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History of Economic Thought: The Austrian School

Fall 1994

Purpose

This course is intended to provide a thorough investigation of the development of the unique contributions of the Austrian School of economics to serious graduate students. Emphasis will be placed on the evolution of the school's insights through its participation in the on going conversation of the economics profession at large. After a presentation of Carl Menger's theoretical system contained in *Principles of Economics*, four major historical debates will be emphasized: the *methodenstreit* or debate over methods, the capital theory debates (Bohm-Bawerk v. Clark, and Hayek v. Knight), the Keynes-Hayek debates on monetary theory and the trade cycle, and the socialist calculation debate of the 1930s and 1940s. These professional debates pre-occupied not only the Austrian school from the 1870s to 1960s, but the general economics profession as well, and consequently they shaped the development of modern economic thought in general. Not only are these debates of interest to intellectual historians, but it is my conviction that many of the issues remain unresolved and as such would have profound implications for modern economics if successfully reconstructed.

Reading

I have put an * next to required reading for each week. Additional citations to both original contributions and modern interpretations are provided for further study by those who wish to pursue research in this tradition of economic scholarship. I have tried to be comprehensive in my citations. I have ordered for the bookstore the following books:

Menger, C. *Principles of Economics*.

Mises, L. *Human Action*.

Hayek, F.A. *Individualism and Economics Order*.

Vaughn, K. *Austrian Economics in America: The Migration of a Tradition*.

Grading

Course grade will be based on four short essay assignments worth 25 points each and a final exam worth 100 points. The short essays will be 2 to 4 double-spaced typed pages and will address specific questions. The final exam will consist of problem sets related to the analytical contributions of Austrian economics and essays dealing with the professional debates covered in the course. Class attendance and participation is expected.

Semester Schedule

Week 1: September 12

Introduction to the Course.

Week 2: September 19

Why Study the History of Economic Thought in general, and the History of the Austrian School in particular?

*Vaughn, Karen. Why teach the history of economics? *Journal of the History of Economic Thought*, 15 (Spring 1993): 174-183.

*Mitchell, Wesley C. On the study of the economic classics. In *Types of Economic Theory* (Augustus M. Kelley, 1967): 1-34.

*Viner, Jacob. A modest proposal for some stress on scholarship in graduate training. In *Essays on the Intellectual History of Economics* (Princeton University Press, 1991): 385-395.

*Boulding, Kenneth. After Samuelson Who Needs Smith? *History of Political Economy* (1971).

*Kirzner, Israel M. Introductions. *Classics in Austrian Economics: A Sampling in the History of a Tradition*, 3 vols. (William Pickering, 1994).

Kirzner, I. Austrian School of Economics. In *The New Palgrave: A Dictionary of Economics*, Vol. 1, edited by John Eatwell, Murray Milgate and Peter Newman (New York: Macmillan Publishing, 1987), pp. 145-151.

Craver, E. The emigration of the Austrian economists. *History of Political Economy*, 18, no. 1 (Spring 1986).

Mises, L. *The Historical Setting of the Austrian School* (Auburn, AL: The Ludwig von Mises Institute, 1984[1969]).

Ebeling, R. Austrian Economics -- An Annotated Bibliography. *Humane Studies Review*, 2, no. 1, and 3, no. 2.

Week 3: September 26

Guest Lecture -- to be determined.

Week 4: October 3

Menger's and the Early Austrian School's Contribution: Marginal Utility and Subjective Value.

A. The Theory of Value

*Menger, C. *Principles of Economics*, chap. 3.

Bohm-Bawerk, E. *Capital and Interest*, Vol. 2, Book 3, Part A, chaps., 1-5, 8-10.

Wieser, F. *Social Economics*, Book 1, chaps. 4-6, 16-17.

Wicksteed, P. *The Common Sense of Political Economy*, 2 vols., New York: August M. Kelley, 1967[1910], Vol. 1, chaps. 1-3.

*Cuhel, F. On the Theory of Needs. In Israel M. Kirzner, ed., *Classics in Austrian Economics*, Vol. 1.

Mises, L. *The Theory of Money and Credit*, chap. 2.

Mises, L. *Epistemological Problems of Economics*, chaps. 4-5.

*Mises, L. *Human Action*, chap. 4.

High, J. and Bloch, H. On the history of ordinal utility theory: 1900-1932. *History of Political Economy*, 21, no. 2 (Summer 1989).

