Economics 881
Theory of the Market Process II
Spring 2013
Tuesdays, 1630-1910
Enterprise Hall, 275

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You will not be far off base if you view this course as examining through a different analytical window some of the material typically covered in first-year micro and macro courses. For the most part, the variables with which economists work cannot be apprehended through observation. Instead, they are products of prior construction, and with that construction being guided by some theoretical framework about which options exist. We can observe El Capitan or Half Dome in Yosemite, but we cannot observe any of the aggregate variables that are used in economic analysis. To the contrary, what we denote as observed variables are products of prior construction, much as the prisoners in Plato's allegory of the cave constructed variables from the images they saw on the wall of the cave.

With respect to Friedrich Nietzsche's oft-noted reference to looking through windows, there are two main analytical windows through which economic variables can be constructed and then observed. What Professor Boettke describes as the mainstream window treats economic variables as pertaining to equilibrium states at some historical moment, as reflected in the method of *comparative statics*. By contrast, what he describes as the mainline window treats economic variables as pertaining to the pursuit of plans by actors without any presumption of systemic equilibrium, as reflected in the method of *emergent dynamics*.

This difference in analytical windows corresponds reasonably well to the distinction between neoclassical and Austrian economics. For this course I have incorporated the readings that Professor Coyne used in 880 and will assume throughout the semester that you have a solid understanding of the ideas explored in those readings. My interest in this course, however, is in pursuing the mainline or emergent dynamic orientation toward economic phenomena without much concern for the genealogy of the theorists or theories.

There are four texts for this course, three of which are available in book form. Each of these books fills a different niche in my plan for this course. First, Professor Boettke's edited collection Handbook on Contemporary Austrian Economics, pretty much follows the organizational format this course will follow. Where he has a three-part framework: methodology, micro, macro, I will follow a four-part framework: methodology, micro, meso, and macro.

Second, Jason Potts's *The New Evolutionary Microeconomics* is strongly compatible with Austrian-style reasoning, and at the same time introduces some analytical frameworks that I think can be usefully incorporated into working with Austrianesque ideas and intuitions. In particular, I refer to Potts's use of graph theory along with the ability of graph theory to lead directly into agent-based computational modeling.

Third, Jane Jacobs's *Systems of Survival* is something I commend to you for several reasons, to say nothing of my great admiration for her body of work. For one thing, her analytical framework is a form of emergent dynamics. Furthermore, her objects of analytical interest are systems of human interaction and governance, and with those systems not being reducible to some stylized optimizing choice within some equilibrated system. Beyond this, her open analytical framework opens a window into how history can unfold in negative and not just in positive directions, contrary to what might be gleaned from the mostly unidirectional movement of aggregate accounting indicators.

Fourth, I will make available a PDF version of the penultimate version of my *Mind, Society, and Human Action: Time and Knowledge in a Theory of Social Economy*, which Routledge published in 2010 and which has not yet issued in paperback. While this version has some modest substantive differences from the final version, due mostly to copy editing, the most significant differences are cosmetic, as illustrated by pagination, an index, and the actuality of a book. You should also examine the symposium on the book sponsored by *Studies in Emergent Order* which Virgil Storr edits and which features essays by Adam Martin, Peter Boettke, Roger Koppl, Paul Lewis, and Bruce Benson.

While these are the only readings to which I make explicit reference, these are not the only items I expect you to read. The way I approach advanced graduate courses, however, is one that leads me to leave much of your selection of reading material up to you. While I could readily 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 vary with 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 a few riffs now and then and not a symphony orchestra that I conduct. 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

To put this point differently, my primary interest in this course, as in all my advanced graduate courses, is in exploring for new formulations to articulate. To be sure, such articulation will require familiarity with past articulations, but those articulations are secondary—as flying buttresses to my primary interest, you might say.

The course material will be explored in four units of three weeks each. These 12 sessions leave us two sessions short of the 14 sessions called for by the academic calendar. Experience with past spring semesters tells me that most of you will miss the 16 April class to attend the APEE meetings. I think this is a worthy activity, so I cancel class that day. Actually, I don't cancel it but postpone it. I will cancel a second class in late April, and replace both of those classes with a double session, also late in April. This double session will take place on either a Friday or a Saturday depending on your schedules and preferences. It will start in the morning, break for lunch which I will provide, and end in mid-afternoon. This session will be devoted to your presentation of drafts of your research papers, along with discussion of those drafts.

For each of the four three-week units, the first two weeks will be devoted to my presentation of potential research topics in a manner that extends, amplifies, or redirects economic ideas pertinent to that unit. For each of those units, my presentation will elaborate on a brief sketch of ideas and questions that I will send you in advance of the first session for that unit. The third week in that unit, each of you will prepare and present a short (three to five page) paper where you sketch some line of thought that you think has potential for advancing economic thought.

