Suggestions for Teaching Intermediate Macroeconomics: A Praxeological Perspective

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Joseph T. Salerno (2004) has presented us with the choice of pursuing economics as a vocation or profession. The focus of the vocational economist is the pursuit of truth whereas the professional economist works primarily to earn an income, enhance his reputation, or influence political decisions. This dichotomy also presents itself when economics professors seek to instruct courses for economics majors, but in the case of education, the question is do we want to train our students to be vocational or professional economists. For Misesian professors teaching intermediate macroeconomics, there is a tension between leading students in the development of sound economic theory and providing them with a working knowledge of the multitude of macroeconomic models they will encounter in graduate studies. Should teachers of undergraduate economics focus more on economic truth that helps students understand the way things really are or more on various macroeconomic models and hot research topics and techniques they may see if they choose to go on to graduate study? What follows are suggestions for meeting the challenge of intermediate macroeconomics by providing intermediate undergraduate students with a working knowledge of the disarray we call modern macroeconomics, evaluated with sound economic theory one derives within the Misesian tradition.

First Principles

When attempting to resolve the tension between teaching only sound economics and teaching information students need to know if they go on to

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graduate studies in economics, it seems that, of all economists, Austrian economists should be concerned primarily with truth (Salerno 2004). The tradition of Austrian economists is one filled with scholars and teachers placing the pursuit of truth above careerism. In addition we owe it to our students to make proper understanding of macroeconomic issues the first priority. Higher education, if it really is to be education, cannot be relegated to job training. It is not merely a pre-professional program. As such, it is crucial that, as teachers, we do not think that we have done our job when we have crammed the hodge-podge of core macroeconomic models down intellectual throats because they are the currently "hip and swinging" models and this is what "professional economists" do.

Instead, to be truly educated in economics, undergraduate students must become thoroughly acquainted with sound economic theory. The hallmark of a true scholar is the pursuit of truth, regardless of what advances one professionally. Even if we take the very narrow position, however, that the goal of a bachelors degree in economics is to prepare the student for graduate studies, it surely is in students' interests to master true economic doctrine so they understand how the economy really works. This can help the student evaluate what they receive in graduate economics programs.

Pedagogically, then, professors of intermediate macroeconomics should teach a core of true praxeological economic theory relevant to macroeconomic issues *before* examining alternative frameworks. It is impossible for students to make sound judgments and evaluations of competing macroeconomic theories if they have no basis for such judgments.

Elements of Austrian Macroeconomics

The tension between pursuing economic truth and following current professional fashions is all the more pronounced when, as William Butos (2006) has recognized, the frameworks of Austrian economics and other macroeconomic approaches are so different. It is relatively simple, for example, to compare and contrast traditional Keynesianism with New Keynesian economics because their underlying paradigms are so similar. What they take as the important issues, variables, and methods are so much alike that they allow for easy transitions from one school to another. Both Keynesians and Monetarists take a holistic view of the macro economy, focusing on aggregates precariously (if at all) linked to the actions of people. Those schools of thought that seek to incorporate the concept of utility maximizing economic agents do so in models that ignore the issue of time and uncertainty. Macroeconomics in the Misesian tradition, however, must be solidly praxeological. It must be firmly rooted in human action.

Praxeological macroeconomics, with its understanding of economic phenomena as the outcome of human actions directed toward an uncertain future, makes for a qualitatively different approach that tends to get obscured if it is merely tacked on at the end of the regular laundry list of contemporary macroeconomic models. As such, Austrian macroeconomics must build upon a solidly praxeological foundation. It presupposes the validity of economic realities such as individual human action, value, marginal utility, time, uncertainty of the future, profit and loss, market prices, and economic calculation.

