Austrian Economics and Development: the Case of Sudha Shenoy’s Analysis

Abstract. The aim of this paper is to describe Sudha Shenoy’s use of Menger, Mises, and Hayek (she explicitly called them ‘the older Austrians’) to explain development and growth. Her aim was to show that the application of Austrian economics, based on the notions of capital structure and division of labor, embedded in a specific legal framework (common law), historically promoted development and growth (as in early modern England); and it can promote development and growth in underdeveloped countries (her specific focus was India). Shenoy also claimed that any policymaking as well as government’s intervention are either useless or dangerous, having them two main dysfunctional effects, which are often interrelated: they make development slower (or even stop it), and they increase corruption.

Introduction: Shenoy within the Austrian school of economics

Sudha Raghunath Shenoy (1943-2008) was an Indian academic scholar\(^1\). She belonged to the fourth generation of Austrian school women economists (Becchio 2018)\(^2\), and had covered a

\(^{1}\) S. R. Shenoy, Ph.D. in Economics (New Castle, Australia, 2001), was educated at Mount Carmel School and St. Xavier’s College, Ahmedabad, India, the London School of Economics, the University of Virginia, and the School of Oriental and African Studies (University of London). Research Assistant at Queen Elizabeth House, in Oxford, between 1971 and 1973. Lecturer in Economics, University of
significant role in the so-called Austrian revival, which took place at the South Royalton conference (1974), which is considered a founding meeting of the modern Austrian movement. In an interview she gave to the *Austrian Economics Newsletter*, Shenoy remembered her “longest connection to the Austrian movement” (Shenoy 2003). Her father, Bellikoth Raganath Shenoy (1905-1978), a student of Hayek’s in the 1930s at LSE, was “the only liberal economist between Athens and Tokyo”³. He deeply influenced his daughter’s political vision as well as her

Newcastle, Australia, between 1973 and 1974. Lecturer in Economics at Cranfield Institute of Technology, between 1975 and 1976. Senior Tutor in Economics, University of Newcastle, since 1977. She held visiting positions at California State University, George Mason University, and Ludwig von Mises Institute.

² Since the beginning of the twentieth century, a group of Austrian women economists gathered around Wieser and Böhm Bawerk first, as well as Mises and Hayek thereafter. The first two generations were Viennese economists active between the early twentieth century and 1938 before the massive emigration due to the Anschluss. The first generation (up to 1919) received their academic degrees outside Austria due to the persistent ban against female students in Austrian universities Else Cronbach (1879-1913), Louise Sommer (1889-1964), Toni (Kassowitz) Stolper (1890-1988). The second generation (active during the interwar period) finally had the opportunity to enroll in and graduate from the University of Vienna: formally students of Mayer, they were massively influenced by Mises Marianne Herzfeld (1893-1976), Martha Braun (1898-1990), Helene Lieser (1898-1962), Gertrude Lovasy (1902-1974), Elly Spiro (1903-2001), Ilse (Schüller) Mintz (1904-1978). The third generation of Austrian School women economists was no longer from Austria: it was formed by Hayek’s students at LSE (1930s-1970s) and by Mises’ students at NYU (1938-1960s: they were Marjorie Grice-Hutchinson (1909-2003), Vera Smith Lutz (1912-1976), Mary Sennholz (1913-), Bettina Bien Greaves (1917-). A fourth more recent generation began after the so called Austrian revival in the 1970s with the work of Sudha Shenoy. Austrian school women economists shared with their mentors and colleagues an economic theory focused on an individual’s plan for coordination and decentralized knowledge; the disutility of any monetary policy as well as of any governmental intervention to minimize distortions; the fundamental role of innovation to explain the link between growth and development, and a specific interest in the history of political economy.

³ B. R. Shenoy was a member team of the Planning Commission for the Second Five year Plan, prepared by the Indian Government in 1955. He was the only one to dissent the plan, because of the following reasons: 1. the plan’s size, (an excess of the capacity of the available real resources would have led to
economic analysis. Shenoy remembered that although both Murray Rothman’s *Man, Economy, and State* and Israel Kirzner’s studies on entrepreneurship were fundamental for her decision to become an economist, it was Hayek’s works on political philosophy, which mostly impressed her. Both *The Constitution of Liberty* and *Law, Legislation and Liberty* were crucial to understand the central role of market in social orders, being the market which precedes the state and not vice versa. Along with Hayek’s works, Shenoy was deeply impressed by Menger’s analysis of institutions:

