

Fall 1979

Volume 2 Number 2

## The Rutgers Conference on Inflation

by Tyler Cowen

Inflation is clearly the most pressing contemporary economic problem. Both its severity and its coexistence with high rates of unemployment were unexpected by, and therefore rather damaging to, the "Keynesian" theorists who had dominated the economic profession for a generation. The inflation crisis has thus

spawned a growing interest in economic theories which both stress the dangers, and offer alternative analyses of the causes of rising prices. The Chicago school's critique of the Phillips curve, Leijonhufvud's contrast between Keynes and the Keynesians, the rational expectations criticism of naive fine-tuning ma-

croeconomic policy, and the growing interest in the Austrian tradition all stem in part from this increased awareness of the dangers of inflation.

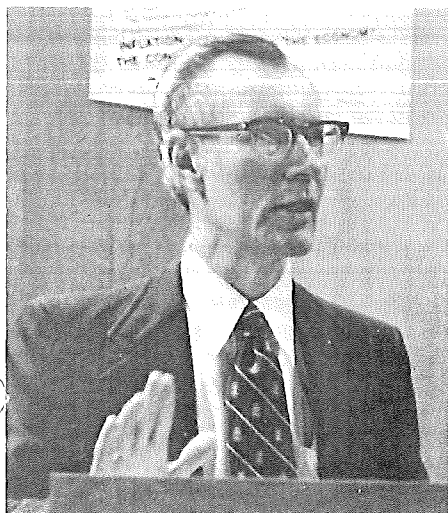
Such concerns were evident on April 28th and 29th when the Newark College of Arts and Sciences, Rutgers University, hosted a conference entitled "Inflation: The Consequences for the Economy". Smoothly directed by Professor Richard Fink (Rutgers), the conference was co-sponsored by the Institute for Humane Studies and Rutgers-Newark, and proved to be the highlight of a successful year of Rutgers' new undergraduate program in Austrian economics. The conference drew a wide cross-section of attendees, including economists from all over the U.S. and England, Rutgers faculty and administration, business leaders, reporters, and graduate and undergraduate students.

A combination of presentations of papers, prepared comments, and discussion, the conference offered a broad overall survey of the inflation problem. Featured were three major panels which discussed the impact of inflation at the levels of the firm, the nation and the world. The first panelists, Thomas Taylor, John Egger and James Buchanan analyzed accounting under inflationary conditions. Then Gerald O'Driscoll, Huston McCulloch and Axel Leijonhufvud examined the domestic consequences of inflation. The international repercussions of inflation were discussed by Leland Yeager, Gottfried Haberler and Joseph Salerno. In addition to the panels, individual lectures were delivered by Martin Feldstein and Ludwig Lachmann.

The first session was entitled "Austrian Insights into Accounting Under Inflationary Conditions". Thomas Taylor of Wake Forest University, an accountant, as well as an economist, integrated Austrian insights into accounting practice in general and dealt with some specific accounting problems caused by inflation. He criticized current accounting thought for failing to deal in terms of current market data and for its inability to compensate for the tendency for inflation to exaggerate profit



Thomas Taylor



Leland Yeager



James Buchanan

Continued on page 2

## The Rutgers Conference on Inflation

(Continued)

### AUSTRIAN ECONOMICS NEWSLETTER

Volume 2 Number 2

Fall 1979

The *Austrian Economics Newsletter* is designed as a research and communications device for work in Austrian economics. As such, it is essential that we have the active support and cooperation of our readers. We need any information which would be of value to other Austrians and we welcome any suggestions for improving the *Newsletter*. The success of the *Newsletter* fundamentally depends on our ability to encourage the participation and involvement of our readers.

#### Editor

Don C. Lavoie

#### Managing Editor

John Kunze

#### Editorial Board

Walter Block

Richard M. Ebeling

Richard Fink

Gerald P. O'Driscoll, Jr.

Mario J. Rizzo

Joseph T. Salerno

Gary Short

The *Austrian Economics Newsletter* is an independent project sponsored by the Center for Libertarian Studies. Published three times per year, annual subscriptions are \$7.50. (Students, \$5.00.)

Austrian Economics Newsletter  
200 Park Avenue South  
Suite 911  
New York, N.Y. 10003

margins. Taylor urged the accounting profession to abandon the "backward-looking" historical-cost method of evaluating assets, and to adopt a replacement value approach recognizing capital gains and losses in the profit figure. Taylor felt this approach held much promise, providing the replacement cost data was relevant to current values. Taylor suggested the use of a general capital maintenance price index to compensate for inflationary distortion. However he emphasized that since it is impossible to come up with a perfect price index it would be better to eliminate inflation than merely to treat its symptoms.

The first commentator, Professor James Buchanan (VPI) expressed strong reservations about Taylor's attempt, to reconcile Austrian subjective value theory with traditional accounting practice which aims at an objective measurement of cost and value. Any translation of these essentially subjective phenomena into objectively measurable magnitudes must ultimately be arbitrary, regardless of the method used. Buchanan wished to limit the function of accounting to recording the objective data of the market process (i.e. prices). Buchanan ended with a call for a clear explanation of the relationship between subjectivism and quantification.

John Egger (Towson State, Maryland) also responded to Taylor's paper. He felt the paper was highly praiseworthy because it successfully used Austrian capital theory and the idea of the market process to explain the proper function of the accountant. Most importantly, Taylor had emphasized the fact that capital in the accounting sense is a tool of economic calculation for the individual businessman. Egger displayed an even stronger scepticism about the use of index numbers under inflationary conditions. He felt that they could be useful as an addendum to an accounting report, but that it is basically the role of the entrepreneur or the investor, not the accountant, to interpret the price distortions caused by inflation.

During the question and answer period which followed several professional accountants expressed their views on Taylor's paper. The highlight of the ensuing discussion and perhaps of the whole conference occurred when Professor Ludwig Lachmann rose to his feet and spontaneously delivered a perceptive analysis of Taylor's paper. He expressed a sympathetic attitude towards the paper, but questioned to what extent Austrian theory is applicable to practical problems.

He stressed the difficulty of measuring asset values under disequilibrium conditions and concluded that the primary role of the accountant should be to inform the owners of a firm when managerial policy was leading to a loss of assets.

At the afternoon session, "The Domestic Consequences of Inflation", Professor Gerald P. O'Driscoll Jr. (NYU) explained a few Austrian insights into inflation, including their historical origin. He attacked explanations of inflation formulated in terms of wage and cost push which in fact could only cause shifts in relative prices, not a sustained rise of all prices. Such a sustained rise could only be due to monetary expansion. O'Driscoll saw Austrian monetary theory, as developed by Mises and Hayek, as the intellectual heir to a tradition started by Richard Cantillon, Henry Thornton, and Knut Wicksell. In contrast to the 19th century quantity theorists, the former tra-



John Egger

dition emphasizes short-run dynamics, the non-neutrality of money, and the importance of the transmission mechanism of inflation. O'Driscoll gave a brief outline of the business cycle, explaining how certain kinds of monetary expansion will generate additional investment in capital-goods industries. This investment, created only by the discoordination of the price system (especially the lowered rate of interest), becomes malinvestment, which must ultimately be liquidated. This liquidation is responsible for the ensuing economic downturn. This, the Mises-Hayek theory, is consistent with the current phenomenon of stagflation, in which we see both rising product prices and high levels of unemployment. O'Driscoll ended his talk by saying that only by ana-

*Continued on next page*

## The Rutgers Conference on Inflation

(Continued)

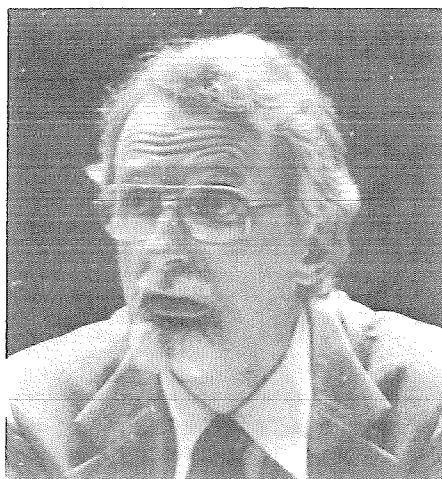
lyzing the distribution effects of inflation can we come to a satisfactory understanding of the political processes behind monetary expansion.

