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Review of Economics as a Coordination Problem: The Contributions of Friedrich A. Hayek by Gerald P. O'Driscoll, Jr.

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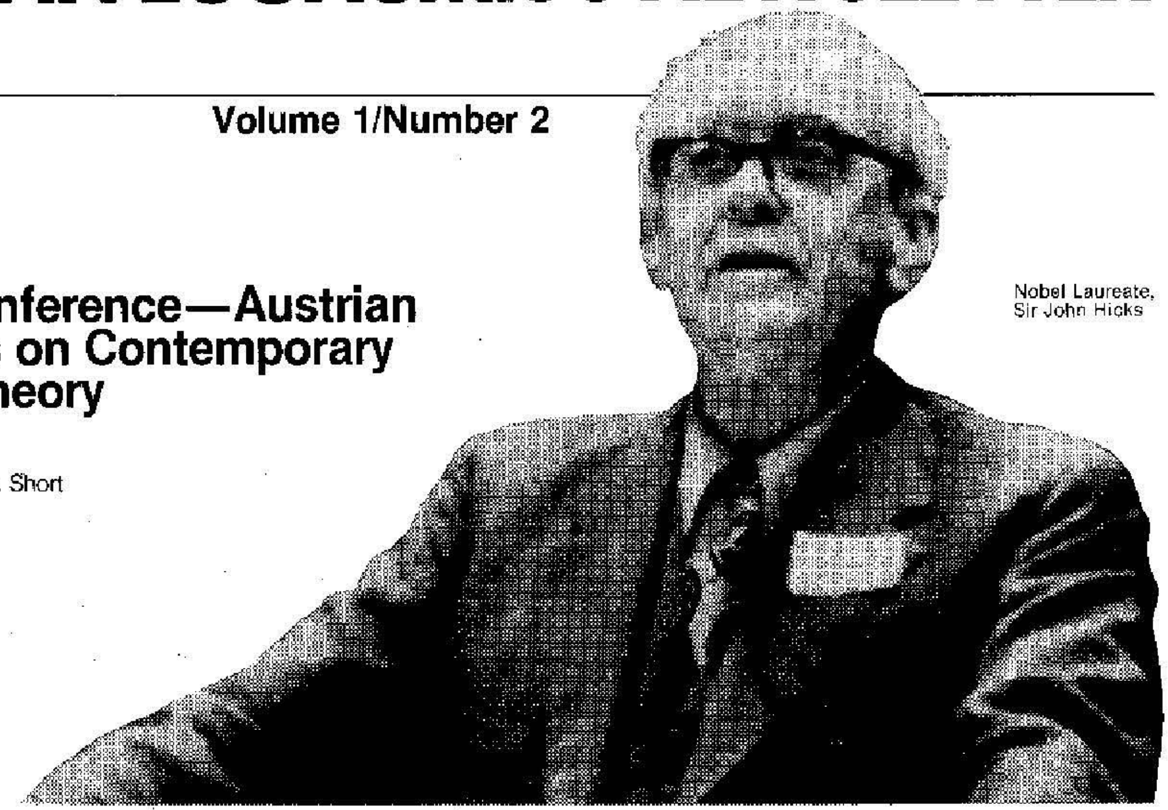
The NYU Conference—Austrian Perspectives on Contemporary Economic Theory

by Gary G. and Eugenie D. Short



Nobel Laureate, Sir John Hicks

Perhaps the most successful of the recent Austrian conferences was held at New York University on Jan. 7-8, 1978. The conference, "Issues in Economic Theory: An Evaluation of Current Austrian Perspectives," was directed by Dr. Mario J. Rizzo and sponsored jointly by the Center for Applied Economics of NYU and the Institute for Humane Studies. Approximately 150 economists attended from various institutions throughout the United States as well as from Great Britain and Australia. Among those attending were the editors of three leading economic journals: *Economic Inquiry*, the *Journal of Economic Literature*, and the *Southern Economic Journal*. Sessions were held at the NYU School of Law and consisted of six papers and comments primarily examining Austrian insights into important questions confronting the economics profession.

