

Economics 881
Theory of the Market Process II
Spring 2014
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*. To illustrate this distinction, suppose you have sets of observations pertaining to two time periods, t_1 and t_2 .

Equilibrium theories treat each set of observations as reflecting equilibrium among the data for each period. Differences between the two periods are by the method of comparative statics explained as the product of exogenous shocks to the data. History is irrelevant to this analytical scheme, though one can and many do interpret the different configurations pertaining to t_1 and t_2 as illustrating history.

By contrast, non-equilibrium theories take the interval t_1 - t_2 as comprising a single unit of observation. Theory in this case pertains directly to history. Economic explanation thus pertains to movies, as it were, and not to snapshots taken at different instants. This alternative analytical schema proceeds through *emergent dynamics* rather than *comparative statics*. Where equilibrium theory treats change by postulating exogenous shocks to data, non-equilibrium theory treats change as an emergent feature of interaction among plans pursued by economizing agents.

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 great concern for historical pedigree. All the same, I will assume throughout the semester that you have a solid understanding of the material Professor Coyne explored in 880. You should remember, however, that I am not interested in past theoretical articulations in their own right; I am interested in them 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.*

There are two texts for this course, both of which are available in paperback. First, 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 Austrian ideas and intuitions. Second, 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.

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 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 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. 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, however, 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. The final two sessions will be devoted to exploitation, where each of you will make a seminar-style presentation of a research paper on market process theory.

The exploration sessions will proceed through four units of three weeks each. For each of the 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. That presentation 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 third week in 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 open 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 two weeks of each unit will proceed through my examination and our discussion of those bullet points. The third week will proceed through your presentation and our discussion of your proposals for that hypothetical conference.

The exploitation sessions will occur at the end of the semester. These sessions will entail your presentation of drafts of your research papers in seminar fashion. There will be no class on 6 March because I will be at the meetings of the Public Choice Society. That class will be replaced by a special class session Friday morning the 2nd of May. Hence, the full set of your seminars will take place the first two days of May, the afternoon of Thursday the 1st and the morning of Friday the 2nd.

Program for Exploratory Sessions

Unit 1: Some Methodological Issues regarding “Social Economy”

In several places I have written that I regard methodology as similar to seasoning in cooking: the seasonings are not the meal, but you wouldn't want to cook without them. Methodology is not economics, but you can't do sensible economics without dealing with methodological matters. For instance, our analytical material is not directly visible to the senses and instead is constructed in some fashion. After all, no one has ever seen the object commonly denoted as “economy.” To the contrary, that object is itself a product of theoretical construction. This situation creates some knotty problems that we will examine in this unit. 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. For instance, is economics a branch of ethology or are there significant differences between theorizing about mammals and about human societies? 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; 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 law, politics, and money as being 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; 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 given. 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 both of structural patterns and of continual evolution in those patterns as emergent features of the ceaseless efforts of market participants to produce successful offerings.

Textual Readings: Potts, Ch.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; 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. 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 Thursday the 8th of May, which is when final exams are scheduled for courses that meet 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 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 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. 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, of course, a lifetime project rather than something to be accomplished 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).