Professor Axel Leijonhufvud (UCLA) delivered the first comment on O'Driscoll's talk, beginning with a sharp attack on the Mises-Hayek theory of the business cycle. Although the theory is analytically coherent, he argued that it is not relevant to recent, if any, actual experience, claiming that we have not seen any general pattern of excessive roundaboutness, an essential characteristic of Hayek's *Prices and Production* scenario. He thought the weakness of the theory was in certain of its institutional assumptions, such as the specific transmission path of the monetary inflation. Leijonhufvud then offered an alternative explanation for recession, which he attributed to Keynes and Wicksell. When the marginal efficiency of investment falls or there is a real increase in saving, the market rate of interest will lag behind the natural rate. This "stickiness" of interest rates will be exacerbated by bearish speculators, who are gambling on the long-run stability of the interest rate. Because the market rate of interest is "too high", investment is not maintained, leading to a contraction of output and employment.

Professor J. Huston McCulloch (Boston College) also spoke on O'Driscoll's talk. He urged Austrians to abandon their definition of inflation as an increase in the money supply, and to adopt the contemporary definition of inflation as a general rise of prices, in order to avoid confusion. McCulloch spoke about what he considered to be two problems with the Mises-Hayek business cycle theory. The first problem is that of the "asymmetry" of the boom and bust cycle. McCulloch questioned why the lengthening of the capital structure was smooth and accompanied by a boom, but its shortening was abrupt and accompanied by a general business downturn. The second problem McCulloch noted was the empirical tendency for nominal interest rates to be high during the boom, and low during the bust, the exact opposite of what the Austrian theory predicts. Although he admitted that Mises and Hayek were concerned with real, not nominal rates of interest, and that deviations between the two could be explained by price expectations, he still felt this was an unsolved problem.

In response O'Driscoll conceded that the institutional assumptions of *Prices and Production* would have to be amended to be made applicable to contempo-

rary conditions. What is essential to Hayek's theory is the discoordination of resources caused by money, specifically, the disparity between savings and investment. However, many of the Austrians attending the session were disappointed that O'Driscoll declined to respond in detail to Leijonhufvud's spirited challenge to the Mises-Hayek theory. During the



Axel Leijonhufvud

discussion period Walter Block and Richard Ebeling spoke up in defense of Hayek. Block argued that the fact that we don't see over-investment in the capital goods industries doesn't mean it isn't there because we do not know what these industries would have looked like in the absence of inflation. Block answered two other points of Leijonhufvud by showing that even a fully anticipated inflation generates a cycle and by defending the concept of roundaboutness, distinguishing it from Böhm-Bawerk's faulty notion of the "average period of production". Richard Ebeling emphasized that the non-neutrality of money was the central point of Austrian monetary theory, and that Hayek's *Prices and Production* is only one particular scenario of this principle. Even if institutional changes have rendered *Prices and Production* somewhat dated, this in no way negates its central message—the non-neutrality of money.

The conference's guest lecture, entitled "Inflation, Taxes, and the Rate of Saving", was delivered by Martin Feldstein (Harvard), current President of the National Bureau of Economic Research. He began by criticising the economic profession for often encouraging inflation through such constructions as the Phillips curve. The focus of his talk was on how

*Continued on next page*

## Proceedings of NYU Conference Published

The papers presented at the January, 1978, New York University conference on Austrian economics (see review in *AEN*, Volume I, Number 2) have just been published. In a volume edited by Mario J. Rizzo, *Time, Uncertainty, and Disequilibrium: Exploration of Austrian Themes*, several prominent economists undertake a fresh evaluation of the perspectives emphasized by the Austrian school of economics. Nobel laureate Sir John Hicks examines crucial questions of equilibrium versus disequilibrium economics and applies his answers to the question, "Is Interest the Price of a Factor of Production?" G.L.S. Shackle develops a penetrating analysis of the conflict between imagination and choice on the one hand and technical formalism on the other. Harvey Leibenstein focuses on the connection between entrepreneurship and X-inefficiency. Harold Demsetz and Mario Rizzo examine some important issues in the rapidly developing economic analysis of law. Leland Yeager presents an insightful dissection of the Cambridge capital paradoxes. Finally, Gerald O'Driscoll, Jr., presents a fresh perspective on the important rational-expectations controversy which he relates to the political-business cycle literature. Other contributors are J. B. Egger, R. W. Garrison, I. M. Kirzner, L. M. Lachmann, S. C. Littlechild, and M. N. Rothbard (256 pp. \$19.95, Lexington Books, D. C. Heath and Company, 125 Spring Street, Lexington, MA 02173).

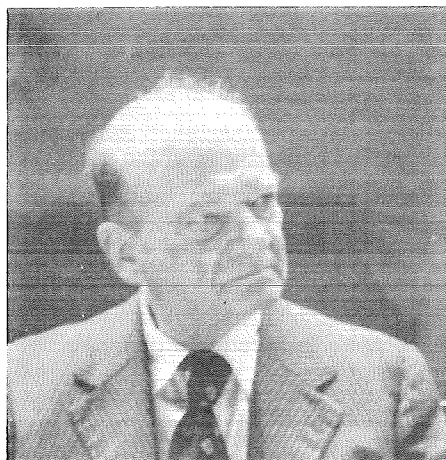
## NYU Update

The Austrian economics program at NYU's Graduate School of Arts & Science will be enhanced this semester by the addition of visiting Prof. S. C. Littlechild from the University of Birmingham, U. K. and post-graduate fellow Roger Congleton from VPI. Congleton wrote his Ph.D. dissertation under James Buchanan on the role of information in choice, and will be teaching Public Finance I. Littlechild, the author of numerous publications in industrial economics, game theory, and Austrian economics including *The Fallacy of the Mixed Economy and Government and Industry: An Austrian Approach*, will be teaching Industrial Organization I (I.O. II will be taught by Prof. Mario Rizzo).

## The Rutgers Conference on Inflation

(Continued)

today's combination of inflation and tax policy destroys savings and income. Feldstein believed the two greatest evils of inflation to be, first, the "bracket-rate" effect, which continually pushes people into higher tax brackets, although they have not experienced any rise in real



Gottfried Haberler

income, and, second, the mismeasurement of capital, which creates illusory profits. He concluded that since there appears to be no immediate end to inflation, we should adjust our tax policy to accommodate it.

Although most participants sympathized with Feldstein's criticisms of current policy, his talk was disappointing in many respects. He spoke primarily in terms of statistics and macro-economic aggregates without supplying the necessary micro-foundation to his analysis by breaking these up into their component parts.