The conference began Saturday morning with a paper by Professor Gerald P. O'Driscoll, Jr., (Iowa State) entitled "Rational Expectations, Politics, and Stagflation." O'Driscoll drew attention to a relatively neglected paradox between two widely discussed bodies of contemporary thought in economics: rational expectations and political business cycle theories. The implication of the former is that economic policy will have no real effects on the economy since individuals will anticipate policy changes and adjust their behavior in a manner which offsets the effect of these policies while the latter theory implies that economic policy does cause real economic fluctuations.

Professor O'Driscoll argued that there are important insights in both theories, as well as errors. Providing a thorough examination of the rational expectations literature, he observed that expectations are certainly important in influencing individual behavior and hence it is desirable to see economists focusing on them. However, he criticized the existing literature for merely replacing the traditional assumption of perfect knowledge of outcomes with the no less restrictive assumption of perfect knowledge of subjective probability distributions. O'Driscoll also pointed out that the rational expectations approach is incapable of dealing with aspects of uncertainty such as "incomplete listability," i.e., a state of affairs where the agent does not know (and does not presume to know) all of the possible outcomes. In other words, the rational expectations approach cannot deal with Knightian uncertainty. Further, O'Driscoll was critical of the rational expectations theorists for neglecting F.A. Hayek's insight that monetary expectations can distort the whole structure of relative prices because of the misinformation that the price system, working through the interest rate, can transmit in such circumstances.

Professor O'Driscoll concluded by comparing the theoretical frameworks used by the Rational Expectations and Political Business Cycle Theorists. He pointed out that the two approaches are similar in that both assume that individuals will respond to policy changes in a "rational" manner. However, the implications derived from these two approaches are quite different since "rational behavior" is interpreted in two rather distinct ways.

Commenting on the O'Driscoll paper was Professor Richard Wagner of VPI, who insisted that the only difficulty with the paper was that it did not go far enough. Drawing from his own work on Political Business Cycle theory, Wagner argued that rather than being primarily concerned with the impact of policy on macro-aggregates, the intent of political action is to influence the state of variables affecting *particular individuals* with aggregate consequences emerging only as a by-product. Working within a public choice framework, Wagner asserted that the motivating factor behind the monetary authorities decision to print money is that some groups are able to profit from inflationary policies and these groups provide incentives for the authorities to pursue this course of action.

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Austrian Economics Seminar, Part I: 1975-76

by Don C. Lavoie

AUSTRIAN ECONOMICS NEWSLETTER

Volume I, Number 2 **Spring 1978**

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.

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When the last of Ludwig von Mises' regular seminars in Austrian economics ended at NYU in 1969, it looked like the last dying gasp of the Austrian school. Ludwig Lachmann had said he expected that when Hayek died he would be the last living expositor of this once widely held point of view. But the resurgence of Austrian economics in the 1970's has exceeded the expectations of even the most optimistic among us. In a series of conferences beginning with South Royalton a whole host of young enthusiasts of modern subjectivism were discovered. And in September, 1975, only six years after Mises' seminar ended, the new Austrian Economics Seminar was formed.

This was the result of the efforts of Professor Walter Block who circulated a letter to some of the prominent exponents of the modern Austrian school living in the New York City area (Professors Grinder, Kirzner, Lachmann, Rothbard and Spadaro) suggesting the formation of a monthly seminar and outlining a possible format. The main purposes outlined were that the Austrian Economics Seminar (AES) serve as an advanced seminar extending the frontier of Austrian economics, and as a vehicle for the criticism and improvement of new Austrian contributions.