At schools like Grove City College it is easier to begin an intermediate macroeconomic course assuming that students have a grasp of praxeological principles, because they already have been taught Misesian economics in at least two courses before they progress to the intermediate theory classes. In fact, their text in principles of macroeconomics is Murray Rothbard's *Man, Economy, and State*. They are, therefore, already familiar with Austrian economics. They understand that economics begins with the axiom that humans act and from that starting point is deduced value theory, the law of marginal utility, price theory, and the importance of economic calculation in an uncertain world. No doubt most Austrian professors of macroeconomics elsewhere do not have the luxury of having students already familiar with Misesian foundational concepts. In this case, it is probable that some rudimentary praxeology may have to be discussed before presenting the core of macroeconomic theory.

Once they are familiar with basic praxeological concepts, intermediate macroeconomics students must be taught the core of sound macroeconomics. This macroeconomic core comprises the theories about what integrates the entire social economy: monetary theory, the nature of the capital structure, and interest theory. Money helps to integrate the social economy because, as the medium of exchange, it is the one good that is traded in all markets. Therefore changes in the "money relation" (i.e., the supply of and demand for money) are felt not only on one market or a few markets, but throughout the entire economy, though not all at once or in the same proportion.

The second concept that ties together the entire economy is the complex structure of production. The production of every consumer good is made possible by the vast structure of capital and original factors employed at every stage of the production process. It is in the production structure that intertemporal investment decisions are made and coordinated.

The final element in the Austrian macroeconomics core is interest theory. The interest rate is that rate that coordinates the time market: the market for present money in exchange for future money. The interest rate is the benchmark indicating social time preferences and is used by investors to determine which projects in which stage of production are profitable. Because the two things that integrate the entire social economy are money and the production structure, any sound macroeconomics must take them both into account and therefore must begin with monetary theory and capital and interest theory that are rooted in praxeology. Roger Garrison (2001) was surely right to entitle his book on Austrian macroeconomics *Time and Money*.

From these elements, Austrian economists have developed economic theory that can be used to analyze the three main issues of macroeconomics: the purchasing power of money, business cycles, and economic expansion.

Austrian intermediate macroeconomic courses should elucidate the connections between these core elements. Doing so allows for students to gain an understanding that economic expansion is the result of capital accumulation made possible only by increased saving and investment.

Bringing together the core elements also teaches students the consequences of trying to buy economic progress with monetary inflation. They will see that the purchasing power of money will decrease and that also inflation via credit expansion will set in motion the boom-bust business cycle. Any apparent economic expansion will end in recession.

Considering the Alternatives

The above is not intended to be an apology for sticking our head in the praxeological sand. Anyone who teaches intermediate macroeconomics owes it to his students to acquaint them with what passes for the professional conventional wisdom in macroeconomic theory. It certainly would be doing a disservice to our students if professors only exposed them to Austrian macroeconomics and did not deal with the plethora of alternative theories that inform the financial media and that they will likely meet if they pursue graduate studies in business or economics.

However, it is only after students have a good understanding of monetary economics, the capital structure, and interest theory that they will be able to adequately judge the various competing theories attempting to explain general business fluctuations. Only after laying a praxeological foundation and erecting a Misesian macroeconomic edifice should professors lead students through the wilderness of dueling macroeconomic models. Once versed in sound economic theory, students will be well-equipped to understand and evaluate the Keynesian cross, the IS-LM model, monetarism, rational expectations theory, new classicism, real business cycle theory, and New Keynesianism.

Beginning with these models and then tacking a bit of Austrian business cycle theory at the end will do little more than frustrate those students who do have a grasp of sound economics and lead others to believe that there is no such thing as economic truth when all is said and done. After all, without a foundation of sound economics, who can say whether Keynes or Friedman or Lucas or Prescott or Mankiw or Mises is more or less correct? If students begin with an understanding of human action and the core of the macroeconomy, they will then be able to sift the intellectual wheat from the chaff and make sound judgments regarding which macroeconomic theory best explains reality. Far from being myopic, students in well-organized Austrian intermediate macroeconomics courses will be the graduates who have the most complete understanding of macroeconomic theory.

