School has always represented a leading approach in social sciences emphasizing the power of logical deduction and key importance of pure theory. The lack of empirical content, however, often prevented the acknowledgement of correct theoretical and policy conclusions by fellow economists. This paper introduces the concept of analytical narrative and argues that this approach developed by Peter Boettke and his followers from the Virginia branch of the Austrian School can enrich the pure theory by empirical content without compromising the power of the Austrian explanation.

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1. Introduction

The methodology in the social sciences undertook a dramatic change in the 20th century. Too often social scientists attempted to uncritically apply the “habbits of thought to fields different from those in which they have been formed“. F. A. Hayek labeled this approach scientism, and he himself belonged to a school of thought that dissented from the economic mainstream. The Austrian School has always represented a leading approach in the social sciences emphasizing the power of logical deduction and key importance of pure theory. However, pure theory was not able to reach the rest of the profession, and the lack of empirical content often prevented the acknowledgement of correct theoretical and policy conclusions by fellow economists. This paper introduces the concept of analytical narrative and argues that this approach developed by Peter Boettke and his followers from the Virginia branch of the Austrian School can supply the pure theory with empirical content without compromising the power of the Austrian explanation. Chapter 1 elaborates on the reductionism of the popular economic method; chapter 2 introduces the essential features of analytical narrative in its original expositon; chapter 3 highlights the innovation added by GMU professor Peter Boettke and

* E-mail: simovat@vse.cz; Department Environmental Economics, University of Economics, Prague, the Czech Republic

** E-mail: josef.sima@vsci.cz; Department of Economics and Management, CEVRO Institute [school of legal and social studies], the Czech Republic

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analyses whether this approach is suitable for the Austrian scholars; chapter 4 surveys some of the modern research using the narrative approach. The last chapter concludes.

2. Reductionism of the popular economic method

Economics, as a science of human action in the world of omnipresent scarcity, differs obviously in its method from sciences studying natural phenomena. An acting man exercising his free will is a radically different object of study as compared to stones, atoms, flowers or animals whose existence is not shaped by their own purposeful choices. This natural distinction, however, evaporated from the economic mainstream around the middle of the 20th century as the prevailing way of doing economics (mainstream) diverged from a traditional economic approach of understanding society and addressing social and economic problems as characterized by the founder of the discipline, Adam Smith, onwards (mainline).¹

One of the reasons why mainstream economists so eagerly wanted to blur the distinction between social and natural sciences was their attempt to achieve in economics precision and sophistication that they admired so much in natural sciences. A progression from a qualitative to quantitative approach epitomized the key recipe for this transformation. They were unhappy about the predictive power and accuracy of traditional economic explanations and longed for a change of what economics is. They wanted to emulate the success of natural sciences. As F. A. Hayek stated in *The Counter-Revolution of Science*:

[Social sciences] became increasingly concerned to vindicate their equal status by showing that their methods were the same as those of their brilliantly successful sisters rather than by adapting their methods more and more to their own particular problems. And, although in the hundred and twenty years or so, during which this ambition to imitate Science in its methods rather than its spirit has now dominated social studies, it has contributed scarcely anything to our understanding of social phenomena, not only does it continue to confuse and discredit the work of the social disciplines, but demands for further attempts in this direction are still presented to us as the latest revolutionary innovations which, if adopted, will secure rapid undreamed of progress.²

The days of “classical economic” theorizing were numbered. Only what gets measured can be scientific – as a slogan of the Econometric Society sums up bluntly “Science is measurement”. The “new science” of economics evolved and “new” economists deliberately cut off all links to institutional content of their disciplines, which purged from economics all debates about the underlying property structure – the core of Smithian analysis. A new generation of economists had gained prominent positions and the overwhelming majority of them were ready to make progress in the

¹ For more on this distinction and implications see Boettke, P.: “Liberty vs. Power in Economic Policy in the 20th and 21st Centuries”. *The Journal of Private Enterprise*, Vol. 22, No. 2, pp. 7-36, Spring 2007.

² Hayek, Friedrich, 1980: *The Counter-Revolution of Science*. Liberty Fund Inc, p. 21

“new” science – propertyless economics – that does not study real people in the real world. Joan Robinson of Cambridge declares for example that “now private property becomes otiose”³ and another future Nobel Prize laureate, Robert Solow, infamously asserted that “the institution of private property has to keep proving itself”.⁴ Professor Solow may hence be the anonymous leading economist (and Nobel Prize laureate) who pointed out in the 1960s that property has no effect on people’s behavior and doesn’t matter in economics.⁵ Economic mainstream and mainline diverged.