Professor Ludwig M. Lachmann (NYU) one of the most respected figures in the Austrian school, delivered the after-dinner talk on the topic "Austrian Economics; Prospects for the Future". In the past, Professor Lachmann noted, he had had reason to doubt whether the Austrian school would survive. He traced its changing fortunes from the "golden age" of 1903-1913, to Hayek's ascendancy in the early 1930's, to the late 1930's when—in the words of Sir John Hicks—"the voices of the Austrians were drowned by the fanfare of the Keynesian orchestra." The 1950's and 60's were dark years for the Austrian school, but an Austrian revival is now taking place which he attributed to three main factors. George Shackle's *Epistemics and Economics*, which urged a strongly subjectivist interpretation of expectations, was the first factor mentioned. The work of Sir John

Hicks was also credited, both for his essay "The Hayek Story" which focused attention on Hayek's achievements, and for his *Capital and Time*, a capital treatise in the tradition of Böhm-Bawerk. The last factor Lachmann noted was Israel Kirzner's excellent *Competition and Entrepren-*



Richard Fink

neurship. Lachmann briefly examined the current schools of economic thought and noted some similarities between the Austrians and the Post-Keynesian wing of the Cambridge School. However, he was especially critical of the latter as well as the neoclassical and Chicago schools for their excessive preoccupation with long-run equilibrium. He ended the talk optimistically, noting all of the young Austrians present and expressing a wish that the Austrian school would flourish for decades.

The final session, "Inflation and its International Repercussions", began with a paper by Professor Leland B. Yeager (U. Va.). He blamed the current instability of foreign-exchange markets on the erratic fluctuations of the purchasing powers of the different currencies. Government intervention, which does not permit exchange rates to float freely, makes the problem worse. He discussed many of the harmful effects of our current inflation, such as the distortion of relative prices and the overinvestment in "inflationary hedges". Yeager felt that such inflationary problems were inherent in our present political situation and that constitutional reform was necessary.

Professor Gottfried Haberler (Emeritus, Harvard; AEI) addressed the audience on Yeager's paper. He spoke very highly of the paper, especially Yeager's analysis of the harmful effects of inflation and the comparative advantages of fixed vs. floating exchange rates. Haberler then offered

a further analysis of both the decline of the American dollar and the new European monetary system. He concluded that fixed exchange rates under an international gold standard would be the ideal system.

Professor Joseph Salerno (Rutgers) also commented on Yeager's paper. He felt the first section of the paper was a superb exposition of the causes and consequences of inflation and exchange rate problems. Special praise was given to the analysis of monetary fundamentals, the basis of Yeager's paper. Yeager was also credited with effectively demolishing the notion that government intervention is the cure for our problems, since the knowledge necessary to plan society can never be possessed by a single mind, but instead is scattered throughout the market. The second part of Yeager's paper, which dealt with possible solutions to our problems, received criticism from Salerno. Drawing upon Clarence Philbrook's "Realism and Policy Espousal" (AER, Dec. '53) Salerno leveled the charge that Yeager lacked a sufficient amount of "analytical radicalism"—he was so preoccupied with the political feasibility of various solutions, that he failed to pinpoint either the source of the whole problem, centralized banking, or the necessary solution, the denationalization of money.

Yeager conceded Salerno's charge, explaining that his reason for not specifying his ultimate policy goals was that he had not made up his own mind about the best way to denationalize money.

All in all, the conference must be viewed as a success, both for Austrian economics, which was given a change to confront differing schools of thought in the field of monetary theory and policy, and for the Austrian economics program at Rutgers.

---

## Accounting Colloquium

The Institute for Humane Studies and the Austrian Economics Program of Rutgers University are cosponsoring an Accounting colloquium at the Hilton Gateway in Newark on October 5 and 6. The purpose of this meeting will be to explore how best to encourage contributions from the accounting profession to economic and social theory. Among the participants will be William Fletcher, John Gil-mour, Ronald Hertz, James McDermott, Arthur Neis, Joshua Ronen, Thomas Taylor and Orace Johnson.



# Methodological Individualism Colloquium Held at Sheffield University

A colloquium on Austrian methodology, jointly sponsored by the Seminar for Austro-German Philosophy and the Carl Menger Society, and organized by the indefatigable Barry Smith, was held at Sheffield University, England, on June 1st and 2nd. The colloquium was an intellectual success, with a consistently high standard of papers and discussion.

The opening paper was by Professor Philip Pettit (Bradford), who distinguished three versions of methodological individualism: a psychologistic, a rationalistic, and a compromise between these two, the "humanistic," which he favors. Pettit attempted to make this humanistic individualism precise in terms of *verstehen* (understanding). He provided an interesting discussion of the problems of translating ideas of one theoretical framework into another, as well as reducing or explaining phenomena at one level, in terms of another. Thus one might attempt reduction of chemical processes to the terms of atomic physics, or social interactions to individual psychology. He also discussed a distinction he has advanced elsewhere between "expressive" and "ontological" emergence of apparent entities.

In a paper on "The Future of Methodological Individualism" Jeremy Shearmur (Research Assistant to Sir Karl Popper) criticized those philosophers who, he said, had developed the individualist approach so that it was compatible with almost any sort of theorizing in the social sciences, and also those within the modern Austrian school who, by denying the legitimacy of aggregation, made individualism incompatible with any theorizing. As an alternative, Shearmur suggested that the individualist-subjectivist tradition should concern itself with the problematic of the historical and institutional schools of economics. Thus it should develop a theoretical economics consisting of a variety of models of institutions or historical situations, and an exploration of the consequences of individual action under these circumstances, together with empirical claims that these models are applicable to particular pieces of history.

But would not such an approach, by abstracting from the concrete situations of particular historical individuals, run the risk of turning into a Friedman-like instrumentalism? Shearmur contended that it need not, and quoted Adam Smith: "Good management can never be universally established, but in consequence of that free and universal competition which forces everybody to have recourse

to it for the sake of self-defence." This focused the theoretician's attention on the character of the system within which the individual was acting. Shearmur proposed an individualist-subjectivist research program which would investigate the kinds of systems within which individuals acted, the constraints these placed on action, and the motives which led individuals to choose one system rather than another. This program should be supplemented by a more descriptively realistic analysis of individual motivation, insofar as the system left any "slack" for the individual.

Hillel Steiner (Manchester) gave a paper, "Menger and Nozick on the Origin of Money," in which he questioned the compatibility of methodological individualism and invisible-hand explanations, using the origin of money as an example. Steiner pointed out that from one point of view, barter was more efficient than indirect exchange, which he supported by tables showing that, contrary to common supposition, fewer transactions were required for everyone to get what they wanted through barter exchange than through the use of money, with or without consideration of divisibilities. In the discussion, it was argued that once uncertainty was taken into account, the apparent superiority of barter would disappear.

Geoffrey Sampson (Lancaster), author of *Liberty and Language*, a critique of Chomsky, argued that the existence of linguistic universals, far from supporting Chomsky's rationalist or nativist view that language reflected the innate structure of the mind, rather tended to support the empiricist and evolutionary conception of language, as having been developed by trial and error, by minds inherently capable of mastering an unlimited range of possible languages. Sampson contended that some of the candidate Chomskyan universals were dictated by the nature of the external world or by human physiology, while others were not true universals, being either false or vacuous according to interpretation. However, the thrust of his argument was that Chomsky was basically correct in positing syntactic universals, which all took the form of hierarchical structures. Sampson then drew upon the conclusions of a paper by H.A. Simon, arguing that in all processes analogous to Darwinian natural selection, the resulting complex structures would be hierarchical, not because of any selective advantage to hierarchy, but because the course of the selective process made it likely that complex structures would arise only from the assembling of

simpler functioning units. This plausible explanation of the origin of syntactic organization by hierarchical ordering of simpler elements dispensed with the need for a theory of innate mental structure, and permitted us to conceive of human beings as endowed with true creative imagination, denied by Chomsky.