The older Austrians were examining institutions and social forces that had already developed in people's actions. Then they were trying to work out the principles that are implicit in how people are acting. The point is that they realized that there was already a market economy out there working. They began to see that people were acting on rules that were first manifested in people's actions and then articulated. This is like language. It is a way of understanding the origins and background of Austrian analytics. The "something" they are analyzing is preexisting, not created by one mind or one generation but over a long period of time. The older Austrians were the latest in this analytical line. (Shenoy 2003)

From a methodological perspective, Shenoy, recognized some peculiar regularities in economic behavior, and the importance of the historical framework in order to understand them. She explicitly criticized the methodological turning point that occurred in economics in the 1930s. i.e. the adoption of mathematics and the method of natural science in economics, which determined the rupture between the discipline and its real object of study: human action, and its uncontrolled inflation and wastage); 2. deficit financing as a mean of raising resources to make the plan working (a hard gap to fill between the size of the investment program and available resources); 3. a short-sighted policy (taxes on lower income groups, extension of nationalization, continuance of controls, price support of agricultural produce which would threaten individual freedom and democratic institutions); 4. institutional implications of the plan itself (a very plausible source of corruption) (Bauer, 1998; White 2012; Anand 2015).
application, which is, according to her, not related with a rational economic agent, but with the complex dynamics of social phenomena, which are the object of economic history\(^4\).

Shenoy’s research field was focused around the historical origins and causes of development. Her Ph.D. thesis dealt with modern England as a case study to show the evolution of Western countries towards a flourishing economy as well as a liberal democracy. In her works, she applied Austrian categories to underdeveloped countries in order to test the validity of those categories and to show the disutility of any governmental policy oriented to promote development (she deeply criticized the massive planned regulation in India, during the 1960s and 1970s, whose aim was to promote development), including Keynesianism. Following Hayek’s suggestions (Hayek 1944), she regarded interventionism as a way to a dangerous escalation towards corruption, illiberalism, and even totalitarianism.

**Development explained by the capital structure and the division of labor**

Growth and development have always been a fundamental topic in economics since Adam Smith’s inquiry on the cause of the wealth of a nation (1776). Shenoy’s researches came after a long debate about the causes of growth of industrial countries, which took place in the 1950s and went on during the following decade. More specifically, during the late 1950s, the concepts of development was distinguished from the concept of growth, and development economics arose as a new research field whose aim was to analyze specific problems of developing countries. Rosenstein Rodan (1943) had previously claimed that a big investment package could be helpful in underdeveloped countries\(^5\). Nurske (1953) proposed the so-called balance growth theory, based on the idea that investments of government in underdeveloped countries would have been able to enlarge the market size, and to provide an incentive for the private sector to invest. Solow

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\(^4\) Shenoy explicitly followed McCloskey’s argument that economists are not scientists, but story-telling historians: “neoclassical economists are even further removed from even the remotest possibility of learning about the issues involved in studying human action” (Shenoy 2010, 60).

\(^5\) More specifically Rosenstein Rodan studied the causes of development, he recognized in four factors: an increase of population, especially in countryside, the so-called ‘agrarian population’; economies of scale; an increase of infrastructures (social overhead capital); the increasing specialization of workers. He applied these factors to the case study of Italy, Latin America, and India.
(1956) explained growth as a consequence of an exogenous technological progress: technology increases the amount of output per workers, which depends on the amount of capital per worker; if capital per worker increases, so does output per worker. In Solow’s model, growth comes from capital accumulation and technological progress; and government has no role. According to Hirschman (1958), development depends neither on an optimal combination of resources nor on the level of savings: it depends on the capacity to discover new capabilities in an uncertain framework. Besides Rosenstein Rodan, development and growth have been studied within the Austrian tradition: Schumpeter (1934 [1912]) and, later, Kirzner (1973) focused their analysis on the role of entrepreneurship, Lachmann (1956) focused his attention of on the role of capital structure.

Sudha Shenoy was part of this story. She did not followed Schumpeter/Kirzner, who insisted on entrepreneurs’ psychology, vision and activity in describing development, nor Rosenstein Rodan’s big push theory. She addressed development using Menger, Mises, and Hayek, and partially, Lachmann’s theory of capital structure. Shenoy’s contributions can be also regarded close to Hirschman’s, although they had an opposite vision about market: Hirschman thought that the market is unable to coordinate dispersed knowledge and potential decisions; Shenoy, considered market as the only institution able to make it.

