

**Economics 881**  
**Theory of the Market Process II**  
**Spring 2015**  
**Thursdays, 1630-1910**  
**Enterprise Hall 318**

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This course explores some of the material you will have studied in your first-year theory courses, only it does so by looking at that material through a different analytical window. Rather than looking at economic observations as pertaining to *states of equilibrium*, this course explores *non-equilibrium processes of motion*. These alternative analytical orientations are not antagonistic. They are non-commensurable. It is possible to work with both orientations, only not at the same time. This situation resembles the relation between relativity and quantum theory in physics, as Roger Koppl noted in his contribution to the symposium on *Mind, Society, and Human Action*, published in 2011 in *Studies in Emergent Order*.

Equilibrium theory posits a set of mutually consistent resource allocations and seeks to give a coherent explanation that uses nothing but contemporaneous data. This type of theory is illustrated beautifully by the various proofs of the existence of a competitive equilibrium, and also the various analytical cousins that are related to that analytical scheme. Within this analytical scheme, history is interpreted as the domain of *comparative statics* where the analytical objective is to explain observations pertaining to two time periods,  $t_1$  and  $t_2$ , through differences in the relevant data between those periods.

In contrast, non-equilibrium or process theories take the interval  $t_1$ - $t_2$  as comprising a single unit of observation. This difference in orientation brings along several differences from equilibrium theories in its analytical train. Theory pertains directly to history, as against being interpreted as history. Economic explanation pertains to movies, as it were, and not to snapshots taken at different instants. The method of analysis is *emergent dynamics* (which has nothing to do with differential equations) rather than *comparative statics*.

Where equilibrium theory posits exogenous shocks to insert change into a situation, non-equilibrium theory treats change as an emergent feature of interaction among plans pursued by economizing agents. For a process-oriented social theory, genuine shocks are rare, perhaps as illustrated by a meteor strike. What are typically described as exogenous shocks within the framework of equilibrium theory are rather manifestations of the continually clashing of plans that are a feature of open-ended processes of creative interaction. Equilibrium theory focusses on resource allocations and reduces economics to acts of choice. Non-equilibrium theory focusses on the arrangements of human governance, with resource allocations being emergent by-products of those arrangements. Finally, non-equilibrium theory operates through complex ecologies of networks, in contrast to the simplicity of field-based theories that characterize equilibrium theories.

This difference in analytical windows corresponds reasonably well to the distinction between neoclassical and Austrian economics. To be sure, this course focusses on pursuing economic theory in a non-equilibrium mode without paying much attention to historical pedigree. Since this course is a continuation of 880, I will assume that you have a solid understanding of the material explored in 880. You should remember, however, that I am interested in past theoretical articulations only to the extent that they prove helpful in arriving at new theoretical articulations. *In this course we are looking to create new theory more than to appreciate old theory.*

## Course Texts and their Use

There are three texts for this course, each available in paperback. In referring to “texts”, I should also note that I don’t use class time to explain texts. Doing that would be a backward-looking activity, and I want only to look forward. Besides, if something has been published you should be able to read it, even if it might take some strenuous effort. The point of this class is to look for ways of pursuing process theories in directions they haven’t been previously pursued. The three texts I have adopted serve different purposes within my scheme for the course.

First, Jason Potts’s *The New Evolutionary Microeconomics* is strongly compatible with Austrian- and process-style reasoning. At the same time it introduces some analytical frameworks that I think can be usefully incorporated into working with these ideas and intuitions. In particular, Potts distinguishes between field-based theorizing and network-based theorizing. The former is suitable for equilibrium theorizing, the latter is necessary for non-equilibrium theorizing.

Second, Peter Boettke’s edited collection titled *Handbook on Contemporary Austrian Economics* has eleven essays that cover most of the course themes. All of these essays are written by GMU graduates. Each of these authors has already established a professional presence, some of them quite a strong presence. Not only will the essays in this book give insight into substantive topics, but also they will allow you to form some judgment of your own scholarly progress, at least with respect to those who have preceded you in going through the GMU program.

Third, my *Mind, Society, and Human Action: Time and Knowledge in a Theory of Social Economy*, provides the organizational framework the course will follow, though I should note that I will not look back to that book but rather will use that book as a platform for going forward in the construction of an alternative scheme for economic theory. The Preface explains how I came to write that book, and now I am in midst of writing additional books that will elaborate and refine various themes I sketched in *Mind, Society, and Human Action*.