Though “[e]conomics has become a mathematical fantasia where the honors go to those versed in calculus, topology, set theory, linear algebra and the like”⁶ there were still islands of prominent economists who dissented, claiming that that mathematical models as such do *not* provide us with relevant economic understanding. The Nobel Prize laureate Ronald Coase put it bluntly:

In my youth it was said that what was too silly to be said may be sung. In modern economics it may be put into mathematics.⁷

Though the view that the mainstream explanation of real-life phenomena such as the wealth and poverty of nations is seriously misguided was supported over time by both theoretical and empirical work,⁸ the most systematic alternative paradigm was developed by the followers of Carl Menger, Ludwig von Mises, F.A. Hayek, i.e. by the Austrian School of Economics (once again, increasingly popular today when we are living through the aftermath of yet another era of the “new economics”). Austrians take special care to distinguish abstract (qualitative) theory and empirical historical experience.

As Ludwig von Mises stated long ago:

Laymen often insist that one can prove anything with statistics. Actually, statistical experience in the field of human action can prove nothing in the sense in which the natural sciences colloquially speak of proof. Historical experience, which is always the experience of complex phenomena, cannot lead to a knowledge of

³ Robinson, 1967, p. 176 cited in Bethell, Tom. 1998. *The Noblest Triumph, Property and Prosperity through the Ages*. New York: St. Martin’ Press, *op. cit.*, p. 193.

⁴ According to Bethell, Tom. 1998. *The Noblest Triumph, Property and Prosperity through the Ages*. New York: St. Martin’ Press, p. 8.

⁵ As reported by others in Kitch, Edmund W. 1983: “The Fire of Truth: A Remembrance of Law and Economics in Chicago”. *Journal of Law and Economics*, 1932–1970, 26(1), p. 229.

⁶ Veljanovski, Cento. 1990. *The Economics of Law: An Introductory Text*. London: The Institute of Economic Affairs, p. 18.

⁷ Coase, Ronald. 1990. *The Firm, the Market and the Law*, Chicago: University of Chicago Press, p. 185.

⁸ For example, see Barro, Robert Jr. 1991. “Economic Growth in a Cross Section of Countries”. *Quarterly Journal of Economics*, 106(2), pp. 407-443; or Olson, Mancur. 1996. “Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor”. *Journal of Economic Perspectives*, 10(2), pp. 3-24; or Furubotn, Eirik and Richter, Rudolf. 2005. *Institutions and Economic Theory*. Michigan: University of Michigan Press.

theoretical laws. Historical experience must be interpreted and explained by the help of general laws gained independently of historical experience.⁹

Whereas this approach remains the key feature of the Austrian approach, as time passed, some scholars from the Austrian camp added a new dimension to their research agenda in an attempt to break the narrow limits of pure theorizing.

2. Analytical Narrative Manifesto

Pure theory elaborated by the Austrians was able to provide understanding of the operation of the economy and show the consequences of economic policies; however, it often fell short of communicating the message or starting a debate with empirically focused scholars outside the Austrian School or outside economics. Hence the idea emerged to supplement the pure theory argument with the flesh and blood of the “real world”, enriching the analysis by the empirical content through analytical narrative, a method used routinely outside economics.

Analytical narratives offer a method for moving from the context-rich world of events and cases to explanations that are logically rigorous, illuminating and insightful...¹⁰

The modern history of narrative studies dates back to 1998 when Princeton University Press published a methodological manifesto of a new approach - a book called *Analytic Narratives*. The team of authors included Robert H. Bates, professor of political science at Harvard University, Avner Greiff, professor of economics at Stanford University, Margaret Levi, professor of political science at University of Washington in Seattle, Jean-Laurent Rosenthal, professor of economics at University of California in Los Angeles and Barry R. Weingast, Hoover Institution fellow and professor of political science at Stanford University. Coming from different backgrounds, their shared effort was to develop understanding of historical development, political systems and institutional changes in society. The book – dedicated to Nobel Prize winning economic historian Douglass North – presents a series of case studies in which analytical narrative serves as unifying analytical tool. “The phrase *analytic narrative* captures our conviction that theory linked to data is more powerful than either data or theory alone.”¹¹ Through this method of qualitative research rooted in case studies, it is possible to get the “data” or “empirical content” depicting human interactions into an analysis without a need to dehumanize the actors and lose the beauty of natural language. The analysis can hence keep rational choice characteristics and remain empirically and institutionally rich. The book

⁹ Mises, Ludwig, 1953. “Comments About the Mathematical Treatment of Economic Problems” [“Bemerkungen über die mathematische Behandlung nationalökonomischer Probleme”]. *Studium Generale*, 6(2), translated and republished by Helena Ratzka as “Comment about the Mathematical Treatment of Economic Problems”. *Journal of Libertarian Studies*. 1977, 1(2), p. 97.

