

The Theory of the Market Process I

The body of economic knowledge is an essential element in the structure of human civilization; it is the foundation upon which modern industrialism and all the moral, intellectual, technological, and therapeutical achievements of the last centuries have been built. It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not annul economics; they will stamp out society and the human race.

- Ludwig von Mises, *Human Action*

This course will be organized around the theme of the Austrian School of Economics in 4 acts: the founders, the developers, the moderns, and the contemporaries. We will spend roughly 3 weeks per act, and we will focus on specific authors and their contributions each week. The founding period will be represented by Carl Menger, Eugen Bohm-Bawerk and Frederic Wieser. The development phase will be represented by Ludwig von Mises, Joseph. Schumpeter and F. A. Hayek. The modern phase will be Murray Rothbard, Israel Kirzner and Ludwig Lachmann. And, the contemporary period will be represented by the work of Don Lavoie, Mario Rizzo, and others.

The Austrian School of Economics has a long and distinguished history as significant contributors to what I have dubbed mainline economics. Paul Samuelson, e.g., in his obituary of Swedish economist Bertil Ohlin, decided to play the game of "what if" -- in this case, "what if the Nobel Prize was established in 1900, then who would have won the prize between 1901 and 1930?" This is list of names Samuelson thinks would have won the prize:

One cannot forbear playing the game of might-have-been. Here is the most likely scenario of awards from 1901 on: **Bohm-Bawerk**, Marshall, J.B. Clark, Walras, and *Wicksell*; **Carl Menger**, Pareto, *Wicksteed*, Irving Fisher, and Edgeworth; Sombart, Mitchell, Pigou, Adolph Wagner, Allyn Young, and *Cannan*; *Davenport*, Taussig, **Schumpeter**, Veblen, and Bortkiewicz; Cassel, J. M. Keynes, Heckscher, J. R. Commons, and J. M. Clark; Hawtrey, **von Mises**, Robertson, H. L. Moore, and *F. H. Knight*.(1981, p. 358, n1, emphasis added)

I have marked in **bold** the members of the Austrian School of Economics in his list, however, in this same list I have *italicized* those that were particularly close in substance to the Austrians though not part of the Viennese intellectual community. And, I am probably missing cross influences, and it is important to note that the cut off for Samuelson's thought experiment was 1930, so he does not have listed figures such as Fritz Machlup and Oskar Morgenstern, let alone

Hayek or Lionel Robbins, all of whom made their major contributions to economic science after 1930. By this accounting, not only is the Austrian School of Economics distinctive, practitioners in the school of thought are among the most distinguished contributors to the scientific conversation in economics, political economy and social philosophy throughout the 20th and into the 21st century. This is also seen in the honors and acknowledgements that they were awarded during their scientific/scholarly careers: distinguished professorships, professional awards in recognition of scientific achievements, editorships of top scientific journals, and offices held in learned societies. Mises, e.g., was named the Distinguished Fellow of the AEA in 1969, and Hayek was awarded the Nobel Prize in Economic Science in 1974.

In my own work, e.g., *Living Economics* (2012), I have come to contrast mainline economics with mainstream economics, where mainline refers to the foundational principles of economics and continuity in the development of those core principles from Adam Smith to contemporary thinkers, whereas mainstream refers to whatever is currently fashionable among so-called elite economic thinkers at any point in time. Sometimes the mainline is the mainstream, but at other times, the mainstream deviates significantly from the mainline, and it is precisely at these moments of disjoint that often schools of thought emerge in economics to stress the necessity of core fundamental principles. In my reading of the history of political economy, the mainline of economics is connected to “invisible hand” reasoning, and, in particular, it is related to the theoretical effort to derive the “invisible hand proposition” from the “rational choice postulate” *via institutional analysis*. David Hume’s argument in his *Treatise in Human Nature* on the foundational role of the institutions of property, contract and consent for social cooperation among humans has been central to the development of economic thought and understanding ever since. In this way, the pure logic of choice is married with situational logic of exchange and production to produce both economic theory and its application to render intelligible the operation of commercial society. This is also the intellectual terrain where in the contemporary presentation of the theory of the competitive market process (Kirzner) is complemented by developments and refinements in law and economics (Coasean), property rights economics (Alchian and Demsetz), and public choice economics (Buchanan and Tullock). The resulting dynamic model of the entrepreneurial market process and the political process has influenced on various margins thinkers of the older generation such as Douglass North and Janos Kornai, or current senior scholars such as Deirdre McCloskey and Joel Mokyr, or contemporary superstars of our profession such as Andrei Shleifer and Daron Acemoglu.

As we will learn, the Austrian School of Economics is a branch of neo-classical economics, but from Menger onward subtle differences in the way the principles of economics were understood and presented were evident. So evident are these subtle differences, in fact, that the Austrian School of Economics has been recognized as unique since its founding 150 years ago. Menger is recognized as one of the three scientific innovators that produced the Marginal Revolution, but his consistent subjectivism set him apart from the others. See this nice discussion by GMU alumni Caleb Fuller ... <https://www.econlib.org/library/columns/y2021/fulleraustrian.html>

The required books for the course are Mises’s *Human Action*; Hayek’s *Individualism & Economic Order*; and Rizzo’s *Austrian Economics Re-Examined*. I will not be assigning any particular page assignments per lecture, instead, you are expected to read all 3 books through the course of the semester – the best way to do that is to make a healthy use of the table of contents, index, and

references in these texts and match to the lecture topic of the week. Yes, I *italicized* references for a reason – as a scholar, you must learn to read footnotes, and excavate the knowledge embedded in footnotes and references. To contextualize the past, but also to draw the line from the past to the present and present to the past when appropriate for the purposes at hand.