While these are the only text-like readings for the course, they are not the only items I expect you to read. The way I approach advanced graduate courses leads me

to leave to you much of your selection of reading material. While I could easily swamp you with suggested readings simply by taking samples from some of my bibliographies, I prefer to have you participate in selecting your readings. For one thing, your future success will depend upon your ability to select useful readings to advance your projects, and this ability is something you acquire through practice. Furthermore, and to recur to an image I have often used, I like a classroom to resemble an improvisational jazz quintet where I offer some riffs now and then, more than a symphony orchestra that I conduct, though I recognize that my ability to do this varies inversely with the size of a class. Some variety among you in the particular things you have read can create interesting forms of classroom interaction that are less likely to occur when everyone is on the same page, so to speak, with respect to readings. Like Shakespeare in *Tempest*, I embrace the idea that the past is but prologue; my use of those texts is to provide orientation for our exploration for potential new theoretical articulations.

## Course Format

The format this course follows reflects my belief that scholarly activity can be reasonably placed into two categories: *exploration* and *exploitation*. You are probably familiar with these categories as they pertain to mining-type activities. Just as one might put a good deal of effort into exploring for good sites to mine for gold or drill for oil, a scholar likewise spends a good deal of time looking for good topics for scholarly articulation. Not all exploration uncovers exploitable material, either mineral or scientific. Once such material is found, exploitation starts, with the objective now being the development of publishable work based on that preceding exploration.

The semester contains 14 class sessions. The first 12 sessions will be devoted to exploration. Those sessions will be divided into four units. The class will start with a two-week unit on methodology, followed by three-week units on praxeology and on catallaxy, and ending with a four-week unit on macro theory. The final two class sessions will be devoted to exploitation, where each of you will make a seminar-style presentation of a research paper on market process theory.

Each unit for the four exploration sessions will have two parts. The first part will entail my presentation of potential research topics in a manner that extends, amplifies, or redirects economic ideas pertinent to that unit. That part of the unit will center on a set of ideas and questions that I will send you in advance of the first session of that unit. For the second part (final week) of that unit, each of you will prepare and present a short (three or four page) essay where you sketch some line of thought that you think has potential for advancing economic theory in a process-oriented motif.

For these exploratory units, I will adopt the posture of a conference organizer who has issued an invitation to submit proposals for papers. A common format for such invitations starts with some text that introduces the thinking of the conference

organizers, followed by an illustrative list of topics. I will start with a few paragraphs to frame the unit and continue with a number of bullet points to elaborate some substantive issues. The first part of each unit will proceed through my examination and our discussion of those bullet points. The second part (final week) will proceed through your presentation and our discussion of your proposals for that hypothetical conference.

The exploitation sessions will occur the final two sessions of the semester. In these sessions, each of you will present drafts of your research papers. There are two Thursdays where I have schedule conflicts that will require a change in meeting dates. Those conflicts occur on 12 February and 30 April. For each date I will substitute a Friday morning meeting, for which I will provide modest compensation in the form of lunch. The dates for those substitute sessions are 27 March and 24 April. This schedule means that your seminar presentations will occur on 23 and 24 April.

To summarize, here is the schedule for our meetings:

Unit 1: 22 and 29 January.

Unit 2: 5, 19, and 26 February.

Unit 3: 5, 19, and 26 March.

Unit 4: 27 March, 2, 9, and 16 April

Exploitation presentations: 23 and 24 April

No class meetings: 12 February and 30 April

Also no class meetings: 12 March (spring break) and 7 May (final exam scheduled)

## **Program for Exploratory Sessions**

### **Unit 1: Some Methodological Issues regarding “Social Economy”**

In thinking about society and its various cousins, we face the problem that we cannot directly apprehend our object by observation. That object can only be apprehended through some preceding act of theorizing, about which options exist. After all, no one has ever seen the object commonly denoted as “economy.” For process oriented theories of social phenomena, complex objects of analytical interest are generated through interactions among simpler entities. You cannot reasonably theorize about social phenomena by making reference to other social phenomena, but rather must use a generative mode of analysis where social configurations emerge from or are generated through interaction among simpler entities, typically individuals. These methodological matters become particularly significant once we recognize that the methods we use influence both the questions we ask and the answers we give. In other words, methodology is not orthogonal to substance, but rather interacts with substance.

*Textual Readings:* Potts, Chs. 1-2, 8; Boettke, Chs. 1-2; Wagner, Chs. 1-2.