According to Shenoy the ‘older Austrians’ contributions were fundamental to understand either the causes of the wealth of industrialized countries or the possible development in underdeveloped countries (Shenoy 1991): like Hirschman, she regarded the local potentiality as fundamental, but against him she thought that only the mechanism of prices in a free market is able to coordinate dispersed knowledge in order to promote the division of labor and to increase the capital structure, which are the two factors of both growth and development.

Shenoy reminded that Austrians considered capital as a heterogeneous set of goods, which might be classified into orders or stages, depending on their closeness to final consumption (as firstly explained by Menger). In order to get a final consumption, capitals must be embedded into a capital structure, made by a series of interlinked investments (capital structure can be simple or very complex). Different production units, such as households, individual producers, and firms, might make investments, which are coordinated into a coherent capital structure by prices.
Depending on technical feasibility and on other historical circumstances, the capital structure can be expanded in order to get a much longer investment process. These investments could be good ones or bad ones: good investments make profits and capital gains, bad investments make capital losses.

According to Shenoy, the re-allocation of investments requires saving, to be classically intended as the willingness to postpone consumption. Quantity of savings also depends on historical circumstances: in any case, saving is necessary to increase the length of any capital structure, which is composed of specific capital goods. When historical circumstances change, capital structure should be adapted. The role of information is crucial in this passage: when capital structure is supposed to change, information will be providing a better way to adjust specific capital goods. Being information very partially acquired, any form of planning results inefficient as well as dangerous.

The same principle is valid for an extending division of labor, which is required to extend capital structure itself: specialization is able to create some new jobs as well as modify some others and it makes some employment disappeared. Like in the transformation of the capital structure, the transformation of labor depends on historical circumstances. Information at this stage is indeed crucial: for the same reason mentioned above about capital structure, any form of intervention on the job market is bounded to fail.

An extended capital structure and an extended specialization (division of labor) are “two sides of the same coin”, i.e. development and growth. In order to be both increased, market exchange should be supported: “this does not mean ‘rational invention in full precognition of the results. It only means the adoption – for whatever reason – of customs and practices that have the effect of extending the division of labor – which cannot be foreseen in any case” (Shenoy 1991, 410).

The notion of katallaxy, originated by Menger’s distinction between organizations and organisms, and then reshaped by Mises and Hayek, is able to explain the emergence of development, to be intended as an extended capital structure and a specialized division of labor in a context of privately evolved legal framework. In fact, in Shenoy’s perspective, capital structure and division of labor are possible only in a specific legal framework, able to extend the market order. From a historical perspective, countries able to expand capital structure and to
make labor gradually specialized have been ruled by Common Law (such as in England and in the United States), or by other systems based on private property such as the Roman empire and the Japanese empire.

In another article about development and Austrian theory (Shenoy 2007), Shenoy tried to apply Menger’s analysis of investment chains against Solow’s (neoclassical) theory that technology is the only, or the most important, factor to explain development. Against the theory of Cameron and Neal (2003), based on the centrality of technology in “raising the ceiling” of economic development, Shenoy underlines the importance of “a fertile environment for productive innovation” (Shenoy 2003, 187): innovations are made possible by an expansion of the capital structure and an increasing division of labor. The role of entrepreneurs and the liberty of institutions are fundamental in starting the so-called investments’ chains, able to produce a various range of final outputs, which determines growth and development, as it happened during the first Industrial Revolution. Again, against the neoclassical theory of the growth, based on mechanical and statistical description of flows of input and output, Shenoy underlined that the Austrian theory of capital structure is grounded in people’s actions: “people’s actions bring about a particular historical context and the investment chains within in” (Shenoy 2003, 207).

Shenoy used to give many examples of what she has in mind when talking about the application of Austrian categories to the notion of development. Her examples included, besides India, Hong Kong, Africa, Latin America. Although the economic and social situation in different underdeveloped countries is very heterogeneous, they share some features:

- an intense emigration (with the historical exception of Latin America countries);
- a low per capita income (which measures only the physical output of goods and services);
- a high rate of population growth (due to high birth rates in spite of a decline in death rates) with a short life-expectancy. This feature shifts the entire economy towards consumption and reduces per capita savings. Therefore investments on human capital are reduced;

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6 This element has an enormous impact on the economy of underdeveloped countries: the age to join the force work is around 8 – 12 out of an expectancy life of 50 and a high rate of infant mortality.
- underemployment mainly due to three factors: high labor supply, low capital supply, and an economy prevalently based on agriculture (in order to supply food for a constantly increasing population);
- illiteracy, to be intended not as a precondition of economic development, but as a consequence of economic development, being it a form of investment which is possible only in a complex capital structure⁷;
- a comparative advantage export, due to low-price labor services and a deregulated labor market, and a consequent tendency to protect their internal market, as in the case of Indian plan, without understanding that any protectionist policy is bound to fail.