B. Opportunity Cost

Bohm-Bawerk, E. *Capital and Interest*, Vol. 2, Book 3, Part B, chap. 4.

Wieser, F. *Natural Value*, Book V, chaps. 1-8.

*Wieser, F. On the relationship of costs to value. In Israel M. Kirzner, *Classics in Austrian Economics*, Vol. 1.

Wicksteed, P. *The Common Sense of Political Economy*, Vol. 1, chap. 9, only p. 373 ff.

Robbins, L. Remarks upon certain aspects of the theory of costs [1934]. In James M. Buchanan and G.F. Thirlby, eds., *L.S.E. Essays on Cost* (New York: New York University Press, 1981).

*Buchanan, J. *Cost and Choice* (Chicago: University of Chicago Press, 1978[1969]), chaps. 1-2.

*Mises, L. *Human Action*, pp. 339-350.

C. Price Formation

*Menger, C. *Principles of Economics*, chaps. 4-5.

Bohm-Bawerk, E. *Capital and Interest*, Vol. 2, Book 3, Part B, chaps. 1-3.

*Wicksteed, P. The scope and method of political economy in the light of the 'marginal' theory of value and distribution. In *The Common-Sense of Political Economy*, Vol. 2, pp. 772-796.

*Mises, L. *Human Action*, chap. 16.

Mayer, H. The cognitive value of functional theories of price. In Israel M. Kirzner, ed., *Classics in Austrian Economics*, Vol. 2.

Heyne, P. Supply and Demand. In Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*.

Week 5: October 10

Menger's Contribution (continued).

IN ADDITION TO THE ABOVE ORIGINAL SOURCES, STUDENTS MAY FIND IT USEFUL TO CONSULT THE FOLLOWING BIOGRAPHICAL AND RETROSPECTIVE ESSAYS ON MENGER'S SYSTEM:

*Vaughn, K. *Austrian Economics in America*, chap. 2.

Wicksell, K. Carl Menger [1921]. In *Selected Papers on Economic Theory*. New York: Kelley, 1969[1958].

Wicksell, K. The New Edition of Menger's *Grundsätze* [1924]. In *Selected Papers on Economic Theory*.

Schumpeter, J. Carl Menger. In *Ten Great Economists*. New York: Oxford University Press,

1951.

Schumpeter, J. Eugen von Bohm-Bawerk. In *Ten Great Economists*.

Schumpeter, J. Friedrich von Wieser. In *Ten Great Economists*.

Hayek, F. Carl Menger. In Carl Menger, *Principles of Economics*.

J.R. Hicks and W. Weber, eds. *Carl Menger and the Austrian School of Economics*. Oxford: Clarendon Press, 1973.

Max Alter. *Carl Menger and the Origins of Austrian Economics*. Boulder, Co.: Westview Press, 1990. However, see my critical review of this book in *Journal of Economic History* (June 1992): 519-521.

Atlantic Economics Journal (1978) [Special issue on Menger].

History of Political Economy (1990) [Special issue on Menger]; subsequently published as Bruce Caldwell, ed., *Carl Menger and His Legacy in Economics*. Durham: Duke University Press, 1990. However, you may also want to see my review essay of this book in *Research in the History of Thought and Methodology*, 13 (1994).

Essay Assignment #1:

Alfred Marshall in his *Principles of Economics*, 8th Ed (Macmillan Publishing, 1920[1890], p. 290) argues that:

We might as reasonably dispute whether it is the upper or the under blade of a pair of scissors that cuts a piece of paper, as whether value is governed by utility or cost of production.

How does this explanation differ from a consistently subjectivist one? Reconstruct supply and demand analysis from a consistently subjectivist perspective?

Due in 2 weeks.

Week 6: October 17

Methodological Concerns of the Austrian School.

A. The Critique of Historicism and The Austrian Alternative

Menger, C. *Investigations*, Books 1-2.

*Bohm-Bawerk, E. The historical vs. the deductive method in political economy. *Annals of the Academy of Political Science* 1 (July 1890). Reprinted in Israel M. Kirzner, ed., *Classics in Austrian Economics*, Vol. 1.

Wieser, F. *Social Economics*, introduction.

Mises, L. *Epistemological Problems*, chaps. 1-3.

*Mises, L. *Human Action*, 1-142.

Schutz, A. *The Phenomenology of the Social World*. Northwestern University Press, 1970[1932], chaps. 1, 4-5.