These expectations were remarkably well confirmed by the ensuing operation of the AES. Genuine and significant contributions to economics have been forged by some of the papers, but it has been the actual two-hour discussions among the leading luminaries of Austrian economics that have proved invaluable. For the first time, two of the most prominent American students of Mises—Murray Rothbard and Israel Kirzner—engaged in controversial discussions with such perceptive Austrian economists as Ludwig Lachmann, Walter Grinder and others. It proved to be a veritable feast of knowledge for those whose intellectual appetites have been stimulated by the various writings of these scholars. The many points of contention among the different participants were brought into sharper focus and the various strands and tendencies of Austrian economics were more clearly identified during these animated discussions than had heretofore been the case. Until recently Austrian economics had often matured independently in the minds of isolated readers, taking on different shades of emphasis and interpretation which had not had much chance for confrontation in the fruitful atmosphere of scientific criticism. It was in the AES that the Austrian spectrum was revealed and the lines of disagreement drawn. Rothbard and others attacked what has affectionately come to be known as "Lachmannia," an allegedly nihilistic tendency associated with Keynes and Shackle. On the other hand, Lachmann and others attacked what they perceived as latent "Ricardianism", a mechanistic tendency allegedly implicit in some of the Austrian literature.

Indeed much of the argumentative history of the AES can be analyzed as a gradual recognition of these two poles of thought, and the clarification or resolution of points of dispute between them. On the one hand, if we treat expectations as entirely autonomous then the future becomes unknowable and it seems that economics can say nothing at all. On the other hand, we cannot be satisfied with mechanistic economic reasoning where events are completely determinate and it seems that economics claims too much.

The "nihilistic" extreme at times appears to discard equilibrium analysis simply because we are never in equilibrium, stressing the diversity of expectations and seeing the market as including both equilibrating and disequilibrating forces. In contrast, the "Ricardian" extreme seems to ignore disequilibrating elements, stressing the market process whereby plans are made more convergent with each other. As in any advanced discussion much effort is required just to understand what each contributor is trying to say, and these "poles" of thought are frequently found to represent only matters of different emphasis.

The first meeting of the AES was held at New York University on December 17, 1975, to discuss Professor Joseph Salerno's "The Modern Monetary Theory of the Balance of Payments: A Subjectivist Critique". There were three major foci of discussion: methodology, the Evenly Rotating Economy and the Keynesian tripartite division of the demand for money. The methodological issue arose in response to Salerno's heavy emphasis on method, given an economic academia in which fundamental methodological questions are rarely asked. Austrians were urged to take pains to show how and where our approach would yield significantly different conclusions. We will be heeded as a scientific school only to the extent

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Gerald P. O'Driscoll, Jr.

Economics as a Coordination Problem: The Contributions of Friedrich A. Hayek. Sheed Andrews and McMeel, xxi, 240 pp. $12.00, pb $4.95

Reviewed by Jeffrey Rogers Hummel

Of the writings of all Austrian economists, those of Friedrich Hayek are undoubtedly the most difficult, complex, even obscure. Any effort, therefore, to explicate them or make them more readily understandable to a wider audience provides a valuable service. Gerald O'Driscoll's first book, *Economics as a Coordination Problem,* is such an effort and, for that reason alone, deserves to be applauded. Furthermore, O'Driscoll has gone beyond a mere summary of Hayek's ideas; he has identified the fundamental theme that integrates and ties together all of Hayek's positions but that Hayek himself never made explicit. Showing how Hayek's treatment of each specific issue is simply another illustration of the coordination problem, which in turn is the central question for the discipline of economics, is a flash of insight from which many students of Austrian economics have profited already.

Unfortunately, *Economics as a Coordination Problem* is also a flawed book with several drawbacks, two of which I will consider. First, while O'Driscoll includes extensive, explicit treatment of most of Hayek's works, especially of *Prices and Production* and *Profits, Interest and Investment,* he all but ignores *The Pure Theory of Capital.* O'Driscoll only mentions *The Pure Theory of Capital* about five times in the entire book, and this despite the fact that one of those times is to refer to it as Hayek's *magnum opus.* In fact, *The Pure Theory of Capital* is Hayek's most difficult work, the one most in need of elucidation. If Hayek's other books deserve a full treatment, then surely it does.