Besides these common features as listed above, Shenoy claimed that underdeveloped countries/areas do not present the peculiar traits of developed countries, i.e. a complex capital structure and a specialized division of labor embedded into a liberal political scenario.

**Against planning and intervention to promote development. The case of India**

Shenoy’s fight against protectionism and planning in the Indian economy could be better understood in the Indian context of her time. Since the 1930s, a planning apparatus for Indian economic development had been set up, and it was renewed after India’s independence in 1947. The plan was especially focused on the development of the industrial sector, and the Indian government’s intention was specifically oriented to strengthen heavy industries. There were very few opponents to the plan; among them, Sudha’s father, the liberal economist Bellikoth Ragunath Shenoy, later joined by his daughter (Bauer 1998; Shenoy 2003; Manish at al. 2015).

The aims of India’s Five-Year Plans were to raise the standard of living of the people, to develop the economy, to reduce unemployment, and to obtain social justice. However, according to Sudha Shenoy (1962; 1966; 1971), it achieved an opposite result: per capita daily food grains consumption had stagnated below the nutritional standard; annual cloth consumption had declined; and conditions of life did not better off. In the same time, the agricultural sector, which usually provided more than 80% of GDP, collapsed.

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⁷ Shenoy considered entrepreneurship as the main attitude of literacy.
Shenoy adopted Hayek’s argument against socialist control of an economy in order to criticize the Indian government’s plan. She thought that both the plan and the specific sectors chosen by the government were a huge mistake bound to fail for three reasons: (1) it would weaken exports; (2) it would create inflation to cover a budget deficit; (3) it would increase corruption, due to the collusion between potential licensees of issuing import and government. This misallocation of resources delayed economic development, increased unemployment, and made inequality higher by transferring wealth from fixed income groups to corrupt functionaries of the state: “permits, licenses, quotas, concessions, and so on, which centralize economic power in the hands of officials, and create numerous monopolies or semi monopolies in the private sector” (ibid). The reasons of this failure stand on the fact that, as in any planning experiment:

“the bulk of the country’s resources are forcibly drawn into the sector with the lowest returns, the public sector (...) about 4 per cent of India’s national income is provided by employment in the public (government) sector. But government absorbed 60 per cent of total resources in the Second Plan; and the Third Plan proposes to raise this figure to about 70 per cent. Practically the entire public sector expenditure is on uneconomic, low-return, heavy industries and on giant river-valley projects—imitation TVA’s”\(^8\).

A few years later the application of the Third Plan, Shenoy described the political situation in India as an oligarchy, to be intended like in Aristotle’s word, i.e. “the government of the richest, who became wealthy not in a free market, but via political connections in both legal and illegal ways” (Shenoy 1966). In such a situation, even wealthy businessmen have been strictly controlled by a complicated network of regulations and by a rigid bureaucracy.

Moreover, the Indian economic system after the plan, resulted to be inefficient due to three more rigid governmental measures:

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\(^8\) As retrieved in https://fee.org/articles/statism-and-the-free-market/
- government’s strict control on import-export⁹;
- no addition to the real national income in spite the government sector’s expansion had provided a rise of employment;
- a dangerous increase of the powers of officials over their fellow men due to additional government’s control over many other sectors of internal economy.

The main dangerous consequence of this plan has been an increasingly limitation of the whole private sector which has no connection with the government. And this reduction of freedom in private sector inevitably has led to a reduction of political freedom, being all businessmen supporters of the government, especially because the international aid is entirely converted to finance the government’s plan. The real nature of planning in India was to be a “forced transfer of resource out of the uses where they would benefit the masses — i.e., the agricultural sector — into an artificially created and propped up ‘industrial’ sector” (Shenoy 1966) making Indian hungrier than before the plan. Shenoy continued:

“Since planning implies the concentration of economic and political power in the hands of the ruling clique, it has effectively smothered a wide range of potential political opposition. (...) Democratic forms in themselves are meaningless. The right to vote can be effective only in the context of a whole network of other freedoms. Elections can be free only in the framework of a free market and the Rule of Law” (Shenoy 1966)¹⁰.

