

## [Lessons for Austrians from Europe](#) [1]

Written by [Sam Bowman](#) [2] | Tuesday 14 December 2010



Boris Johnson was on [great form yesterday](#) [3] reminding all the more-progressive-than-thou Europhiles about their snooty disdain for Eurosceptics during the 1990s over the EMU. Those of us who pointed out that the eurozone was never an optimal currency area were mocked as nationalists and retrogressives who blamed the EU for every problem. Now, as Boris has pointed out, the euro has been exposed as a shambolic political project and its sidelined critics have been proved right. Even people like Barry Eichengreen, who loudly supported the euro project, have recanted. The whole issue is analogous with another element of monetary policy where outsiders are routinely mocked ? money and banking in general, the outsiders being the Austrian school economists.

The Austrians ? who generally favour either free banking or gold-backed 100% reserve banking ? are usually ignored. The Austrians, like the eurosceptics, disagree with the new way of running the money supply: where previously interest rates were set by the loanable funds market as a function of the number of people lending and the number borrowing, now they are set initially by central banks. Under the old system, investment in one area could only happen if savings were made in another ? so the lending and borrowing system accurately reflected where resources were being applied in the real economy. In the new system, artificially-low interest rates create a combination of excess consumption fuelled by borrowing and excess investment ? again, fuelled by borrowing. This is unsustainable and leads to bubbles, which ultimately burst.

This perspective is logically and empirically robust. That is not to say that it is necessarily correct ? far smarter people than I have rejected it ? but those who are convinced by it are ignored and mocked by the political establishment (and often the academic establishment too). How often have you heard a politician wringing his hands about the absence of a coherent explanation for the financial crisis? They're apparently unaware that the Austrian school gives a rather good one. So too for the journalists who paint Chicago school monetarism as the ?free market? school of monetary policy.

The same mockery that faced sceptics of the euro now faces Austrian sceptics of the central banking system. The new sceptics should learn from the old sceptics? vindication, as well as the old saying: First they ignore you, then they laugh at you, then they fight you, then you win.

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