A second flaw in O'Driscoll's book is, in my opinion, more serious, and it stems partially from the first. O'Driscoll, in a series of chapters that successively build upon one another, gives Hayek's approach to issues of increasing complexity until reaching the final issue: business cycles. While discussing this final issue, O'Driscoll treats the title essay of Hayek's *Profit, Interest and Investment* as the most advanced statement of Hayek's business cycle theory. This sequence, in effect, represents *Profits, Interest and Investment* as the culmination of Hayek's thought.

This is a peculiar way to view *Profits, Interest and Investment* for three reasons. To begin with, Hayek conducts the analysis in that book within the context of four very restrictive and far-reaching, though usually unrealistic

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Reviewed by Richard M. Ebeling

When studying social phenomena, it is necessary to remember that all man-made objects and recorded data of prices and quantities are merely the historical sediments of previous human plans. To successfully understand the relationships between those objects, quantities and prices it is incumbent upon the social scientist to analyze the ends and means of the human actors involved. If we are to know what things mean in the social world we must try to understand what the purposeful acting agents meant.

The task is the same—and no less difficult—when it involves the analysis of an author's work. To successfully capture another person's perspective as presented through his written words is a notable achievement. This is what makes Dr. Gerald P. O'Driscoll's book, *Economics as a Coordination Problem: The Contributions of Friedrich A. Hayek,* such a valuable addition to the bookshelf of Austrian literature.

Dr. O'Driscoll has brought together the various strands of thought developed by Friedrich A. Hayek and has demonstrated the underlying theme in all of them. In the forward, Professor Hayek admits that he "was occasionally . . . surprised when I found in professor O'Driscoll's account side by side statements I made at the interval of many years on quite different problems, which still implied the same general approach."

The underlying theme that O'Driscoll has seen in Hayek's work concerns an understanding and appreciation of how, in a world of imperfect knowledge, the divergent plans of a multitude of individuals are brought into consistency in the market economy.

Existing general-equilibrium theory guarantees the consistency of plans by postulating a set of conditions that makes anything less impossible. It has never fully explained how those conditions could be expected to exist in a real market or what forces could be expected to propel the economy towards the equilibrium solution.

As Dr. O'Driscoll explains, Hayek was interested in analyzing both the institutional arrangements under which coordination could be brought about and the nature of the process involved. It was the price system as a transmitter of information that Hayek came to see as the focal point of this process.

In the three central chapters of the book, O'Driscoll provides an extremely

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The NYU Conference—Austrian Perspectives on Contemporary Economic Theory (Continued)

Conference director Mario Rizzo presented the second paper, "Uncertainty, Subjectivity and the Economic Analysis of the Law." Dr. Rizzo examined the now popular contention in much of the law and economics literature that the law of torts promotes economic efficiency. He demonstrated that there are serious difficulties understanding the meaning of this contention since "efficiency" is either irrelevant to the economic agents or it is a tautology since every situation will be seen to be efficient if all relevant constraints are recognized. Additionally, Rizzo examined six major legal precedent areas which appear to contradict the assertion that the law of torts promotes efficiency. Finally, he presented the position that outside of general competitive equilibrium, the minimization of objectively measurable costs does not ensure the minimization of true social opportunity costs. Therefore, even if it were possible to show that tort law minimizes the former, (which he argues it does not), it would still not follow that it minimizes the latter.

Professor Murray N. Rothbard of the New York Polytechnic Institute commented on Dr. Rizzo's paper. He voiced his wide agreement with the paper and stressed the meaninglessness of the concept of economic efficiency. Following Rothbard's comments a lively discussion from the audience ensued. Harold Demsetz, from UCLA, took Rizzo to task for the view that six cases were enough to counter the vast empirical research of Posner, Landes, and others which supports the hypothesis that tort law does promote efficiency. Rizzo responded that the cases discussed in his paper were important legal precedents which show that in significant areas the law of torts clearly does not promote efficiency.