Strigl, R. Economic theory in the service of economic policy. In Israel M. Kirzner, ed., *Classics in Austrian Economics*, Vol. 2.

Haberler, G. Economics as an exact science. In Israel M. Kirzner, ed., *Classics in Austrian Economics*, Vol. 2.

Robbins, L. *An Essay on the Nature and Significance of Economic Science*. London: Macmillan, 1932.

USEFUL SECONDARY SOURCES TO EXAMINE WOULD BE:

White, L. *The Methodology of the Austrian School Economists*. Ludwig von Mises Institute, 1984[1977].

Bostaph, S. The methodological debate between Carl Menger and the German Historicists. *Atlantic Economic Journal*, 6, no. 3 (September 1978).

*Bostaph, S. The methodenstreit. In Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*. Edward Elgar Publishing, 1994.

Prendergast, C. Alfred Schutz and the Austrian School of Economics. *American Journal of Sociology*, 92, no. 1 (July 1986).

Week 7: October 24

B. The emergence of positivism and formalism as methodological forces in economics

Caldwell, Bruce. *Beyond Positivism*. London: Unwin, 1982.

Hutchison, T.W. *The Significance and Basic Postulates of Economic Theory*. New York: Kelley, 1960[1938], chaps. 1-2, 4.

Knight, F. What is truth in economics? In *On the History and Method of Economics*. Chicago: University of Chicago Press, 1956.

Friedman, M. The methodology of positive economics. In *Essays on Positive Economics*. Chicago: University of Chicago Press, 1953.

*Hayek, F. The facts of the social sciences. In *Individualism and Economic Order*, ch. 3.

Hayek, F. *The Counter-Revolution of Science*, chaps. 1-10.

Machlup, F. The problem of verification in economics. *Southern Economics Journal* (July 1955).

Hutchison, T.W. Professor Machlup on verification in economics. *Southern Economics Journal* (April 1956).

Machlup, F. Rejoinder to a reluctant ultra-empiricist. *Southern Economics Journal* (April 1956).

Rothbard, M. In defense of extreme apriorism. *Southern Economics Journal* (January 1957).

Smith, B. Austrian economics and Austrian philosophy. In Wolfgang Grassl and Barry Smith, eds., *Austrian Economics: Historical and Philosophical Background*. New York University Press, 1986.

Boettke, P. Interpretive reasoning and the study of social life. *Methodus*, 2, no. 2 (December 1990). Reprinted in David L. Prychitko, ed., *Individuals, Institutions, and Interpretations*. Avebury, 1995.

Boettke, P. Storytelling and the Human Sciences. In Peter J. Boettke and David L. Prychitko, eds., *The Market Process: Essays in Contemporary Austrian Economics*. Edward Elgar Publishing, 1994.

Essay Assignment #2:

Many critics of Austrian economics argue that the school is too preoccupied with methodological questions. Why does methodology matter so much to representatives of the Austrian School?

Due in 2 weeks.

Week 8: October 31

The Theory of Capital and Interest from Menger and Bohm-Bawerk to Mises and Hayek.

A. Imputation and the Structure of Production.

*Menger, C. *Principles of Economics*, ch. 1, pp. 55-74, chap. 3, pp. 149-174.

Wieser, F. *Natural Value*, pp. 69-113.

Bohm-Bawerk, E. *Capital and Interest*, Vol. 2, Book 2 and Book 3, ch. 7.

Hayek, F. Some remarks on the problem of imputation [1926]. In *Money, Capital and Fluctuations*. Chicago: University of Chicago Press, 1984.

Hayek, F. *Prices and Production*, Lecture 2.

Fetter, F. Recent discussion of the capital concept. In *Capital, Interest and Rent*. Kansas City: Sheed Andrews and McMeel, Inc., 1977.

Skousen, M. *The Structure of Production*. New York: New York University Press, 1990.

B. The Theory of Interest.

Bohm-Bawerk, E. *Capital and Interest*, Vol. 2, Book 4, chaps. 1-3.

Fetter, F. The "roundabout process" in the interest theory [1902]. In *Capital, Interest and Rent*.

*Kirzner, I. Ludwig von Mises and the Theory of Capital and Interest. In *Perception, Opportunity and Profit*. Chicago: University of Chicago Press, 1979.

*Kirzner, I. The pure time-preference theory of interest: an attempt at clarification. In Jeffrey Herbener, ed., *The Meaning of Ludwig von Mises*. Boston: Kluwer Academic Publishers, 1993.