## **Unit 2: The Person and Human Action inside Society**

Leonard Savage opens his *Foundations of Statistics* with a section titled “The Person,” where he sets up his approach to human action in a statistical framework that takes account of personal qualities and not just objective features of an environment. While this is not a course on statistical theory, conceptualizing the person is central to pursuing a research program of non-equilibrium theorizing. In consequence of its equilibrium presumption, orthodox economics mostly proceeds as a series of exercises about individual optimization. In these formulations, society is background that does no significant work because the scope for such work has been neutered by the presumption of equilibrium, as an illustration of how methodology influences substance. In contrast, non-equilibrium theorizing treats society as its object of analysis, and with any individual person engaged in continual interaction with other persons. This change in analytical orientation toward the person leads in turn to different orientations toward rationality, behaviorism, time preference, team production, altruism, and self-interest from what one finds in the orthodox literature. It is noteworthy in this respect that Carl Menger viewed such societal phenomena as law, politics, custom, norms, and money as emergent properties of human interaction in the face of scarcity and the conflict, latent or real, that accompanies scarcity.

*Textual Readings:* Potts, Chs. 5-6; Boettke, Chs. 3-4; Wagner, Chs. 3-4, 8.

## **Unit 3: Prices and Markets as Emergent Qualities of Human Interaction**

Orthodox micro theory is often characterized as “price theory” or “market theory,” and yet it is really not much of either, at least in a substantive as distinct from formal fashion. Price, for instance, is not treated as set of strategies through which a firm seeks to generate revenue; instead it is treated as a scalar that a firm takes as a piece of data. Left out of this formulation is the continuing process by which firms seek to generate revenue which, in turn, leads to prices having an emergent quality as against being data. The same point applies to markets. “Market” is an abstract noun that pertains to networks of transactions and relationships among participants in those transactions. Within the conventions of private property, moreover, markets are a form of societal commons whose features are emergent qualities of interactions among entities that choose to engage in activities within the relevant domain. What is surely especially notable about markets is their continual evolution, and in many ways. Markets are not at all adequately described as some given structure because adequate description requires recognition that any perceived structure is continually changing through the ceaseless efforts of market participants to pursue commercial success.

*Textual Readings:* Potts, Ch.7; Boettke, Chs. 5-7; Wagner, Chs. 5-6.

## **Unit 4: Systems Theorizing and Ecological Macro Theory**

The micro-macro relationship is one of parts to whole, which is not at all reasonably captured by reducing macro to micro through working with either representative agents or statistical representations. Standard macro theory presents a peculiar situation: it's impossible to produce pencils independently of a market process, as Leonard Read (1958) explains, and yet standard macro theory reflects the presumption that it is easy to plan the production of pencils. The move from parts to whole (from micro to macro) is a move in the direction of increasing complexity with increases in the number of parts that are brought into that whole. A theory of the whole should thus involve analysis of an object that is of greater complexity than any of the objects that comprise that whole. Yet orthodox macro theory treats its object as of equal simplicity with any of the objects that are but parts of that whole. What allows this reduction of complexity to simplicity to appear reasonable is the presumption that all observations pertain to states of equilibrium. This unit seeks to do better than that, and it explores some analytical challenges that such an effort must face.

*Textual Readings:* Potts, Chs. 3-4; Boetke, Chs. 8-11; Wagner, Ch. 7.

### **My Appraisal of Your Work (Grading)**

Your four exploratory essays will collectively count for 40 percent of your course grade. My evaluation of your research paper will also count for 40 percent of your course grade. The remaining 20 percent will be based on my evaluation of your classroom contributions, distributed across your presentations and your contributions to the presentations of others in the class (and for which I include my presentations).

I should perhaps explain that I never assign IN grades, nor do I accept late papers. My interest in this class is in helping you to become successful contributors to economic scholarship of a process-oriented genre. There are habits and practices that contribute to success, and there are habits and practices that detract from it and contribute instead to failure. Tardiness contributes to failure, so don't be tardy in submitting your work. If you have accepted an invitation to present a paper at a conference and then don't appear, perhaps because you haven't finished your paper, your reputation will be downgraded by conference organizers and participants. Someone who aspires to success will not incur such capital losses. Requesting a grade of incomplete is just a way of asking forgiveness for an unfinished paper, and I will have nothing to do with such failure-supporting conduct.

Your short essays will be due at the end of the final session for each of the four units. Your research paper will be due at 1630 on Thursday the 7th of May, which is when final exams are scheduled for courses that meet in our time slot, though this course will not have a final exam. (Toward the end of the semester, however, I will pass out a set of questions that will illustrate the kinds of questions I am likely to submit for the Market Process field exam.) You can submit your papers

electronically. You should also use a reasonable professional format that would be suitable for submitting papers to professional journals.

