The Theory of Dynamic Efficiency
Jesús Huerta de Soto
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Jesús Huerta de Soto is professor of political economy at King Juan Carlos University in Madrid and has made a name for himself as a prodigious author on the history of economic thought and on the Austrian School. This book contains twenty essays, sixteen of which have already appeared elsewhere during the period 1994–2004. They span a wide range of topics that include the methodology and history of economics, entrepreneurship, socialism, nationalism, central banks and free banking, ethics, and liberal social thought (in the European sense of the term). *Dynamic efficiency* is defined as "the capacity of an economic system to stimulate entrepreneurial creativity and coordination" (29). It serves as a cover term describing the ability of an economy to adapt quickly and at low cost to changed economic conditions. It is meant as an alternative to Pareto's criteria for the efficiency of markets.

For three reasons, the concept of dynamic efficiency does not represent a good overall title for the various papers. First, it is not a characteristic of the market process exclusive to the Austrian view. Balancing between short-run (static) efficiency and long-run shifts of production possibilities through innovation, new technology (or increased resources) is part of neoclassical analysis. That dynamic efficiency can be enhanced through microeconomic reform and increased competition, which provide incentives for businesses to innovate and adapt, is also not a prescription limited to the Austrian school. Of course, Schumpeter was the great theoretician of dynamic efficiency, but the book mentions "creative destruction" only once in its first chapter, which is an overview article. Additionally, many "Austrians" in the narrow sense do not admit Schumpeter's vision as part of the "club," mainly because of his different methodological assumptions.

Second, what efficiency actually means is largely left open in the book. If it means something other than only an outward shift of a production possibility frontier, then is it an allocative or technical, parametric or nonparametric, deterministic or stochastic notion? Huerta argues against the static and therefore reductionist sense in which efficiency has been used by Pareto, Walras, and welfare economics. However, creativity and coordination, as defining moments of entrepreneurship, raise more questions than they settle (10f.). Kirzner, Rothbard, Cordato, Leibenstein, Schumpeter, North, and Coase are each briefly mentioned but nothing close to a real definition emerges. "Ethics" is presented as a "necessary and sufficient condition for dynamic efficiency" (19). If, however, ethics is reduced to the single precept of property—"each person has the right to appropriate the results of his entrepreneurial creativity" (20)—how is this a sufficient condition for dynamic efficiency? Because entrepreneurial talent, as a resource at the personal level, is stochastically distributed, how does it make some economies more dynamically efficient than others? Assuming the absence of other resources for entrepreneurs to work with in a closed economy, would an abundance of entrepreneurship alone cause an outward shift of production possibilities and an expansion of welfare?

Many "natural experiments" invalidate this assumption. Jamaica has, at the microeconomic level, an abundance of entrepreneurs with often amazing ideas for product and process innovation. The regulatory system is less restrictive than that of the United States; why, then, does the Jamaican economy not grow? The absence of global efficiency must be seen in a host of other factors, some of which are more deterministic than others, ranging from culture to climate, import restrictions in other countries to insufficient transportation infrastructure, crime to emigration and education, in a rather complex web of causality. According to Huerta's definition, all these factors would have to be part of the "economic system," and this does not make the concept clearer. Global measures of dynamic efficiency have of course been developed (such as in data envelopment analysis), but Huerta does not go there (and does not use the concept in the other chapters).

Third, efficiency in the mainstream industrial organization literature is not an end in itself but a means toward the end of greater competitiveness, and the idea of competitive advantage does not receive explicit mention in Huerta's book. It has traditionally been thought of as deriving from existing resources and conditions, always judged in comparative terms, which entrepreneurially alert managers may utilize for developing pofitable strategies. Because competitive advantage, be it a result of comparatively lower costs of production or a more differentiated consumer demand, always depends on being realized and acted upon, it would seem to fit well into an Austrian theory of entrepreneurship and the market process. Huerta does not travel this route, maybe because his book does not deal with price theory (neither "consumption" nor "production" is mentioned in the index) or because his notion of entrepreneurship excludes the possibility of using "existing resources" (the entrepreneur in a sense creates new ones). The book focuses on institutions such as central banking, policies such as immigration, and ideologies such as liberalism and nationalism, most of which have little to do with dynamic efficiency. The breadth of issues discussed would have suggested a broader title.