*Rothbard, M. Time preference. In Richard Ebeling, ed., *Austrian Economics: A Reader*. Hillsdale College Press, 1991.

C. Capital Theory Controversy.

Knight, F. Professor Mises and the Theory of Capital. *Economica* (November 1941).

Knight, F. Professor Hayek and the Theory of Capital. *Economic Journal* (1935).

Knight, F. The Theory of Investment once more: Mr. Boulding and the Austrians. *Quarterly Journal of Economics* (1935).

Machlup, F. Professor Knight and the 'Period of Production'. In Israel M. Kirzner, ed., *Classics in Austrian Economics*, Vol. 2.

Kaldor, N. The recent controversy on the theory of capital. *Econometrica* (July 1937).

Hayek, F. *Capital and Industrial Fluctuations*. In *Prices and Production*.

Hayek, F. Maintenance of Capital. In *Profits, Interest and Investment*. New York: Kelley, 1975[1939].

Week 9: November 7

Capital Theory (continued).

Students may find it useful to consult:

Kirzner, I. *An Essay on Capital*. New York: Kelley, 1966.

*Lewin, Peter. Capital Theory. In Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*.

Week 10: November 14

The development of the Austrian Theory of the Trade Cycle.

A. Origin and Function of Money.

*Menger, C. *Principles of Economics*, chap. 8.

Menger, C. *Investigations*, Book 3.

Menger, C. On the origin of money. *Economic Journal*, 2 (June 1892). Reprinted in Israel M. Kirzner, ed., *Classics in Austrian Economics*, Vol. 1.

Mises, L. *The Theory of Money and Credit*, chaps. 1-8.

*Mises, L. *Human Action*, chap. 17.

B. Real and monetary aspects of the Trade Cycle.

Mises, L. *The Theory of Money and Credit*, chap. 19.

Mises, L. Monetary stabilization and cyclical policy [1928]. In *On the manipulation of money and credit*. New York: Free Market Books, 1978.

*Mises, L. *Human Action*, chap. 20.

Hayek, F. *Monetary Theory and the Trade Cycle*. New York: Kelley, 1966[1933].

Hayek, F. *Prices and Production*, Lecture 3.

Hayek, F. Price expectations, monetary disturbances and malinvestments [1933]. In *Profits, Interest and Investment*.

*Hayek, F. The Ricardo Effect. In *Individualism and Economic Order*, chap. 11.

Essay Assignment #3:

How does the Austrian conception of a time structure of production and the imputation of value differ from the neoclassical conception of a circular flow? Does this matter for studying the trade cycle?

Due in 2 weeks

Week 11: November 21

The Hayek-Keynes Debate.

*Butos, W. The Hayek-Keynes Debate. In Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*.

McCormick, B. *Hayek and the Keynesian Avalanche*. New York: St. Martin's Press, 1992.

Skidelsky, R. *John Maynard Keynes: The Economist as Savior, 1920-1937*. New York: Penguin Press, 1994, pp. 454-459.

Hayek, F. Reflections on the pure theory of money of Mr. J. M. Keynes: Part 1. *Economica* (August 1931).

Keynes, J.M. The pure theory of money: a reply to Dr. Hayek. *Economica* (November 1931).

Hayek, F. A rejoinder to Mr. Keynes. *Economica* (November 1931).

Hayek, F. Reflections on the pure theory of money of Mr. J. M. Keynes: Part 2. *Economica* (February 1932).

Keynes, J.M. *The General Theory*. New York: Harcourt Brace Jovanovich, 1964[1936].

Sraffa, P. Dr. Hayek on Money and Capital. *The Economic Journal* (March 1932).

Hayek, F. *The Pure Theory of Capital*. Chicago: University of Chicago Press, 1975[1941].

Lachmann, L. Austrian Economics under fire: the Hayek-Sraffa duel in retrospect. In Wolfgang Grassl and Barry Smith, eds., *Austrian Economics*.

Hicks, J.R. The Hayek Story. In *Critical Essays in Monetary Theory*. New York: Oxford University Press, 1967.

*Garrison, R. Intertemporal coordination and the invisible hand: An Austrian perspective on the Keynesian vision. *History of Political Economy* 17 (Summer 1985).

Week 12: November 28 (Hanukkah -- attendance optional)

The Austrian Critique of Marx from Bohm-Bawerk to Mises.