Ian Steedman (Manchester) gave what proved to be a controversial paper on "Economic Theory and Intrinsically Non-autonomous Preferences and Beliefs." Steedman advanced the familiar thesis that it is not legitimate to treat consumers' preferences and knowledge as exogenous data, but unusually, he eschewed any reference to advertising or Keeping Up With The Joneses. According to Steedman, the very notion of a preference ordering is intelligible only because individuals have *reasons* for wanting things. Early writers like Menger paid much attention to these reasons, but they later dropped out of the picture. Any action would logically depend on the prior possibility of describing it, and would therefore be limited by the individual's access to a public language. It was not even logically possible for a feral man to want Carl Menger's chessboard, or candles for a birthday cake. Thus, individual rational action would depend on the social (including the "economic") context, and the individual agent invoked by economic theory was intrinsically a social product. It was not tenable to claim that the individual's wants, though shaped by society, were not shaped by the "economy," as the economic was pervasive throughout social life. For instance, the growing child was surrounded by artifacts of the economic system.

Steedman argued that microeconomics was consequently vitiated both as an explanatory theory and as the basis for a welfare assessment of the market. The former necessarily entailed a circularity, as knowledge, beliefs and preferences were produced by the economic system. "When one's 'data' depend on one's explanation, one has not achieved an explanation," asserted Steedman. The latter was like shooting an arrow into a blank wall, drawing a target round the arrow, and claiming that the arrow had made a perfect hit. Acceptance of this argument would mean that efficiency in satisfying preferences could not be used to assess economic systems, so that other criteria of assessment, such as fairness, would have to be employed.

Discussion centered on the autonomy or dependence of preferences and know-

*Continued on page 11*

## Letters

# On the Recent Controversy Concerning Equilibration

In the Spring 1979 issue of this newsletter Lawrence H. White comments on "a controversy sparked by Professor Lachmann's thought which has arisen in Austrian circles over the question of general equilibration." I have thus far refrained from commenting on an issue I could not understand. Outside the textbook industry general equilibrium has few defenders these days, and the more thoughtful among them now readily admit that it has little to do with the real world. It puzzles me that some Austrians seem ready to die in the last ditch for a cause that is not theirs and the outstanding exponents of which, from Pareto to Hahn, have never concealed their contempt for Austrians and their ideas.

Now, however, White has set down a number of points I think I can understand. In commenting on them I may hope to further the cause of clarification he has made his own, even where I disagree with him.

(1) White, quoting from my 1943 article on expectations,<sup>1</sup> has me note that expectations are "largely the result of the experience of economic processes." I added, however, on the next page: "This experience, before being transformed into expectations, has, so to speak, to pass through a 'filter' in the human mind, and the undefinable character of this process makes the outcome of it unpredictable." (ibid, p. 67) Thirty-six years later, I adhere to this view.

(2) On the other hand, White makes me look a more extreme *ex ante* man than I actually am. "Lachmann has taken primarily an *ex ante* perspective."

I do not deny that often, where possible, *ex ante* views have to be compared with *ex post* outcomes and that agents have to judge the success of their actions in these terms, nor that economists have to take note of this fact. What I deny is that such judgments permit us to predict what agents will do next. Learning from our mistakes, as from other experience, is a problem-solving activity, and none of us can take his success in it for granted.

(3) Does White agree? In a significant passage he strikes a cautious note. "In serial expectational processes learning is possible, provided the sequence of decision, action, result, and interpretation takes place with speed sufficient to outrun significant changes in the objective circumstances. Learning can play an important role in providing accurate foresight and coordination of the decision maker's (amended) plan with the plans of other market participants." We note, first

of all, that "learning is possible", not necessary, and that it depends on speed. Slow learners, we surmise, do not stand much of a chance.

The crux of the matter is that traders, by entering into those transactions from which they stand to learn most, may transform the "data" of our model, White's "objective circumstances." Are we to believe that in a world in which contracts are binding (no *tâtonnement*) disequilibrium transactions will not give rise to gains and losses which modify the distribution of wealth? Or that "false quantities" of goods produced in response to disequilibrium prices will not affect the freedom of subsequent action of their producers? Do we have to assume that in White's model good learners learn fast enough to prevent all malinvestment (presumably an objective circumstance), even that indulged in by the slowest learners?

Painless learning, alas, is possible only under the gentle guidance of the universal auctioneer.

(4) White, while dissociating himself from the Walras-Pareto model, wants us to accept the "affirmation that such an economy harbors a strong tendency toward an overall equilibrium." The word "tendency" denotes a constant general direction, while it is of the essence of a groping process that in successive periods the groping takes place in different directions. In White's model there can thus be no trial and error. Nor is much comfort to be drawn from the statement that the said "tendency" is here to be interpreted "as the *likelihood* that the configuration of an economy (particularly its array of prices) will be *near* to a general equilibrium configuration." A configuration the data of which are continuously transformed as the result of disequilibrium transactions, can hardly be said to occupy any distinct "area," and thus does not permit us to describe any events as happening in the "vicinity," or at some "distance" from it.

(5) Where do we go from here? Without an auctioneer, what happens in each market as well as the movement of relative prices depends on the actual sequence of events, the temporal order of market processes. Theoretical generalizations about the outcome of such processes which fail to take account of the order in which events happen in markets are therefore unwarranted.

Fifty years ago, when the inadequacy of the Walras-Paretian general equilibrium model for our understanding of economic processes was first noticed, some

Swedish economists, such as Lindahl<sup>2</sup> and Lundberg,<sup>3</sup> suggested process analysis as an alternative paradigm. Like much else that was of value in the 1930's, these ideas were swept away by the Keynesian revolution. Today we realize that these thinkers have paved the way for the notion of market process now widely accepted among Austrians.

But two points must be kept in mind. In the first place, a purely mechanical process model that has no room for choice, the subjectivism of expectations, and the interpretation of information, would be no improvement at all on general equilibrium. Secondly, different markets evolve different institutions which influence the sequence of events on them. There are even some real auction markets in the world today (wool). Hence the market process assumes different forms in different markets. We must study them with some care.

We can all agree with Lawrence White in seeing virtue "in encouraging diversity in the exploration of possible new opportunities," but we have to realize that such diversity implies the incompatibility of plans. There can be no competitive game without losers.

## Notes

1. "The Role of Expectations in Economics as a Social Science". *Economica*, February 1943. Reprinted in *Capital, Expectations and the Market Process* (Kansas City: Sheed Andrews & McMeel, 1977) p. 66.

2. Erik Lindahl *Studies in the Theory of Money and Capital* (London: Allen & Unwin, 1939) Part I.

3. Erik Lundberg *Studies in the Theory of Economic Expansion* (London: P. S. King, 1937).

## Ludwig M. Lachmann

I am pleased that Professor Lachmann has chosen to reply to my piece, for I believe that his reply clarifies his position. Part of the issue which he professes not to have understood was an uncertainty over whether he was prepared to affirm a belief in spontaneous order, i.e. affirm that markets do succeed in coordinating plans. It is now clear that he is not prepared to make any such general affirmation. We are told: "Without an auctioneer, what happens in each market as well as the movement of relative prices depends on the actual sequence of events, the temporal order of market processes. . . . [T]he market process assumes different forms in different markets." One of my objectives was to show that Lach-

*Continued on next page*

## On the Recent Controversy Concerning Equilibration

(Continued)

mann's writings should not, on the other hand, be construed as a blanket denial of belief in spontaneous order.

Professor Lachmann asks whether I agree with the last two sentences in his section (2). In the unqualified way in which they are put, I do not. It seems to me that it is not only possible for agents to learn, but in some cases it is also possible for the economist to predict the direction of plan amendment subsequent to feedback and interpretation. If pattern prediction of this sort were *never* possible, I do not see what sort of process analysis we could ever do. On the other hand, I would also answer in the negative to the three questions posed in the second paragraph of section (3).