Course Organization

Unit 1: Matters of Scope and Method

In several places I have written that I regard methodology in economics as similar to seasoning in cooking: the seasonings are not the meal, but you wouldn't want to prepare your meal without using them. Methodology is not economics, but you can't do sensible economics without some awareness of methodology. Our variables of interest are not directly visible to the senses and instead are products that we construct prior to our analytical efforts. This situation creates some knotty problems that we will examine. Also relevant to this unit is whether economics should follow what is thought to be the method of the natural sciences or whether economics should proceed in *sui generis* fashion. 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.

Readings:

Boettke, *Handbook*, Introduction plus Chs. 1-3.
Potts, *Evolutionary Microeconomics*, Chs. 1-2.
Wagner, *Mind, Society, and Human Action*, Chs. 1 & 2.

Unit 2: Micro: Conceptualizing the Person and Human Action

In his *Foundations of Statistics*, Leonard Savage opens with a discussion titled "The Person" where he seeks to set up his approach to human action in a statistical framework that takes account of personal qualities and not just objective features of some external environment. This is not a course on statistical theory, of course, but conceptualization of the person is central to pursuing a mainline research program that offers an alternative to the mainstream program. In consequence of its equilibrium presumption, mainstream 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, mainline economics treats society as its object of analysis, and with any individual person engaged in a series of interactions 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 mainstream literature.

Readings:

Boettke, *Handbook*, Chs. 4-7.
Potts, *Evolutionary Microeconomics*, Chs. 5-6.
Wagner, *Mind, Society, and Human Action*, Chs. 3-4.

Unit 3: Meso: Between Micro and Macro through the Emergence of Institutions

Mainstream 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, and instead is treated simply as a scalar that, moreover, a firm must take as given. Left out of this formulation is the continuing process by which firms seek to generate revenues which, in turn, leads to prices having an emergent quality as against being data that must be accepted.

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 by some such scalar as price, for adequate description requires recognition both of structural patterns and of continual evolution in those patterns as an emergent feature of the ceaseless efforts of market participants to produce successful offerings.

It is noteworthy that Carl Menger viewed law, politics, and money as all emergent properties of human interaction in the face of scarcity and the conflict, latent or real, that scarcity entails. Following in this Mengerian path, this unit incorporates collective activity into market-based activity. In particular, conflicting rationalities are set in motion by different forms of property rights and the social relationships that are established through those different forms. Jane Jacobs is particularly illuminating in her treatment of monstrous hybrids that can arise through political-economic interaction.

Readings:

Jacobs, Systems of Survival, Chs. 1-14.
Potts, Evolutionary Microeconomics, Chs. 3-4.
Wagner, *Mind, Society, and Human Action*, Chs. 5-6, 8.

Unit 4: Macro: Theorizing about Turbulent Ecologies

The micro-macro relationship is one of parts to whole. The central principle of mainline economics is that the various parts that constitute an economy fit together reasonably well even though no person has the ability to fit those parts together. Nowhere is this theme presented more crisply than in Leonard Read's essay *I, Pencil*, which is available from FEE and which all of you should read. Despite this recognition of the impossibility of someone even articulating a genuine plan for the production of pencils, which is altogether different from assembling ingredients that have been created through market processes, many macro theorists reduce the world to a one-good model of aggregate output. Hence we have a most peculiar situation: it's impossible to produce pencils independently of a market process, and yet standard macro theory operates on the presumption that it is easy to produce pencils through policy planning.

The move from parts to whole 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 mainstream 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. The mainline orientation seeks to do better, and this unit explores some analytical challenges that such an effort must face. (I should perhaps also note that while I think mainstream macro is a conceptual abomination for reasons I have just asserted, I also think that it is the macro or systemic level of theorizing where the material of greatest analytical significance lies and which, therefore, is in greater need of our reformatory effort than is micro theory.)

Readings:

Boettke, *Handbook*, Chs. 8-11.
Potts, *Evolutionary Microeconomics*, Chs. 7-8.
Wagner, *Mind, Society, and Human Action*, 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 mainline economics. 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 third session for each of the four units. Your research paper will be due at 1630 on Tuesday the 14th of May, which is when final exams are scheduled for courses meeting in our time slot. You can submit these papers electronically. You should also use a reasonable professional format that would be suitable for submitting papers to professional journals. (Among other things, don't send me single spaced papers.)

Most likely, you will select the substance of your research paper from one of your four short essays, though I do not 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 a mainline or Austrian 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 an aspiring participant 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. In this respect, a grade of **A** signifies that I think what I have read points in 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, and I think you can attach reasonable meaning to those grades by extrapolation.)

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. The first two quotes have relevance for our 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, of course, more on the order of a lifetime project than something to be accomplished during your few short years as students. But you do have post-student life ahead of you, and I think Shackle's statement is, among other things, a lovely summary of the central qualitative distinction between mainline and mainstream economics.