Bohm-Bawerk, E. *Karl Marx and the Close of His System*. New York: Kelley, 1975, pp. 1-118.

Hilferding, R. Bohm-Bawerk's criticism of Marx. In *Karl Marx and the Close of His System*, pp. 121-196.

Rosner, P. The Bohm-Bawerk - Hilferding Debate. In Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*.

Bukharin, N. *The Economic Theory of the Leisure Class*. New York: Kelley, 1970[1919].

Wicksteed, P. Das Kapital: A Criticism. In *The Common Sense of Political Economy*, Vol. 2.

*Mises, L. Economic calculation in the socialist commonwealth [1920]. In F. A. Hayek, ed. *Collectivist Economic Planning*. New York: Kelley, 1975[1935].

Mises, L. *Socialism*, Part 2, chs. 5-11.

*Mises, L. *Human Action*, 200-231; 689-715.

Week 13: December 5

The socialist calculation debate.

*Hayek, F. The nature and history of the problem [1935]. In *Collectivist Economic Planning*. Reprinted in Idem., *Individualism and Economic Order*, pp. 119-147.

*Hayek, F. The present state of the debate [1935]. In *Collectivist Economic Planning*. Reprinted in Idem., *Individualism and Economic Order*, pp. 148-180.

*Hayek, F. Socialist Calculation III: The competitive solution [1940]. In *Individualism and Economic Order*, pp. 181-208.

*Hayek, F. The use of knowledge in society [1945]. In *Individualism and Economic Order*, 77-91.

Lange, O. On the economic theory of socialism. *Review of Economic Studies* (October 1936 and February 1937), reprinted with additions in Benjamin Lippincott, ed., *On the economic theory of socialism*. New York: Kelley, 1970[1939].

STUDENTS MAY FIND IT HELPFUL TO CONSULT:

*Vaughn, K. *Austrian Economics in America*, chap. 3.

Vaughn, K. The socialist calculation debate. In Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*.

Kirzner, I. The socialist calculation debate: lessons for Austrians. *Review of Austrian Economics* 2(1988). Reprinted in *The Meaning of Market Process*. London: Routledge, 1992.

Lavoie, D. *Rivalry and Central Planning: The socialist calculation debate reconsidered*. New York: Cambridge University Press, 1985. **Note: this book is widely considered the best scholarly summary of the debate. The book had a significant impact in reversing the mainstream interpretation that the Austrians had lost the debate to Lange and Lerner. In the wake of Lavoie's revisionist interpretation, the terms of the debate in the literature shifted. It was originally written as a PhD thesis at NYU under the direction of Prof. Israel Kirzner.**

Hoff, T. *Economic Calculation in the Socialist Society*. Indianapolis: Liberty Press, 1980[1949].

Boettke, P. *The Political Economy of Soviet Socialism: The Formative Years, 1918-1928*. Boston: Kluwer Academic Publishers, 1990, pp. 23-29, 130-132, 169-171.

Boettke, P. *Why Perestroika Failed: The Politics and Economics of Socialist Transformation*. London: Routledge, 1993, chap. 3.

Essay Assignment #4:

During the socialist calculation debate the focus seems to shift from Mises's emphasis on calculation of the relative merits of different capital investments to Hayek's emphasis on the knowledge generating role of market competition and the price system, how (if at all) do these arguments fit together?

Due on last day of finals week, December 22.

Week 14: December 12

The Fall and Resurgence of the Austrian School Reconsidered.

A. The Fall of Austrian Economics

Hayek, F. The trend in economic thinking. *Economica* (May 1933).

O'Driscoll, G. *Economics as a Coordination Problem*. Sheed Andrews and McMeel, 1977, chs. 1, 6-7.

High, J. *Maximizing, Action, and Market Adjustment: An Inquiry into the Theory of Economic Disequilibrium*. Munchen: Philosophia Verlag, 1990, ch. 1-2, 5.

B. The Resurgence of Austrian Economics, 1970-

*Vaughn, Karen. *Austrian Economics in America: The Migration of a Tradition*. New York: Cambridge University Press, 1994.

*Boettke, P. and Prychitko, D. The present status of Austrian economics. In Peter J. Boettke and David L. Prychitko, eds., *The Market Process: Essays in Contemporary Austrian*

Economics. Aldershot: Edward Elgar Publishing, 1994.

C. The Future of Austrian Economics

*Rizzo, M. Austrian Economics for the Twenty-First Century. In Bruce Caldwell and Stephan Boehm, eds., *Austrian Economics*. Kluwer Academic Publisher, 1992.