In the first three sentences of section (4), Lachmann seems to impose on my discussion of the meaning of "a tendency toward equilibrium" a definition of the word "tendency"—namely, "a constant general direction"—that I explicitly eschew. I certainly did not want to suggest that a tendency toward an economic equilibrium is inconsistent with trial and error. I am puzzled that I could be so interpreted. I might add that I am puzzled also by the similar misinterpretation implicit in the last two sentences of Professor Lachmann's opening paragraph. The Hayekian equilibrium theory I and other Austrians would defend is quite distinct—in my mind at least—from the equilibrium theory of the Pareto-Hahn tradition.

Lawrence H. White

By specifying the contents of the "general affirmation of belief in spontaneous order" Lawrence White has helped me to understand at last what the quarrel is about and what it is that's wanted from me.

First a minor point: the difference between a *tendency* and *trial and error*. A point of semantics perhaps, rather than Austrian economics. To my mind one precludes the other. It may be possible *ex post*, in charting the course of a trial and error process of the past, to discover a tendency in it, but never *ex ante*. To say "Let us try and see, but only in a South-easterly direction" is to limit the scope of the search. See Joan Robinson in *JEL*, December 78, on the impossibility of finding equilibrium by trial & error (p. 1322).

Now the main point. Is the "spontaneous order" permanent? If not, how long does it last? Take the U.S. railroad system. In 1900 it certainly presented all the features of spontaneous order, coordinating the plans of millions of people,

including shareholders receiving dividends from most of the railroads. But today? White says I can only master the *ex ante* perspective. But if we take the *ex post* perspective, was the U.S. railroad system a spontaneous order?

It puzzles me that White fails to see that, by pretending to see "spontaneous order" everywhere, we are playing right into the hands of our opponents who merely have to point to obvious instances of malcoordination to win debating points. Every case of malinvestment can be held against the market economy. Does it not show malcoordination? The "absence of universal futures markets" in Arrow and Hahn as an argument against the market economy makes sense only, but, alas, does make sense, against such "universal affirmations" as I am now asked to subscribe to.

What has gone wrong? We have to distinguish between real phenomena and those ideal types we use to classify the former as "more or less..." Some markets coordinate plans better than others, and it is the job of us Austrian economists (and others) to study them and classify them. If we assert that "the market coordinates all plans" (always?), we substitute an affirmation of faith for what should be the outcome of serious study of the real world. In defending the market which certainly provides people with opportunities (they often miss) to orientate their plans to others, we must beware of claiming too much. Plans that often extend into the remote future, with details often as yet unspecified, cannot all be consistent with regard to every element. By the way, how can the plans of competitors be compatible?

In refusing to sign the blanket affirmation referred to I appeal to common sense. I know that among economists that is not much of an argument. It seems to me, nonetheless, that Austrian economics is more likely to prosper if common sense is not ignored.

I repeat as an empirical generalization: Learning from experience is a problem-solving activity, and none of us can take his success in it for granted.

General demand and supply equilibrium cannot serve as a "center of gravity", a source of permanent forces of constant strength as, under the impact of innovation, technical progress and simple changes of taste, relative demand and supply of various commodities are continuously changing. A planet whose composition and mass are undergoing continuous transformation could not exert a gravitational force of constant strength. If

so, how can it be asserted that economic equilibrium forces, necessarily of varying strength over time, will always overwhelm and outlast all other forces?

Ludwig M. Lachmann

## Recent Articles About F.A. Hayek

Readers may be interested in the lead article of the February, 1979, issue of *Economica*, "On the Origin of the Notion of 'Intertemporal Equilibrium'" by Professor Murray Milgate of Trinity College, Cambridge University. Milgate traces the early use and development of the intertemporal equilibrium concept with a major focus on the contribution of F.A. Hayek. Hayek, Milgate argues, ought to stand beside Lindahl, Myrdal and Hicks as a major developer of this idea.

The cover story of the October 1st issue of *Forbes* is a well-done, indepth study of the economic, social and political ideas of F.A. Hayek. Author Lawrence Minard, *Forbes*' European Bureau Manager, discusses the recent revival of interest in Hayek's important work. Of particular interest to economists is the clear treatment of Hayek's notion of spontaneous order—the idea that the most useful and vital institutions are the result of long evolutionary growth rather than of deliberate design.

## Symposium on the Methodology of the Social Sciences

On October 12-14 the first of two Liberty Fund symposia on social science methodology is being held in Hot Springs, Virginia. The major papers to be discussed will be: T.W. Hutchison, "On Prediction and Economic Knowledge"; John Moorehouse, "Mechanistic Foundations of Economic Analysis"; Richard B. McKenzie, "The Non-Rational Domain and the Limits of Economic Analysis"; James Buchanan, "Is Economics a Science of Choice?"; Vincent Tarascio, "Theories of Behavior and Public Policy"; and Brian Loasby, Chapters 1-3 of *Choice, Complexity and Ignorance*.

# Austrian Economic Seminar, Part IV: 1978-1979

by Don C. Lavoie

The Austrian school, like neoclassical economic theory, traces its roots to the subjectivist/marginalist revolution of the 1870's and its fundamental theory of value is essentially that of mainstream microeconomics.

As against the unsuccessful classical attempt to formulate a coherent objective theory of value by which "social wealth" could be measured, the subjectivist theory of value makes individual choice the guiding principle of explanation, and explicitly abandons the search for an objective standard of value. For both Austrian and mainstream economics, exchange and production relations can be explained by tracing them to their origins in the choices of individual minds. However, as the fourth academic year of the Austrian Economic Seminar illustrates, there are some crucial differences, at least in emphasis and form of exposition, and perhaps in substance, between mainstream and Austrian forms of choice theory.

Frederich Hayek's work has been fundamental in showing the dangers of a preoccupation with the world of perfect knowledge that mainstream equilibrium theory postulates. For Hayek and the Austrians competition is a rivalrous discovery process in a world replete with ignorance. The September '78 session of the AES began with two short papers by Brian Summers dealing with Hayek's contributions on "The Division of Knowledge" and "The Limits of Knowledge."

The price system is a complex order of separate and decentralized decision-makers each with specific knowledge of his own connections to the constantly changing structure of social production, but guided toward coordination with others by the knowledge that competition generates. No one mind could ever know the detailed motion of this vast system of production, much less plan its evolution. Competing plans of imperfectly informed individuals both cause changes in and are crucially guided by the spontaneous order of the price system. This feedback system results in a complex order far beyond the comprehension of any of its individual participants, hence the "limits of knowledge."

The individual plans already embody the extent of planning complexity that the limited mind can effectively handle, specialized in particular segments of the network of production. The extent of knowledge that would be necessary to centrally plan this entire network would have to subsume all the details of this divided knowledge as well as the knowledge of their interaction which is now

communicated in decentralized form by prices. Thus the complexity of an individual plan is limited by the finite capabilities of the human mind, regardless of whether an individual plan has the advantage of being one among many interacting in a complex order, or alone constitutes all of social production. The "division of knowledge" in this order makes possible a far more complex overall structure of production than could be designed by any individual mind.

A criticism of these papers was that in certain places the author (unintentionally) implied that an equilibrium system of prices exists. When discussing the coordinating role of prices in the network of production and their tendency to reveal the relative scarcity of different resources, we must be careful to emphasize that these prices never perfectly correspond to the separate plans that underlie them.

Equilibrium theory can be very helpful in bringing conceptual clarity into our understanding of the various categories of exchange in the economy. Careful delineation of the differences among and the relationships between such categories as consumer goods prices, factor prices, wages, rents, and interest in a static world facilitates the dynamic explanation of the way the struggle for profit opportunities acts as an equilibrating force which tends to eliminate those very profit opportunities.