¹⁰ Bates, Robert and Greif, Avner and Levi, Margaret and Rosenthal, Jean-Laurent and Weingast, Barry. 1998. *Analytic Narratives*. Princeton: Princeton University Press, p. 236

¹¹ Bates, Robert and Greif, Avner and Levi, Margaret and Rosenthal, Jean-Laurent and Weingast, Barry. 1998. *Analytic Narratives*. Princeton: Princeton University Press, p. 3

presents five case studies covering topics such as trade development in Genoa in 12th century, the impact of fiscal policies on absolutist European governments; conscription in France, US and Prussia in the 19th century, or emergence, development and decline of the *International Coffee Organisation* in which the steps of the narrative method are used – detailed grasping the situation, understanding the institutions, relations, specifics, preferences of actors etc. followed by analysis which rationalizes and logically explains the narrative.

The analysis offers an explanation referring to an existing – i.e. real – situation not an abstract – i.e. model – situation.

3. Boettke's attempt to contextualize Austrian Economics

Whereas the Bates's book in its introductory methodological chapter suggests the "pluralistic" approach arguing that the researcher needs to be open to "be surprised" by the narrative and let the narrative penetrate his seemingly consistent explanations, it does not follow necessarily that "anything goes". When the analytical tool is – as it typically is the case in Bates's book – game theory, the explanation problem is just a sequence of isolated "puzzles". There is another possibility, though. And this is an innovation by Professor Peter Boettke of George Mason University. He placed Austrian praxeology to the center of his narrative research project.

The beauty of analytical narrative for Austrian scholars lies exactly in the fact, that, in the eyes of the mainstream economists, is their weakness. Austrians have argued for more than a century that economics is a science supplying us with timeless, universally true laws. This position exemplified the opposition to the ideal of contingency of economic understanding defended by the German Historical School. Carl Menger won this famous battle over economic method, and the Austrians still today proudly adhere to this position. As Austrians do believe in the power of logical deduction and the universality of implications of human action, their method gives them very powerful analytical glasses. Analytical narrative of their variety can hence be built on a very firm foundation – underlying structure of understanding – which then gives us a key to see through a complicated social reality and sort it out in a meaningful way. The theory is instrumental in looking for a narrative; it helps to identify key actors whose activities shape the narrative, discover appropriate questions for interview, etc.

Narratives are used to contextualize the price theory – to explore and explain the relevant institutional and historical detail. The narrative style is important not only because it permits the political economist to access the "messy" particulars of specific historical and institutional contexts but also because the "fully human" agent who is the central actor in Boettke's political-economic approach is a complex, often contradictory, and formally intractable character.¹²

¹² Leeson, Peter. 2010: "The Political Economy of Peter Boettke". *The Journal of Private Enterprise*, 26(1), p. 50.

As a consequence, the analysis is both abstract and empirical. It keeps its status of a universally true theory which is – now – supplemented with real-life empirical context.

In Boettke's setting, analytical narrative represents the missing quadrant in the matrix of empirical research which depicts currently used empirical methods and the status of conclusions reached. We can divide the methods into "clean", i.e. statistical–regression analyses, and "dirty", i.e. interviews, historical documents or ethnography. The conclusions are either universally true (thin) or time- and space-specific (thick).

Classification of methods of empirical research

	"Dirty" empirical work	"Clean" empirical research
THIN description	Analytic narrative	Standard economic analysis (constrained optimization, statistical significance)
THICK description	Traditional anthropological, sociological, area studies, political science work (social forces and cultural analysis, case study and ethnography)	Statistical sociology and political science ("Kitchen sink" statistical analysis which throws everything in the right side of the equation in search of explaining the left side)

Source: Boettke, 2000

4. Current narrative research

Critical discussion about the suitability of the method is still going on (see e.g. J. Elster, 2000 or A. Alexandrova, 2009 arguing against, and Boettke, 1998, M. Levi, 2004, in favor of it). A core of the criticism is the belief that analytical narrative overemphasizes the rationality of action, ignoring the irrational and emotional part of human decisions, against which the defenders argue that the intimate insights into the problems can incorporate into the model all relevant views and irrational behavior. This debate is, however, only mirroring the debate about the use of formal models and formal techniques in the economic mainstream generally. For analytical narrative of Boettke's provenience that builds on Misesian praxeology, the accusation of too much rationality does not hold. Praxeology is indeed a rational choice theory; however, it does not assume omniscience and non-existence of errors.