In her last writing on India (Shenoy 1971), Shenoy summed up the Indian situation after ten years of plan: government’s plan has brought an overemphasis on industrial and urban sectors, and it had increased inequality. She suggested the abolition of such economic regulations as industrial licensing and capital issues controls, as well as exchange and trade controls; and the abolition of all price and distribution controls and economic regulations which were applied to

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⁹ No import was permitted without a license, and prohibitive tariffs had been imposed on a large number of goods. Furthermore, all exchange earnings were fixed by the Reserve Bank at an official price, which was below the market price. Furthermore, it was forbidden to send rupees out of the country in any form.

¹⁰ As retrieved in https://fee.org/articles/the-coming-serfdom-in-india/
specific industries such as road transport and textiles. She also suggested the elimination of public sector claims on capital resources, implying sale to private industry of all public undertakings as well as the abolition of food-grain controls. In fact, the growth of the agricultural sector, which provides jobs for many people, has been held down moneylenders’ legislation.

**The road to true liberalism: the battle against Keynesianism**

Strictly related with her fight against government’s intervention was her critique of Keynesianism. During the meeting of the South Royalton conference, Shenoy presented a paper on inflation, recession and stagflation that was co-authored with O’Driscoll (O’Driscoll and Shenoy 1976). The authors attacked both Keynesianism and monetarism for relying on the general assumption that, over the long term, the real side of the economy is in equilibrium, and that monetary factors influence “only the price level or money income and not the structure of relative prices or the composition of real output” (O’Driscoll and Shenoy 1976, 185). The authors suggested, as the only possible alternative to both Keynesianism and monetarism, the Hayekian analysis, based on the assumption according to which any monetary changes in real terms will break the spontaneous economic order.

Central in her battle against Keynesianism was Shenoy’s introduction to *A Tiger by the Tail* (Shenoy 1972): a historical reconstruction of the debate between Hayek and Keynes after the publication of Hayek’s *Price and Production* (1931). Shenoy recognized that the main fault of Keynes’ macroeconomics was to neglect the real structure of production and the insistence on aggregative macro concepts. According to Shenoy, Hayek’s approach to macroeconomics, based on an analysis of the structure of relative prices and their interrelations as an allocative tool, is much more able to explain macro dynamics than Keynes’ macroeconomics. She insisted on the fact that Hayek did not adopt the neoclassical framework of a general economic equilibrium, according to which prices are seen as “dynamic shifts between two general equilibria”. Hayek considered prices as “empirical reflectors of specific circumstances and price changes as an *interrelated* series of changes” able to produce “a gradual adaptation in the entire price structure
(and hence in the outputs of different commodities and services) to the constant, unpredictable changes in the real world” (Shenoy 1972)\(^{11}\).

According to Shenoy, Keynesianism has many faults when applied to an underdeveloped country. It is useless, and can be dangerous, for the following reasons:

- the level of inflation, raised in order to reduce unemployment in the short run, must be continuously increased, and the consequence would be a decrease in domestic demand;
- any income policy would freeze a particular set of price and wage while their supply and demand are continually changing, especially in economies oriented toward development;
- any income policy presents a “discoordinative” aspect which will affect the price system and will require a permanent income-policy which will inevitably lead to a form of permanent planning
- a permanent planning, especially in underdeveloped countries, will likely lead to some form of dictatorship or totalitarianism.

The only institutional framework able to make price mechanism possible to perform as informative signal is the liberal system. Shenoy used the term ‘liberal’ in a very Austrian sense: her reference was the classical liberalism. Quoting Mises, she defined liberalism as a system based on “free trade, free movement of people, free movement of capital, falling prices, [as] a continuation of the growing division of labor on a global basis” (Shenoy 2003). Following Hayek (1948), Shenoy’s aversion against any government intervention had a fundamental part in her own battle for true liberalism. Any other political framework will have two effects: to stop development and growth and to lead towards forms of totalitarianism.

Unfortunately, according to Shenoy, many liberals (in the sense of leftist liberals) consider economic freedom, even in democratic systems, as an instrument of wealthy people (what today it is called “the 1%”) to exploit the many (today’s “the 99%”). Though, for a true liberal (a classical liberal) freedom is indivisible, and it spreads through the market process of profit and loss. Shenoy saw freedom as the foundation of the social system as a whole: intervention is bound to destroy the social order and to establish “an order founded on the principle of political

\(^{11}\) As retrieved in https://mises.org/library/hayek-keynes-debate-1931-1971
exploitation: the politically strong exploiting the politically weak. In short, intervention leads to the suppression of potential political opposition and thus ends in totalitarianism” (Shenoy 1966).