As background, you might find it helpful to read the following historical treatments of the Austrian School, or at least synopsis of these works and/or reviews that are accessible. First, Erwin Dekker's *The Viennese Students of Civilization*. Second, Karen Vaughn's *Austrian Economics in America*. And, third, Janek Wasserman's *Marginal Revolutionaries*. This exercise will be important to historically situate the Austrian School in the literature on the history of economic thought. Furthermore, to familiarize yourself with the main contributions of the Austrian School, I would also suggest consulting the following reference volumes I have edited: (1) *Elgar Companion to Austrian Economics* (1994); (2) *The Handbook of Contemporary Austrian Economics* (2010); and *The Oxford Handbook of Austrian Economics*, with Chris Coyne (2015). These books will be valuable throughout the term (and in fact your career) as reference works, but there really is no substitute for the original works themselves. Finally, one easy way to familiarize yourself with contemporary Austrian School of Economics would be to read the presidential addresses for the Society for the Development of Austrian Economics from 1996 to the present ... <https://www.sdaeonline.org/about>

For those completely unfamiliar with the Austrian School of Economics, perhaps my monograph with Chris Coyne – *The Essential Austrian Economics* (2020) will provide a useful overview of the basic tenets as well as the videos associated with this monograph. <https://www.fraserinstitute.org/studies/essential-austrian-economics> . I would also recommend you look at Don Boudreaux's *The Essential Hayek* as well as the videos associated with that monograph. <https://www.fraserinstitute.org/studies/essential-hayek>

In fact, I would recommend all the Fraser “Essentials” monographs and instructional videos as helpful to providing a thorough background on the economic ideas you will be exploring and eventually teaching. They are very well done in my opinion.

If you have had some exposure to Austrian ideas but would benefit from an overview, I would recommend the video course by Richard Ebeling and his corresponding book.

<https://www.fff.org/freedom-in-motion/video/introduction-austrian-economics-part-1/>

<https://www.fff.org/freedom-in-motion/video/an-introduction-to-austrian-economics-part-2/>

<https://www.fff.org/freedom-in-motion/video/an-introduction-to-austrian-economics-part-3/>

<https://www.fff.org/explore-freedom/article/introduction-austrian-economics-part-4/>

<https://www.fff.org/freedom-in-motion/video/an-introduction-to-austrian-economics-part-5/>

<https://www.fff.org/freedom-in-motion/video/an-introduction-to-austrian-economics-part-5-2/>

<https://www.fff.org/explore-freedom/article/introduction-austrian-economics-part-7/>

<https://www.fff.org/explore-freedom/article/an-introduction-to-austrian-economics-part-8/>

<https://www.fff.org/explore-freedom/article/introduction-austrian-economics-part-9/>

Or, you can consult the book and 7 part video series by Steve Horwitz
<https://youtu.be/J5Xx736haOA>

These videos are all in relatively short format, so easily digestible.

Class Format

Each week we will have a lecture running roughly 1 hour to 1 hour and 15 minutes, followed by break and then open discussion for the remainder of the class.

Date	Topic
Aug 25 th	Course Introduction: The Austrian Contribution to Economic Science, Political Economy and Social Philosophy
Sept 1 st	<u>The Mengerian Revolution</u> : <i>Methodenstreit</i> & the Methodology of the Social Sciences
Sept 8 th	<u>The Mengerian Revolution</u> : Value, Costs, Prices
Sept 15 th	<u>The Mengerian Revolution</u> : Time & Production Activities
Sept 22 nd	<u>Mises & Hayek</u> : Money & the Role of Monetary Calculation
Sept 29 th	<u>Mises & Hayek</u> : Economics as a Coordination Problem
Oct 6 th	<u>Mises & Hayek</u> : The Socialist Calculation Debate
Oct 13 th	<u>Modern Austrian Economics</u> : The Keynesian Diversion
Oct 20 th	<u>Modern Austrian Economics</u> : Market Process Theory & Application
Oct 27 th	<u>Modern Austrian Economics</u> : The “Libertarian” Moment in Two Parts
Nov 3 rd	<u>Contemporary Austrian Economics</u> : A Methodological Reawakening
Nov 10 th	<u>Contemporary Austrian Economics</u> : Internal Debates, and External Opportunities
Nov 17 th	<u>Contemporary Austrian Economics</u> : New Directions
Nov 24 th	Thanksgiving break
Dec 1 st	Course Conclusion: What is the Austrian School of Economics Today?

Grading Policy

We will have 3 sources for your course grade. Four essays 6-8 double spaced pages due roughly at the end of each of the sections. A research paper that you are working on to submit to a peer-reviewed journal, such as *Review of Austrian Economics*. There will also be a take home final exam consisting of 5 questions that will be designed to prepare you for the field exam if you so choose to pursue that path in your graduate career.

The short essays will constitute 25%, final exam 25% and the research paper 50% of your final grade.

I do expect active and engaging participation from everyone in this class. To reiterate this is a graduate level economics course in a specialized sub-field that *you* have expressed an interest in learning about, and perhaps devoting your scientific/scholarly life to exploring. Be ready to contribute.

Course Objectives

Upon completion of this course, you will:

- Understand the foundational contributions of the Austrian School of Economics
- Understand the major strands of academic literature in Austrian Economics in methodology, analytics, and applications to political economy and public policy
- Be able to synthesize existing ideas in the field of Austrian Economics and build on these ideas to generate novel contributions to this literature
- For MA students – be able to apply the core concepts in Austrian Economics to current events
- For PhD students - be able to write academic papers in the field of Austrian Economics suitable for peer review.