*Boettke, P. Alternative Paths Forward for Austrian Economics. In Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*.

Week 15: December 19

Final Exam Due

Exam

Answer ten questions out of the twelve listed below. Exam must be typed and returned by 7:00pm 19 December.

1. Israel Kirzner, in his introduction to his 3 volume edited work, *Classics in Austrian Economics* argues that Ludwig von Mises's work in theoretical economics was a result of consistently pursuing the Mengerian *vision*. What exactly was Menger's vision? What analytical positive economic propositions unique to Mises flowed from the vision and in what way does this corroborate Kirzner's intellectual history observation?
2. In Max Alter's *Carl Menger and the Origins of Austrian Economics* the argument is made that Menger suffered from a transformation problem not unlike the one attributed to Marx. Alter argues that Menger cannot derive a determinant price from his theory of subjective values. Why is this a questionable conclusion to reach concerning Menger's price theory?
3. How does the Walras system of general equilibrium, as first presented by him and usually reproduced by his expositors, deal -- explicitly or implicitly -- with the following: (a) the law of diminishing returns (or of nonproportional output); (b) the law of returns to scale; (c) the optimum size of the firm; (d) the degree of competition; (e) the homogeneity or heterogeneity of productive resources; (f) the mobility of productive resources; (g) the profits of entrepreneurs; (h) the elasticity of supply of labor; (i) the liquidity preference; (j) the supply of money; (k) the time structure of the production process; (l) the accumulation of capital?

How does the Menger theory of market processes, as developed by him and elaborated by those developing the Austrian tradition, deal with these issues?

Is Austrian economics simply verbal neoclassical economics?

4. Reasoning along the lines of Bohm-Bawerk's capital theory, assume that land is abundant and that there are two, and only two, alternative ways of using labor in the production of consumers' goods: one without any roundabout ways and the other with an average investment period of one year. With the latter method, labor is 20 percent more productive than with the former.

From these assumptions one might conclude: (a) that the rate of interest will be 20 percent; (b) that the interest rate will be zero and wages will be determined by the productivity of labor used in the more productive way; (c) that the rate of interest might be anything between zero and 20 percent; (d) that the rate of interest might be well above 20 percent. Discuss each of these alleged possibilities and state any additional assumptions needed for it to be realized.

5. Without indicating your own opinions or inclinations, present both sides in the controversy between Frank Knight and the "Austrians" with respect to the following points: (a) that all capital is conceptually perpetual or conceptually nonpermanent; (b) that economic progress may result in a "shortening" of the investment period; (c) that an increase in the supply of capital need not change the production period of any single product; and (d) that it is not possible to identify the contributions of the original factors of the remote past.

6. In *The Pure Theory of Capital*, Hayek introduces the terminology of money as a "loose joint". What does he mean by this terminology? How does it affect our understanding of: (a) the quantity theory of money; (b) the classical dichotomy; and (c) the neutrality of money. With these points in mind -- how would you respond to modern theorists, such as Robert Lucas, who have claimed Hayek as an influence on the contemporary development of equilibrium theories of the trade cycle?

7. Austrian economics, by most observers of economic science, is viewed as closely associated with classical liberalism politics. Austrian economists, however, are insistent that their approach to economics is "value free" and not ideological. What are the Austrian arguments for value-freedom and why -- even with strict adherence to value-freedom -- do Austrians argue that they can critically assess arguments to politically plan or intervene in the economic system?

8. In January 1931, before his lectures series at LSE, Hayek gave a one-lecture version to the Marshall Society at Cambridge. Keynes was unable to attend the lecture, but Richard Kahn was in the audience. After Hayek's lecture there was complete silence induced by disbelief. Kahn broke the ice by asking: "Is it your view that if I went out tomorrow and bought a new overcoat, that would increase unemployment?" "Yes," Hayek was supposed to have replied, turning to the blackboard filled with triangles, "but it would take a very long mathematical argument to explain why." First, does this story of Kahn's (repeated often in Keynesian lore) seem plausible to you? Second, assuming that it is true, what would be the logic of Hayek's argument why the purchase of a new overcoat would increase unemployment? How does this logic contrast with Keynes's logic to such a degree that upon reading Hayek's *Prices and Production* stated that the book was "an extraordinary example of how, starting with a mistake,

a remorseless logician can end in Bedlam"?