Shenoy had always had clearly in mind the connection between politics and social order: the market cannot work alone, of course: in a complex historical milieu, it needs a good performance of some essential functions by the state, which are aimed at establishing and maintaining the Rule of Law. Shenoy defined the Rule of Law as a legal system grounded on a concept of selective justice (Shenoy 1965). Selective justice is the idea that the same rules should apply to all. In contraposition with selective justice there is the concept of social justice. Social justice is the application of the rules accordingly with the circumstances of those to whom the rules are intended to be applied. Social justice is an instrument for politicians to exploit minorities. Instead of limiting the freedom of entrepreneurs (the minority who form the only class able to increase the capital structure and the division of labor), authentically liberal politicians should promote liberty for them.

Unfortunately, Shenoy insisted, it is impossible to take for granted that the state, which is formed by politicians and bureaucrats, will adequately perform its essential functions. Usually, the state will go beyond its limits and will attempt “to do things beyond its scope”, by interfering in economic issues. When this happens, the state becomes illiberal, or even dictatorial. Furthermore, the resulting distortions in the market (due to the interference of governments) will be regarded as normal phenomena of the market, and government’s interventions will be considered necessary:

“The politicians will then proceed further with the identical policies that caused the imbalance in the first place—or with worse policies—all to the accompaniment of humanitarian slogans, and with the encouragement of these so-called "liberals." This is a vicious circle, and the essential duties of the state will probably be forgotten or neglected” (Shenoy 1962).

At this point, Shenoy mentioned the situation in the United States in that period (early 1960s):

“Thus, when American and other ‘liberals’ (statists) criticize something labeled ‘free enterprise,’ they imagine they are criticizing the free market. But what these people
consider to be the natural corollaries of the free market are not integral parts of it at all. They are distortions produced in its working by misguided interventionism—the attempts of the state to do the duty of other parts of society, while neglecting its own duties. This causes imbalances and distortions in the market, and these are usually taken by the statists to be its normal and essential features” (Shenoy 1962).

When social order is constrained by politicians, social development is stopped, and corruption arises in order to get confidence from the many; furthermore, the economic system becomes even more constrained. Totalitarianism might arise from this chain of economic regulation and restriction, as it happened during interwar in Italy, in Germany and in communist countries. The influence of Hayek (1944) on her has no need to be remarked.

**Early modern England: a case study to explain historical development in Austrian terms**

Shenoy’s Ph.D. thesis (Shenoy 2010) deals with the application of older Austrians’ (Menger – Mises –Hayek) economic categories to a specific historical case study, namely, the history of early modern England. Shenoy adopted Menger’s organicism, Mises’ market process, and Hayek’s catallaxy in order to describe the peculiarity of the economic and political system in early modern England. Modern England is the best historical example of how the combination of Austrian categories (division of labor, capital structure, and common law) worked and made development and growth possible during the XVIII century. Shenoy claimed that the combination of a peculiar economic vision (individualism and free market), the expansion of both the capital structure and the division of labor, within a specific legal framework (common law), made the first industrial revolution and the following development possible. The history of England between XVII and XIX century is the story of capital accumulation through savings, a constantly increasing of division of labor embedded in a common law framework, as described by Austrian categories. The same process happened in the rest of Western countries, although later and more quickly.

Shenoy’s analysis started with a Mengerian classification of social phenomena, to be regarded as “the unintended results of human action and of historical development” (Shenoy 2010, 9). Among them, she included language, customs, moral rules, common law, capital structure, and catallaxy (the social order). These social phenomena are objects of either analytical investigation
or historical research, as clarified by Menger in his *Untersuchungen* (Menger 1985), and therefore by Mises and Hayek as: “an undersigned historical growth, developing gradually from unstated custom to wider, interrelated, and more complex rules” or “the unintended outcome of individual actions pursuing individual ends” (Shenoy 2010, 17). According to Shenoy, Mises’ praxeology, more than Menger’s notion of organicism, better clarified the way modern societies emerged and developed: people’s actions and interconnections gradually formed a historically grown and complex social structure, without any rational-designed contract.