Early in the refinement of equilibrium theory the existence of interest appeared to pose a problem. If competition tends to grind profit down to zero why is there this regular emergence of a positive rate of interest? As Böhm-Bawerk showed, interest cannot be attributed to a payment for the productivity of capital, since in equilibrium such productivity should already be reflected in the higher value of the capital goods. Interest represents the ratio between the values of present and future goods, and the price of future goods already includes, and indeed is primarily based upon, judgments of the productivity of these goods. The question remains, why the regular emergence of positive interest rates?

Böhm-Bawerk himself unfortunately reverted to a productivity explanation of interest, and this has been retained in the influential works of Fisher, J.B. Clark and many contemporary theorists. The October '78 session of the AES discussed an excellent paper by Gerald O'Driscoll (NYU) on "The Time Preference Theory of Interest Rate Determination" which offers both a critique of such productivity

explanations and a positive presentation of a nonproductivity explanation of the rate of interest. In this theory, as formulated by Frank Fetter, interest is fundamentally due to the subjective discounting of the future, time preference, and not at all to productivity.

This argument between Fisher and Fetter is not, as has often been implied, between mutual determination (subjective value and physical productivity) and unilateral determination (subjective time preference alone). Both theorists believed in mutual determination. Rather the issue is over what we should take as our dependent and independent variables. In the Fisher diagram the units on each axis are in value, not physical terms, thus the whole opportunity locus, which Fisher is trying to make into an independent productivity component in interest rate determination, is itself dependent on the rate of interest. Physical productivity is the *object* of the subjective discounting process. It may indirectly induce changes in time preference, but the source of interest must be located in that time discounting process. To treat productivity as a direct determinant of the interest rate is to confuse the thing to be discounted with the discount. Austrian economics takes the subjectivist revolution in value theory very seriously. Its thoroughgoing methodological individualism attempts to locate the source of all economic phenomena in the minds of individual actors. It is only through its interpretation by individual minds that objective reality exerts its influence on economic change. The pure time preference theory is essentially an attempt to make neoclassical value theory more consistently subjectivist by basing all causal explanation on the choices of individuals.

But the more important Austrian criticism of neoclassical choice theory is the one implicit in Hayek's work on knowledge and particularly in the Mises-Kirzner theory of entrepreneurship. The remaining seven sessions of the AES were devoted to papers concerned in various ways with *entrepreneurship*, the focal point of the most fundamental Austrian critique of equilibrium economics.

The preoccupation of many modern theorists with the description of equilibrium and the state of perfect competition has narrowed their conception of choice to a simple maximization problem, the optimal application of given means to given ends. All actors in this view are assumed to be price takers, influenced by, but not influencing, the price system.

*Continued on next page*



## Austrian Economic Seminar, Part IV: 1978-1979

(Continued)

The question immediately arises, how do prices ever change? The fiction of the auctioneer has been widely used to move prices to their equilibrium levels, but this, as most theorists readily admit, hardly comprises an adequate notion of real equilibrating processes. Yet without an explanation of the equilibrating process the usefulness of the whole edifice of general equilibrium theory is rendered highly suspect. Equilibrium theory properly depends upon a coherent theory of processes under disequilibrium conditions, and to have this, Austrians argue, the conception of choice must be broadened from what Professor Israel Kirzner calls "Robbinsian maximizing" to include entrepreneurship. The real choice context of acting men is not the perfect knowledge context of equilibrium theory. We are inextricably embedded in a world of uncertainty, and choice is not simply optimizing against given constraints but encompasses the process of conceiving of new ends/means frameworks. The entrepreneur's discovery of new profit opportunities is the impetus to the equilibrating process, thus the concept of the entrepreneur is the crucial theoretical link between equilibrium theory and the analysis of actual economic processes in the disequilibrium world.

Kirzner's (NYU) paper "Alertness, Luck, and Entrepreneurial Profit," the topic of the November AES session, went a long way toward clarifying this sometimes elusive notion of entrepreneurship. On the one hand, being defined as precisely that aspect of choice which is absent from equilibrium, entrepreneurship cannot be viewed as a factor called alertness for which pure profit is a payment. To the extent that "entrepreneurial talent" is consciously employed as a means toward other ends, it is fully subsumable within equilibrium formulations, but then the real entrepreneurship is on the part of the decision-maker who has the alertness to recognize this talent in others. But, on the other hand, being the driving force behind equilibrating processes, entrepreneurship also cannot be attributed to pure luck. Kirzner presented a careful elaboration of the nature of entrepreneurial profit both for the isolated individual actor (Crusoe entrepreneurship) and for the participant in a market order. In the former case an expected opportunity for psychic profit impels the alert to take action to grasp it, while in the latter case an expected opportunity for monetary profits, as revealed in the disequilibrium price system, impels the alert to take action to grasp it. In both cases, the

new opportunity reveals an inconsistency in the prior evaluation of ends and means.

The need for a theory of process, though usually seen as secondary to equilibrium theory, has not gone unnoticed by mainstream economists. Every elementary economics text makes passing reference to the law of supply and demand in which a high price "causes" a reduced demand and an increased supply. The December '78 and the March '79



Jack High

sessions were devoted to much needed surveys of mainstream economists' attempts to analyze equilibrating processes. Lawrence White's (UCLA) December paper "Entrepreneurial Price Adjustment" focuses on the price adjustment models of Samuelson, Arrow, Phelps and Winter, Barro, Frank Fisher and others, and indicates three kinds of shortcomings in this literature. Some theories fail to locate the source of price movement in the decisions of individuals, relying on a mythical centralized auctioneer of some kind. Others place the source in individual choice but fail to make this choice self-motivated, relying upon ad hoc price adjustment rules. Still others postulate an unrealistic theory of the knowledge of individuals making them know far too much or learn far too little to be acceptable as a coherent theory of equilibrating processes.

This last issue, the coherence of the theory's attribution of knowledge to market participants, is important in the Austrian critique of equilibrium theorizing. The knowledge possessed by economic actors cannot be presumed too great, or the model will reduce to equilibrium where no process is necessary, nor too small, or the model will lack the learning and coordinating which is neces-

sary to fuel the equilibrating process. There is a degree of ignorance that is ineradicable but not overwhelming, with which all economic actors must cope. Economic choice can neither be reduced to objective optimizing calculations, nor to random stabs in the dark; again, we have Kirzner's paradox that entrepreneurship can be neither a known optimizable resource nor pure luck.

Clearly the analysis of risk and uncertainty is central to this issue. The January '79 session discussed Mario Rizzo's (NYU) "Knight's Theory of Uncertainty: A Reconsideration" which examines the important distinction between transformable uncertainty (risk) and nontransformable uncertainty (true or radical uncertainty). If all conditions of uncertainty can be adequately dealt with by assuming complete knowledge of the probability parameters of a situation instead of complete knowledge of the situation itself, then uncertainty poses no significant problem for the pure maximizing model of choice. Rational Expectations literature is a recent example of attempts to analyze uncertainty as fully susceptible to the objective probability calculus. The development of Bayesian statistics and subjective probability theory in general is often taken to mean that Knight's famous distinction between risk and uncertainty is obsolete, that all uncertainty can be transformed into models embodying knowledge of objective probability distributions.

As Rizzo's paper shows, however, the radical uncertainty which human actors face is not so easily transformed into neat formulations of expected values and standard deviations, and Knight's distinction is therefore worthy of greater attention by modern economics.

By the judicious grouping of cases whose frequencies show regularity over many observations risk can be converted into a fixed cost. But most instances of uncertainty which entrepreneurs face are not susceptible to such grouping or can only be made so at prohibitive cost. Most action with regard to the future does not refer to possibilities whose frequencies are known. And even in a situation such as insurance where actuarial tables seem to alleviate uncertainty, there is still an ineradicable element of uncertainty. An entrepreneurial judgment is necessary to determine that the particular situation at hand is properly a member of the class of events whose distribution in the past is known. The unknowability of the future cannot be dismissed with a facile refer-

*Continued on next page*

## Austrian Economic Seminar, Part IV: 1978-1979

(Continued)

ence to probability theory, and thus the narrow Robbinsian-maximiser model of choice, while applicable to equilibrium states, cannot be salvaged for direct application to disequilibrium conditions.