Regardless of the title, the papers in the volume have much to offer everybody who is interested in a classical-liberal and Austrian perspective on some central issues in social science. It explains the differences between the Austrian and the neoclassical approach to economics (chapter 2); presents a generalized definition of socialism (chapters 4 and 5); and suggests a liberal theory of environmentalism (chapter 6), free immigration (chapter 8), and social security (chapter 9). Banking is a distinct specialty of the author, and a criticism of fractional-reserve banking figures prominently (chapters 10 and 11). Issues of ethics and ideology occupy an equally prominent place: the ethics of capitalism (chapter 12), a Hayekian strategy to implement free-market reforms (chapter 13), and the future of liberalism (chapter 14). Huerta does not share the disdain of some other Austrians for democracy but sees definite advantages in the Swiss model of direct democracy and the right of secession as an antidote to a strong state. The last part of the book consists of several papers on the history of economic thought, one of which is based on personal recollections. Juan de Mariana and the School of Salamanca, Mises, Rothbard, Hayek, and even Ricardo receive consideration (chapters 15–20). In an appendix, an interview with the author on the "Spanish roots of the Austrian school" is reprinted.

Some quandaries remain. The view that an entrepreneur somehow "creates something out of nothing," even if it is "only" information (68) is surely questionable. *Creatio ex nihilo* is reserved to God, whereas entrepreneurs as earthlings combine factors of production—particularly products developed by other entrepreneurs—with their alertness and vision, which may well be specific to them. Every new technology starts from a given technology, which is—often in unpredictable ways—altered and adapted to consumer wants that are typically not verbalized but only imagined. Entrepreneurs build on the creativity of previous entrepreneurs, and on the fortuitous presence of other resources such as location, know-how, or raw materials. To deny this would mean to deny a view of the market on which both Mises and Hayek have placed much emphasis: that of a necessarily social institution for exchanging both resources and finished products. Huerta's focus on coordination should warn against it.

Although some circles now regard it proper to tout "liberal nationalism," it goes against the very essence of liberal thought, individualism. Liberal thinkers from Lord Acton to Tocqueville, Mises, and Hayek, have placed nationalism where it belongs: together with socialism, feminism, and racism in the camp of freedom-denying collectivisms. Explaining why he was not a conservative, and particularly not one of the American kind, Hayek wrote: "Connected with the conservative distrust of the new and the strange is its hostility to internationalism and its proneness to a strident nationalism. Here is another source of its weakness in the struggle of ideas" (*The Constitution of Liberty* [1960], 405).

How then can one cherish entrepreneurship, the essence of which is innovation, and nationalism at the same time, and how can the latter ever be "liberal"? Mises has emphasized that "the principle of unlimited sovereignty cannot be maintained in a world where the international division of labor results in a mutual dependence of every nation on all other nations" (*Selected Writings of Ludwig von Mises* 2000, 3:183). He served as an advisor to the League of Nations, favored the reconstitution of a supranational state on the territory of the former Habsburg Empire, and for postwar Europe envisaged a structure much like the European Union: "What they cannot obtain from their own country and what only a European constitution can give them is the right of Pan-European citizenship" (Mises, 46). For Mises, nationalism was "the corollary of a domestic policy of government interference with business" (19). History has indeed shown that every nationalism—in Germany, Spain, or the United States—degenerates to collectivism and therefore precludes the "harmonious, pacific and fruitful cooperation between all social groups" that Huerta hopes for (111). Mises and Hayek, internationalists both, provided the arguments.

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