Texts

As has been described by Butos (2006), the task of teaching a well-ordered Austrian intermediate macroeconomics course is made more challenging due to the lack of a text in the pure Misesian tradition. This means that at present one must resort to a text written within a more or less conventional framework, with Austrian supplementary readings providing the core of the positive theory. Finding supplements that are tailor made for elaborating Austrian macroeconomics is not easy either, mainly because such supplements were not specifically designed for an intermediate macroeconomics course. Although this is not necessarily ideal, I have, up until now, assigned sections on the production structure, interest, and money from Rothbard's *Man, Economy, and State*. I have also incorporated into the syllabus chapters from Garrison's *Time and Money* on the business cycle, although students sometimes become more intrigued by and focus on Garrison's graphical apparatus rather than on what he is trying to communicate with it.

I then turn to a conventional text when expounding alternative macroeconomic paradigms. A historical approach to macroeconomics is an effective way to compare and contrast the several competing extant macroeconomic theories. Even though most academic economists eschew orthodox Keynesianism, the financial media and vast majority of policy makers still operate in a primitive Keynesian framework, so it is helpful for students to begin their tour of alternative theories with Keynes. Additionally, most macroeconomic theories that followed were reactions to Keynes and the early Keynesians. I have used Froyen's *Macroeconomics: Theory and Policies* (2005) and most recently the newly released *Modern Macroeconomics: Its Origins, Development, and Current State* by Snowden and Vane (2005). Both Froyen's and Snowden and Vane's books are very suitable for this approach.

Virtues that make Snowden and Vane attractive, given present circumstances, include an outstanding bibliography and insightful interviews with major macroeconomic theorists. They also tend to be even handed in presenting each macroeconomic paradigm, although it is clear that they are Keynesians at heart and view economic downturns in general and the Great Depression in particular as products of insufficient aggregate demand. Additionally, Snowden and Vane include a chapter on Austrian theory authored by Roger Garrison. Garrison's chapter is essentially a condensed version of portions of his *Time and Money*. Even with Garrison's contribution, however, Snowden and Vane's text lacks an Austrian core.

Substantial help has arrived with the English publication of de Soto's *Money, Bank Credit, and Economic Cycles* (2006). Chapters 5 and 6 of de Soto's work provide an excellent, up-to-date exposition of Austrian macroeconomic theory, including the theory of the business cycle. Chapter 7 is a critique of Keynesian and Monetarist doctrines. De Soto also includes a brief critique of rational expectations theory. At the present time, it appears that de Soto's work will serve quite nicely as the main text for teaching Misesian macroeconomics, supplemented by a mainstream text such as Froyen or Snowden and Vane.

For a critique of non-Misesian macroeconomic paradigms, there are a number of outstanding sources. Rothbard's analysis of the Keynesian cross, found in chapter 11 of *Man, Economy, and State* is excellent. Garrison's chapters critiquing Keynesian and Monetarist theories are the best chapters in *Time and Money*. Again the seventh chapter in de Soto's *Money, Bank Credit, and Economic Cycles* looks promising. I also end my course by having students read an outstanding article by Roger Garrison, "The Austrian Theory of the Business Cycle in the Light of Modern Macroeconomics" (1989). In it, Garrison provides a clear, concise, and insightful comparison between Austrian macroeconomics and alternative frameworks that intermediate students find understandable and engaging.

Concluding Thoughts

In this article I present suggestions for how Austrian economists might attempt to solve the dilemma faced by professors of intermediate macroeconomics: should we teach what is true or what we think our students need to know to be successful professionally? The short answer is that, if done right, we don't necessarily have to choose between one and the other. To be true to our vocation as economists, we must provide our students with a true praxeological framework for macroeconomic analysis. It is this very framework, however, that allows us to consider and correctly evaluate the several alternative macroeconomic paradigms that are currently used in the profession. An intermediate macroeconomics course similar to the one outlined above is one way to provide economic students with a firm understanding of economic truth and the various economic fallacies that currently pass for professional wisdom.

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