Among the most important dangers of the modern preoccupation with equilibrium theory is in policy espousal. The February AES paper, Leland Yeager's (U. Va.) "Pareto Optimality in Policy Espousal" discusses a number of objections to the direct application of the abstract notion of Pareto Optimality to the real world, some of which closely parallel Austrian criticisms of equilibrium theorizing. A policy is called Pareto-Optimal when it would adversely affect no one and benefit at least one individual. It is often believed that value-free science can freely adopt the ideal of Pareto-Optimality without descending into the controversial realms of ethics or political science, but Yeager argues persuasively that Pareto Optimality is itself laden with value judgments, including some rather controversial ones.

But more fundamentally, Yeager questions the applicability of this rigorous though narrow concept of efficiency to real world policy. In the Pareto-Optimal State there exist no further opportunities for gain, i.e. there is that fully coordinated ideal of general equilibrium or perfect competition models, an efficiency ideal which the real world tends toward but never reaches. The world is so far removed from this "elegant" abstraction that it is at best a clumsy tool for policy espousal. Thus Yeager opposes "erecting a Pareto-optimal state as a benchmark or ideal in comparison with which states of affairs in the real world are to be approved or condemned." A process approach to policy would have to examine a competitive market economy, in Yeager's words, "as a device for gathering and transmitting information about not-yet-exhausted opportunities for gains from trade, . . . for conveying incentives to exploit such opportunities, and for coordinating decentralized activities."

In the March session the AES renewed its direct examination of modern attempts to provide a theory of price adjustment with a discussion of two preliminary chapters of Jack High's (UCLA) dissertation: "Disequilibrium Economics: Survey and Analysis." High divides modern approaches into three broad classes, stability analysis, search theory, and market process analysis. The first category, including Samuelson, Patinkin, and Arrow and Hahn, is an offshoot of general equilibrium theory whose crucial shortcoming is its failure to explain price ad-

justment in disequilibrium as self-motivated behavior. Search theory attempts to analyze price adjustment as a conscious search for knowledge but remains narrowly confined in a "Robbinsian optimizer" model of choice and fails to recognize the existence of Knightian uncertainty in disequilibrium choice. (One section of High's paper includes an argument that Bayesian probability theory cannot dispose of this problem of radical uncertainty). High sees the main difficulty for market process analysis in its perplexing concept of a costless mental process which perceives entrepreneurial opportunities for gain.

Both High's and White's surveys leave the impression that the analysis of equilibrating processes offers a promising intellectual entrepreneurial opportunity for Austrian economists. As with economic profit opportunities, it is the error and discoordination of the existing state of disequilibrium in process literature which motivates the tendency to coordinate and learn. The shortcomings of existing attempts to analyze equilibrating processes alert us to the positive features that an adequate process theory must possess.

The April AES session was honored by a visit by the distinguished author of *Cost and Choice*, perhaps the most thoroughgoing statement of the subjective theory of cost ever penned. Professor James Buchanan (VPI) offered a summary of some very interesting explorations he has recently conducted on the Austrian school's major research program, entrepreneurship.

In the disequilibrium context the entrepreneur always seeks positive profits, this being the impetus to equilibrating processes, yet on net only some entrepreneurs are successful, others incurring unexpected losses. This suggests that "entrepreneurs as a whole" (or a representative entrepreneur) are regularly disappointed, and are in general over-optimistic about profit opportunities. Buchanan surveys some possible implications of this general entrepreneurial optimism. For example, suppose two entrepreneurs expect to gain \$100.00 of pure entrepreneurial profit from a project, and each in fact gains \$50.00 when his plan materializes. Looking at one another's plan, Buchanan suggests, each optimistic entrepreneur, having been disappointed by his own project, will switch to the other one. Managers at professional sports franchises are an example of a resource Buchanan believes to be "overswitched" due to this over-optimism factor. In the

discussion Lachmann pointed out that Buchanan is assuming that people learn from their own mistakes but not from those of others. One discussant pointed out that the variance of the distribution of expected positive profits may differ from that of realized profit/loss. Another noted that there is a continuous turnover of entrepreneurs in which many new optimists enter the fray as disappointed entrepreneurs leave.

One of the more controversial features of Kirzner's theory in *Competition and Entrepreneurship* has been his sharp analytical distinction between the role of the entrepreneur and that of the owner of resources through time, in which the arbitrageur who instantaneously buys in one market to sell in another is taken as the essence of entrepreneurship. But as Buchanan succinctly pointed out, this timeless arbitrageur ought to properly be seen as one end of a spectrum including arbitrage through time as a more representative case. Buchanan also argued that Kirzner's attempt to distinguish his equilibrating entrepreneur from Schumpeter's disequilibrating entrepreneur was more a difference in convention about how to view equilibrium than one of substance.

While Buchanan implied that perhaps all he was doing was belatedly learning what Kirzner and Schumpeter had been trying to tell us all along, his fresh approach in grappling with entrepreneurship made for one of the most stimulating sessions of the AES to date. His closing comments make evident the importance he assigns to entrepreneurial theory: "I've become more and more convinced, in working on this, that somehow we must break out of the intellectual constraints that are imposed on us by the equilibrium constructions of neoclassical economic theory."

The Austrian "market process" approach represents a bold challenge to prevailing theories as well as a wide open field of scientific pursuit in its own right. In May '79 the AES discussed Lachmann's essay "Equilibrium and the Market Process" (planned to be the first chapter of a book on market process theory) in which Lachmann sets out the methodological foundations of disequilibrium economic theory, the shortcomings of equilibrium theory, and some suggestions on the appropriate direction for the "new paradigm" of market process theory "to replace that of General Equilibrium."

Lachmann grounds market process theory in the realistic knowledge-context

*Continued on next page*

## Austrian Economic Seminar, Part IV: 1978-1979

(Continued)

of acting man. Uncertainty and unexpected change are as thoroughly infused in every feature of our world, as they are completely absent from general equilibrium constructions. Particularly the important problems in capital theory demand a relaxation of perfect knowledge assumptions and an examination of disequilibrium processes. Economic theory must be able to deal with genuinely unexpected technical change that significantly impinges on the values of existing fixed capital. In place of the perfect competition view in which product differentiation is seen as a monopolistic practice, we must view product variation and imitation as two phases of an on-going and iterative competitive process. And Lachmann places special emphasis upon the "disequilibrating forces" of an economy, the changes in the data that continuously keep complete coordination out of the reach of equilibrating forces.

While Austrian views are often seen as a correction and addition to the contributions of neoclassical economics, Lachmann is more inclined to see Austrian economics as a radical departure from, and fundamental challenge to, equilibrium economics. For example, Kirzner demands "going beyond" general equilibrium and Lachmann suggests we "reject" it. Sometimes Lachmann seems unclear about how much of general equilibrium theory he is rejecting or about how we can hope to explain equilibrating forces in disequilibrium without some coherent notion of what direction such forces push us toward. Some discussants tried with limited success to pin the good Professor down to an admission of the theoretical usefulness of general equilibrium. Nevertheless Lachmann's challenging radical subjectivism continues to serve as a stimulating point of departure for the Austrians' important study of disequilibrium process economics.

This academic year of the AES included some of the best contributions to Austrian scholarship in contemporary economics and bodes well for the influence of the Austrian challenge to neoclassical theory in the 1980's.