There is a growing list of papers combining the Austrian method and analytical narrative covering a wide range of topics from de-socialization to US foreign policy.¹³

¹³ See e.g. Stringham, Edward and Boettke, Peter and Clark, Jeff. 2008. "Are regulations the answer for emerging stock markets? Evidence from the Czech Republic and Poland". *The Quarterly Review of Economics and Finance*, 48(3), pp. 541–566; Leeson, Peter. 2007. "Trading with Bandits". *Journal of Law*

In all cases, the authors build on advantages of analytical narratives, i.e. base their analyses on understanding rooted in praxeological analysis, rather than measurement, which in many instances does not give us enough data for doing the standard empirical analysis anyway.

[G]iven the complexity of human predicament, natural language is far better suited than formalism to conveying these truths. Although the particular ends sought and means employed vary among people, places, and time, purposeful behavior in the most general sense is itself an omnipresent feature of the world. Thus, although the applicability of particular laws of economics derived from starting point of human action will vary from place to place, their truth value is universal. The universality of purposeful human behavior begets the universality of the economic truths that explain this behavior. Economics can explain tendencies and direction of change, even if it cannot explicitly model or measure statistical significance of change.¹⁴

It seems to be clear that narrative alone cannot give us better theoretical understanding of the world. Analytical narrative rooted in praxeology, however, is enriching the analysis and to the qualitative aspects of praxeology adds an empirical dimension. Equipped with this “dirty” empiricism, Austrian economists can take part in debates with fellow economists, lawyers, sociologists or historians, demonstrate the power of their explanations and, thereby, introduce to them core Austrian insights which – left in the pure praxeological exposition – were not accessible or attractive to them. Whereas historians and sociologists have always been open to this kind of empirical work, economists resisted. Things may be, however, on the move even within the economic profession, and the window of opportunity is wide open for expanding the spectrum of traditionally accepted methods of inquiry. The Nobel Prize awarded to Elinor Ostrom for her institutional analysis is not only appreciation of the Bloomington program but good news for scholars using analytical narrative as well.¹⁵

Conclusion

The method of analytical narrative represents a return to the roots of economic science and belief that we cannot understand market mechanism without understanding a man as an acting human being realising his dreams in the real world. Analytic narrative rooted in the deductive method of the Austrian School gives

and Economics, 50(2), pp. 303-321; Coyne, Christopher. 2007. *After War: The Political Economy of Postwar Reconstruction*. Stanford: Stanford University Press; Beaulier, Scott and Subrick, Robert J. 2007. “Limited Government and Economic Growth in Botswana“. *The Journal of Private Enterprise*, 23(1), pp. 51–64.

¹⁴ Boettke, Peter J. and Coyne, Christopher and Leeson, Peter. 2003. “Man as Machine: The Plight of 20th Century Economics“. *Annals of the Society of Economic Thought*. 43(1), p. 4

¹⁵ On the essence of Ostrom’s research agenda and links to Austrian research program see Aligica, Paul Dragos and Boettke, Peter J. 2009. *Challenging Institutional Analysis and Development: The Bloomington School*. New York: Routledge.

scholars a powerful tool to talk in a new way about the world. Economic logic can, hence, co-exist with “dirty” empirical data resulting in flesh and blood explanation of historical events or policy steps. In addition, it gives Austrian economists – whose natural language explanation and broad humanistic approach has been always appreciated by non-economists¹⁶ – an additional tool helping to increase understanding to get their powerful message about the functioning of society across to students of all social sciences.

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¹⁶ See e.g. Crespi, Gregory Scott, 1998: “Exploring the Complicationist Gambit: An Austrian Approach to the Economic Analysis of Law”. *Notre Dame Law Review*, 73(2), pp. 320–321 and Novak, Michael. 2001. “Economics as Humanism”. In Younkins, E. ed. *Three in One*. Lanham, Md.: Rowman & Littlefield, pp. 202-06.

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