Most likely, you will select the substance of your research paper from one of your four short essays, though I don't require that you do so. My teaching objective in this course is to help to cultivate among you an interest in and talent for advancing economic theory within an Austrianeque orientation. In this respect, the future character of economic theory will be forged through competition among theorists who are injecting competing visions into the scholarly arena. Your research papers should aspire to make such contributions, as well as to help put you in a position to make further such contributions in the coming years.

I evaluate all of your written work on the basis of what I judge to be its publishable potential. I regard each of you as aspiring participants in the creation of the economic scholarship of the future, and I render my grades based on what I see as the potential in the contribution you have placed before me. While my evaluation of your proposals will be based on less information than my evaluation of your papers, my orientation is the same for both types of work. In both cases I seek to appraise the potential of what I read for carrying forward a process motif into economic theory.

With respect to your papers, a grade of **A** signifies that I think what I have read points in what I regard as a publishable direction if carried to what I judge to be its destination. A grade of **B** indicates that while you have convinced me that you show good understanding of your material, you have not shown me that you are headed in a publishable direction. A grade of **C** means that I detect some significant holes in your knowledge and understanding of your material. A grade of **F**, which is the only other recognized graduate grade means . . . , well, let me articulate that in private if I find it necessary to do so. (Various pluses and minuses are also possible grades because, similar to judging in diving and figure skating, I strive to create consistent ordinal rankings within each category.) My appraisal of your proposals follows the same principle, only the distinction reflects my readiness to assign you a slot at the conference.

### **Three Quotations to End the Syllabus on an Advisory Note**

I close this syllabus, as I have closed all of my recent syllabi, with three quotations that I believe speak valuably to your situation as advanced students standing on the edge of your future careers. The first two quotes have relevance for your daily activities. The third quote speaks more to a type of planning horizon, you might say.

First, from Samuel Johnson comes this recognition that fits well with Joseph Schumpeter's statement that theorizing starts with a pre-analytical cognitive vision that we try to articulate, with varying degrees of success:

Every man has often found himself deficient in the power of expression, big with ideas which he could not utter, and unable to impress upon his reader the image existing in his own mind.

Dr. Johnson describes a situation we all have to wrestle with in trying to render our intuitive hunches intelligible to others. Trying to go from intuitive hunches to sensible text is typically hard work and can be accompanied by a good deal of frustration. You cannot escape this situation. The only option is to work through it. So keep Dr. Johnson in mind when you find yourself struggling and wrestling with your material.

Second, from Albert Einstein comes this sage counsel (given to me by Roger Koppl):

If we knew what it was we were looking for, we wouldn't call it research, would we?

Research doesn't always yield happy endings. We write many more pages than we publish. The process of writing triggers thoughts that often lead us to recognize that where we thought we were heading isn't such a desirable place after all. So we change our angle of attack. Dead ends, cul-de-sacs, and just plain old frustration are part of the research process, and you must learn to persist in the face of such setbacks.

Third, during my student days I came across this statement from George Shackle's *Uncertainty in Economics* about what it takes to be a good economist (to be sure, Shackle wrote this in the 1950s, when few women studied economics):

To be a complete economist, a man need only be a mathematician, a philosopher, a psychologist, an anthropologist, a historian, a geographer, and a student of politics; a master of prose exposition; and a man of the world with experience of practical business and finance, an understanding of the problems of administration, and a good knowledge of four or five languages. All this is, of course, in addition to familiarity with the economic literature itself.

As for the type of person best suited to the study of economics, Shackle later suggests it is

. . . the outstanding intellectual all-rounder with some leaning towards the arts rather than the natural science side. The person who finds mathematics fascinating without, perhaps, marching through the school course with that instinctive and professional certainty that would mark him as an out-and-out mathematician; who betrays a connoisseurship of words and a delight in language, a gift for expression in English and



a sufficient pleasure in the classical languages to awaken thoughts of scholarships, without really promising to become a Porson's prizeman; who can find in every chapter of the history book the universal and eternal problems of man's dependence on his fellow-men side by side with his rivalry and conflict with them, and can see with the historian's eye the age-long empirical struggle to reconcile self-interest and enlightened compassion; who delights in maps and finds them, perhaps, more interesting than test tubes—this is the potential real economist.

What Shackle describes is a lifetime project and not something you can accomplish during your few short years as students. But post-student life lies ahead of you, and I think Shackle's statement is, among other things, a lovely summary of the central qualitative distinction between an Austrianeque orientation toward social economy and the orthodox reduction of economics to a set of exercises on individual optimization (or failures of optimization).