## Auburn Conference Held

On the 27th of April twenty scholars gathered at Auburn University (Auburn, Alabama) for a two-day colloquium on Austrian economics. The colloquium was sponsored by the Institute for Humane Studies in cooperation with the Liberty Fund. Professor Mark Jackson of Auburn served as director and Louis Spadaro, President of the Institute for Humane Studies, was the moderator. Interest in Austrian economics and familiarity with its salient aspects were common denominators of those participating.

The stated purposes of the colloquium were twofold: (1) to discuss "the impact of the important insights of Austrian theory on the various parts of mainstream economic analysis," and (2) to identify "points on which differences between the two imply the need for further exploration and development by Austrian theorists." Despite these intended themes, actual discussion during the three 90-minute sessions gravitated to the old issues. "Why don't Austrians recognize the usefulness of equilibrium constructions?" They do. But they are not mesmerized by equilibrium relationships as are the neoclassicals. They recognize that the more interesting economic phenomena, involving, for example, uncertainty, the use of knowledge, and entrepreneurship, are best handled outside the equilibrium framework. "Why do Austrians have an aversion to mathematics as a tool of analysis?" Austrians believe that mathematics is uniquely appropriate for describing equilibrium states or what Mises called "states of inaction." The math serves to highlight the fact that there is no purposeful behavior in such constructions. (Purpose is a concept alien to all mathematics.) Because the Austrians are interested in human action rather than inaction, they find little or no use for mathematics.

## Inventory of the Private Papers of Ludwig von Mises

Ludwig von Mises' private papers have now been catalogued by L. John Van Til of Grove City College where these papers are available to researchers. Included are long lists of his published and unpublished works and a short biography of Mises. A copy can be obtained for \$1.50 from the Public Relations Office, Grove City College, Grove City, PA 16127.

## Methodological Individualism Colloquium Held at Sheffield University

(Continued)

ledge. Although the market influenced preferences, it did not determine them absolutely. Some discussants felt that any degree of autonomy for preferences was quite sufficient to make the claims of microeconomics non-vacuous. Furthermore, that the market influenced preferences did not necessarily mean that it influenced them in a convenient direction, and the influence might be much slower than the adjustment to existing preferences. Even if the market strictly determined all preferences prior to, and in phase with, the process of satisfying them, it did not necessarily follow that the independence of preferences should be rejected as an analytic expedient.

The colloquium concluded with a paper on "Misesian Apriorism" by David Ramsay Steele (Hull), followed by a lively discussion. Arguing for a Hayekian, as opposed to Misesian, methodology, Steele questioned the Misesian contention that it was possible to arrive at substantive and highly specific conclusions about the world by strict deduction from apodictic axioms and a handful of broad empirical generalizations. In some cases (e.g., the impossibility of socialism) the Misesian conclusions were sound, though dependent on unstated empirical assumptions. In other cases, the conclusions were so abstract as to say very little that was specific and definite about the real world (for example, the Misesian argument for positive time preference did not demonstrate a positive market rate of interest). Praxeology was essential to economics but was not the whole of economics. It was no more than a calculus to be applied to real world situations in conjunction with numerous empirical hypotheses.

Dr. Barry Smith (Sheffield) questioned Steele's assumption that there were no *a priori* synthetic propositions, and claimed it ought to be possible to work out material theories about human society from apodictic truths about human action, even though Mises' attempt had not been an unqualified success.

# London Conference Held by Carl Menger Society

by John Blundell

On Saturday May 19th, the London based Carl Menger Society held its second one-day conference entitled "Three Issues in Political Economy—An Austrian View." Readers of the *AEN* will remember that the Society has moved from running monthly seminars to organizing full One Day Conferences, the first of which was held on October 28th, 1978 (see report *AEN* Volume 2 No. 1).

Over 40 participants heard Professor Madsen Pirie (Hillsdale College and Adam Smith Institute), open the conference with his paper, "The Crisis of 20th Century Economics—The Austrian Opportunity". During a lively and stimulating presentation, Pirie argued that there were competing schools of thought in economics which should be judged on their ability to generate successful predictions and explanations. He dismissed the Keynesians on their manifest failures singling out the phenomenon of stagflation in the UK over the past 10 years. On the Chicago School he had three main reservations: (1) On time lag the Chicago economists were once quite specific but now seemed to be flummoxed. (2) They continually redefine money in order to try to make it fit the facts. (3) The monetarist theory does not tell us enough about what actually takes place in inflationary times, particularly about the misallocation of resources. Turning to the Austrians Pirie identified two sub-schools: the Mises/Rothbard "a priorists", and the Hayekian "empiricists". He claimed that the former were "philosophically unsound" and that the Austrian school, if it is to expand and progress, should reject a priorism.

From an empirical examination of the nature of markets, Pirie deduced the three main elements of the Austrian approach: the motives of individuals, the dynamic process, and the retaining of information by avoiding misaggregation. Concluding this introductory session he claimed that the Austrians were the only consistently correct school of thought, a school whose time had come.

Mark Brady (University College, Cork) in his paper, "The Political Economy of Trade Union Law", examined the position of trade unions in the UK, drawing on the work of Mises, Hayek and Rothbard. One theme of his paper which was particularly "striking" in the context of the current British discussion, was his suggestion that, rather than attempting to remove some of what are perceived as legal privileges of British trade unions, the correct policy would be to extend these rights to everyone.

Walter Grinder (Cork) questioned ortho-



Walter E. Grinder, Mark Brady, John Blundell, D. Madsen Pirie, Jeremy Shearmur, David O'Mahony.

dox assumptions about public goods in his paper, "Public Goods: Market Concept or Political Rationalization". He found several assumptions to be based apparently neither on accurate history nor on sound economic theory. "All public goods have at some point in history been provided by the market", he stated, thoroughly exposing the "Lighthouse fallacy". In doing so he made use of the "demonstrated preference" theory of Mises, in a manner reminiscent of Rothbard's "Toward a Reconstruction of Utility and Welfare Economics".

Concluding the main conference sessions, Professor David O'Mahony of University College, Cork presented a paper entitled "The Labor Managed Firm and the Market Economy". He argued that such a firm does not emerge in the market economy because it is not conducive to the performance of the entrepreneurial function. Workers cooperatives are usually a last clutch attempt to save jobs, he claimed, and not a spontaneous market phenomenon.

Vice Chairman of the Society, Jeremy Shearmur, brought the sessions to a conclusion with a review of both the papers that had been read and the ensuing discussions. He made two more general points. He urged that the Austrian school should take the greatest care not to allow its view of itself as a new "paradigm" to lead to its losing contact with the problematic of the wider economic tradition,

or with criticisms of other economists—a path that would lead to its becoming a closed and dogmatic system. He also suggested that there was a tension between its heuristic emphasis on imperfect knowledge and the wish to make strong claims about, say, the coordinating or the welfare consequences of a free-market approach, the problem being that the weaker, logically, one's premises are, the less one can demonstrate from them.

At the time of this writing, readers of *AEN* will be interested to hear of the following forthcoming Austrian events:

- Sunday, October 21, the Carl Menger Society will have a guest lecture by Professor Israel Kirzner (venue, etc., to be arranged).

- On Monday, October 22, there will be a one-day conference, "Entrepreneurship", organized by the IEA. Speakers will include Prof. Kirzner; proceedings including discussion to be published.

- On Tuesday and Wednesday, October 23rd and 24th, Prof. Kirzner will undertake a series of staff and student seminars in various universities, arranged by the Carl Menger Society.

- On Saturday, October 27 the Carl Menger Society will hold its third one-day conference at the Imperial Hotel, Russell Square, London WC1. Theme and speakers to be decided.

- The fourth one-day conference is being planned for the spring of 1980, also to be held at the Imperial Hotel in London.