*Division of labor and exchange.* The crucial element in the genesis of modern societies is the division of labor, which increased final goods in quantity and quality, and it has been extended from an autarkic household model to a worldwide scenario. According to Shenoy, among older Austrians, Mises emphasized this specific role of the division of labor, which, along with reason and language, had shaped what he called the ‘Great Society’. The history of humankind was a progressive intensification of the division of labor, which led to the evolution from autarky of households to the worldwide markets of XIX century. Among the categories of human actions, the category of exchange is fundamental in order to understand the beginning of any development. Mises also saw the division of labor and exchange as values *per se*, and not ends-dependent: the division of labor and exchange “bring peace without agreement on ends” (Shenoy 2010, 181).12

Following Mises, Shenoy insisted on the fact that the division of labor enabled the emergence of social cooperation, morality and justice, which “are the other side of the coin of social cooperation” (Shenoy 2010, 22). Like Menger and Mises, Hayek gave emphasis to the complexity of social phenomena, and besides the division of labor, he introduced the centrality of the division of information, which produces knowledge, and knowledge, that is always complex and dynamic, increases development. The market, in Hayekian terms, is the place where fragmented knowledge is coordinated and individual plans can be achieved, being not the results of anyone’s design, but the spontaneous outcome of social order13. Hayek’s theory of

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12 Shenoy underlined that Mises’ analysis is far away from the neoclassical notion of perfect competition, perfect markets and Pareto-optimality.

13 Menger, Mises and Hayek recognized that social phenomena could be of two kinds: organization (designed by people) and organism (spontaneously arisen).
groups’ selection enable us to understand the success of some groups within a society, and a success of some countries among others, constantly having in mind historical circumstances. The division of labor, and knowledge, and the expansion of capital have been allowed the selection of successful groups and societies.

The capital structure. As in her previous publications, Shenoy insisted on the centrality of the capital structure composed by the investment chain, which led to the final output. She recalled older Austrian’s focus on the fact that development is made possible by the ability of ‘consumer-savers’ to handle with the complexity of capitals’ investments in a framework of time – preferences. Western developed countries in the mid-twentieth have been built up this capital structure over centuries:

“Previous generations saved and invested to such effect that production processes were repeatedly lengthened; political and social conditions did not repress large-scale saving and investment; the world economic order, which developed faster in the nineteenth century, enabled large quantities of capital goods to be transferred to the capital-importing developed areas, and also to the less developed counties. Thus all areas now benefit from the actions of past generations – all have more resources to obtain their several ends”. (Shenoy 2010, 55).

At the beginning of modern age, in England, a complex capital structure began to increase: in Menger’s terms, people learnt to use higher order goods, and the quantity and quality of final goods continuously increased. Menger, Mises, and Hayek considered the production chains as adaptations to a particular set of historical circumstances: especially Hayek (1931; 1941) abandoned the average period of production to be focused on a multi-period of production.

In Anglo-Saxon villages, final outputs were simple and limited in quantity; the division of labor was narrow, with a scant specialization. When agricultural investments, based on specialization and technical improvements, extended the capital structure, more resources were removed from

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14 Shenoy pointed out Menger’s critique to Smith about the division of labor as the only cause for the wealth of a nation: according to Menger, says Shenoy, that the division of labor can only increase specialization in goods already available. Only an increase in capital structure can introduce innovations in the market.
the final consumption, and the specialization of labor was increased. The distance between new productive stages and between them and outcome gradually increased, and a huge quantity of goods-in-progress were produced. At each stage of production, a massive wave of new investments have been introduced, providing a continuous flow of intermediate as well as final goods. This complex capital structure generated a sophisticated division of labor:

“Since each individual investment is only part of a link in an investment chain, profit and loss are equally essential (...) As historical circumstances change, particular investments will have to be altered to maintain the chain and its contribution to the range of final outputs, themselves changing. So, capital and operating losses remove the malinvestments that no longer ‘fit’, while better adapted investments, including new ones, earn profits and capital gains” (Shenoy 2010, 246).

Common law and catallaxy. A fundamental condition to create a social order based on a complex capital structure and a specialized division of labor, is given by common law rules, which are able to create favorable conditions for the spread of catallaxy. Catallaxy is the system of economies (Hayek included households, enterprises and governments among them): “an overall order which enables people to cooperate in the production of the final outputs they all purchase” (Shenoy 2010, 47).