9. Joseph Schumpeter argued in *Capitalism, Socialism and Democracy* that "So far as economic logic is concerned, it cannot be held that socialism of the kind envisaged, while theoretically capable of coping with the recurrent tasks of the administration of a stationary economy, would necessarily fail in the solution of the problems presented by "progress." In other words, Schumpeter argued that rational economic calculation under socialism was possible as opposed to the argument put forth by Mises. To reach this conclusion, Schumpeter relied on the "elementary proposition that consumers in evaluating ("demanding") consumers' good *ipso facto* also evaluate the means of production which enter in the production of those goods." First, discuss this elementary proposition in detail. Second, how, according to Hayek (see "The Use of Knowledge in Society") is Schumpeter's application of this proposition a symptom of a serious theoretical shortcoming in modern economic theorizing? Third, why -- if Hayek is correct -- is Schumpeter's argument concerning the feasibility of socialist calculation analytically flawed?

10. In Karen Vaughn's *Austrian Economics in America* a tension in Mises's work, especially *Human Action* is highlighted. Mises presents at one and the same time a radical critique of previous classical economics (with regard to value theory) and contemporary trends in economic research (e.g., mathematical equilibrium models, econometric testing, and game theory) on the one hand, and a defense of the liberal order employing "modern" orthodox economics against the interventionist arguments of Keynes and the socialist arguments of historicism and institutionalism on the other. Rhetorically, Mises is both political radical and economic theory conservative and political conservative and economic theory radical. How would you resolve this apparent tension in Mises's thought?

11. In Hayek's *The Counter-Revolution of Science* he argues that all the advances in modern economic theory were due to the consistent extension of subjectivist thinking. Moreover, Hayek argues that Ludwig von Mises -- more than any other theorist -- is responsible for that extension and it is for that reason, Hayek conjectures, that many of Mises's ideas concerning methodology, capital theory, value theory, socialist calculation and business cycles strike the reader as odd at first glance. Mises, Hayek states, is running ahead of his contemporaries on consistently developing the insights of the marginalist/subjectivist revelation of the 1870s. Elaborate on Hayek's Argument -- what exactly are those contributions and is it true that Mises, more than anyone else is responsible for them.

12. Oskar Morgenstern was trained in the Austrian tradition of economic scholarship at the University of Vienna. He was a close colleague of both Fritz Machlup and F.A. Hayek. Moreover, he was a regular participant in Mises's economic theory seminar in Vienna. He also served as the director of the Austrian Institute for Economic Research (a research Institute founded by Mises) before moving to the U.S. In the 1930's, Morgenstern wrote a paper highlighting the contradictions inherent in the idea of perfect foresight and general equilibrium

theory. Consider the example of Sherlock Holmes and Professor Moriarty (Holmes' arch-rival):

Sherlock Holmes, pursued by his opponent, Moriarty, leaves for Dover.

The train stops at a station on the way, and he alights there rather than travelling on to Dover. He has seen Moriarty at the railway station, recognizing that he is very clever, and expects that Moriarty will take a special faster train in order to catch him at Dover. Holmes' anticipation turns out to be correct. But what if Moriarty had been still more clever, had estimated Holmes' mental abilities better and had foreseen his actions accordingly? Then obviously he would have travelled to the intermediate station. Holmes, again, would have had to calculate that, and he himself would have decided to go on to Dover. Whereupon Moriarty would have "reacted" differently. Because of so much thinking they might not have been able to act at all or the intellectually weaker of the two would have surrendered to the other in the Victoria Station, since the whole fight would have become unnecessary. Examples of this kind can be drawn from everywhere. However, chess, strategy, etc. presuppose expert knowledge, which encumbers the example unnecessarily (Morgenstern, "Perfect Foresight and Economic Equilibrium," 1935).

In Hayek's Essay "The Meaning of Competition" he refers to Morgenstern's paper in the context of "the familiar paradox of the paralyzing effect really perfect knowledge and foresight would have on all action." Is this point concerning the paradox of perfect knowledge developed by Morgenstern "Mengerian"? If so, how was it developed by subsequent generations of Austrian economists? Many have argued that once this problem is taken seriously that game theory is the obvious paradigm to adopt. Morgenstern, in fact, did do exactly that. Why have other Austrians not followed suit? In your opinion, does game theoretic techniques aid the economic theorist in addressing the problems for economic theory that follow from the paradox of perfect knowledge?

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