Before Burke, Edward Coke was the first scholar to describe the nature of common law in England as “an outcome of many generations of judicial decisions”. His position was basically an attack against Hobbes’s contract theory. Later, Burke applied common law principles to legislation: he considered social phenomena as undersigned, and put legislation under the scrutiny of common law principles. Mandeville explained in the same way other social phenomena, especially economic phenomena, which have been able to accumulate and to transmit knowledge. Smith and Hume went further on: they regarded the division of labor, as well as exchange as results of individuals’ actions with no deliberate intent in order to raise their real income. Catallaxy is the result of the division of labor and of the increase of capital structure: it started in modern England, and it globally spread to the rest of western countries and in some Asian regions.
The signs of development. According to Shenoy, between XVI and XVIII centuries, the signs of development in England can be detached as follows:

- population grew up by 111 per cent, but the rural population decreased;
- production increased in quantity and quality: the capital structure had been extended through a massive rise of investment goods further removed from final use;
- non-agricultural sectors arose and more than doubled;
- employment increased and diversified;
- clothing and footwear rose in quantity and quality, and was produced partly in household, partly outside, and fabrics were specialized according to gender and to any possible use;
- furniture developed in style and grew in quantity and quality;
- non-basic goods, such as pottery, and service for leisure were introduced in any social group;
- housing became a consumer asset: houses’ size increased and they were modernized.

Along with these features, which enlarged the investments’ chain, development had been increased by an extended exchange through non-local trade. The final stage of this historical process was the so-called first industrial revolution, which had been made possible by a more specific division of labor as well as by a complex investments’ chain. Simultaneously, the legal framework in England developed as well: transactions were concluded with formal agreements, and legal professions expanded; number of civil cases arose as well as competition amongst courts. A new society needed a set of institution that enforces the law, and therefore the liberal revolution spread in England (as Mises taught, any government is a praxeological necessity), showing the intertwined growth of common law and market order.

Conclusions
Among Austrian school economists, Menger, Mises, Hayek linked the possibility for a country to prosper to the nature of its institutions, to be intended as the unintentional results of individual actions in a historical framework. Austrian theories on development and growth allowed to build up an endogenous theory of development, which was able to explain real-world economic growth and to understand why some countries had been prospered while others did not (Schulak and Unterköfler 2011; Manish and Powell 2014).
Shenoy combined older Austrians’ definition of common law, catallaxy, the division of labor, and the capital structure, in order to describe and to explain development and growth (as in the case of early modern England) as well as to criticize any form of economic government’s plan (as in the case of India).

Older Austrians, in Shenoy’s terms, found out highly complex regularities in individuals interactions; the combination of these complex interactions among people created a social cooperation, which had been embodies into institutions. The main interaction was exchange, which started within a system of autarky and therefore it spread worldwide. England and other western countries were the first comers: industrial revolutions happened as consequences of a combination of the accumulation of capital, entrepreneurial spirit, and the rule of law. In the late XIX century, the expansion of the international catallaxy made opportunities possible to arise in underdeveloped countries, such as India.

Shenoy explained that development works only in a spontaneous way through innovations, not in a designed way planned by a political agenda. Spontaneous innovations generate a better capital structure, “which gradually emerges over time in the context of privately evolved legal rules” (Shenoy 1991, 20). The nature of social complex phenomena, which enable development, is end-purposeless, or, in Hayek’s terms un-designed. Therefore, government is only required to guarantee private property and individual freedom. Due to the high level of corruption among politicians and the lack of any specific competence or knowledge of politicians, any other governmental intervention is regarded by Shenoy as a possible cause of perverse economic consequences as well as corruption, which inevitably will be leading to structural underdevelopment.

**Shenoy’s Austrian Glossary**

*Capital structure*: an unintended, historically developed, social formation made by the investments chain, which encompasses all the specific investments made by all the firms (Menger, Mises, Hayek, Lachmann)

*Catallaxy*: a continuous process of adaptation to new circumstances, an overall order which makes individuals possible to cooperate (Mises, Hayek)
*Common Law:* judicial order which had historically evolved through people’s actions - formal and informal - over time (Menger, Hayek).

*Development and Growth:* the results of the combination of capital structure, division of labor, and common law.

*Division of Labor:* a synonym of ‘society’, i.e. the way through which individuals get their aims by serving the aims of others (Mises).

*Government’s actions:* a set of designed actions or plans, which disturbs the spontaneity of social order; it decreases the possibility of development as well as it introduces negative externalities, such as corruption.

*Social Order:* people’s complex set of interactions (exchange) on the basis of common rules to achieve individuals’ ends (Hayek).
References