Nobel Laureate Sir John Hicks presented Saturday's final paper, "Is Interest the Price of a Factor of Production?" His remarks were wide ranging and only in the second half of the paper did he address his title question, answering it in the affirmative. Throughout the first half of his paper Sir John chided the Austrians for their excessive mistrust of the notion of equilibrium, accusing them of rejecting equilibrium analysis "even as a tool of analysis." However, Hicks himself admitted to having become "quite critical of equilibrium economics"—at least of the manner in which it is often utilized.

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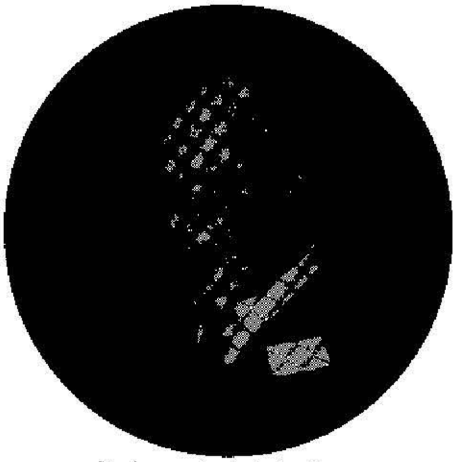
The NYU Conference—Austrian Perspectives on Contemporary Economic Theory (Continued)

Ludwig Lachmann, visiting professor at NYU commented on Sir John's paper. In his comment Lachmann stated that there is much common ground between Hicks and the Austrians although "the sources of our disagreements run rather deep." Lachmann explained that Austrians do not object to the concept of equilibrium *per se*, particularly individual equilibrium (self-consistent action), or Marshallian partial equilibrium. They do, however, object to the general equilibrium models of Walras and Pareto. Lachmann further contended that there is more to economics than determinate models and that "human action, in its more interesting forms, cannot be pressed into this mold without losing most of its distinguishing characteristics."



Professor Ludwig Lachman

Following the discussion of the Hicks' paper, a cocktail party and banquet was held. After dinner Professor Israel Kirzner of NYU gave a warm and inspiring tribute to Professor Lachmann, honoring him for his contributions to Austrian economics and to the NYU program. (Professor and Mrs. Lachmann have since returned to South Africa after a three year stay in the U.S.) The evening ended with Sir John toasting the health of the Austrian school.

Professor Harvey Leibenstein of Harvard opened Sunday's session with his paper, "The General X-Efficiency Paradigm and the Role of the Entrepreneur." He briefly outlined his work on x-efficiency and then related it to the theory of entrepreneurship. Leibenstein argued that the greater the x-efficiency there is in an economy, the greater is the role for entrepreneurship. He also stressed that there is no role for the entrepreneur within a general equilibrium framework

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Austrian Economics Seminar, Part I: 1975-76 (Continued)

that our method can handle problems and surmount obstacles which other approaches cannot.

The Misesian imaginary construction of the Evenly Rotating Economy was the second major topic of discussion. Mises had argued that the ERE was unrealizable in the real world but was only a construct intended to explain the result of the tendency of entrepreneurial action. In the real world of change entrepreneurs must continually adjust their actions toward greater coordination, though complete coordination is never achieved. On the other hand, in a mental experiment where no other changes impinge, we can imagine complete coordination (the equilibrium state of the ERE) resulting. This issue was brought up in relation to Mises' argument that in the ERE the demand for money would fall to zero since money is only useful in a world of uncertainty, and thus prices would rise to infinity and the market process would end. Some participants argued that in approaching such a world another commodity, for example some readily accessible form of credit, would become the most marketable commodity and accounting prices could still be used in non-money units. It was widely agreed that the usefulness of the mental construct does not depend on its realizability.

This discussion led to a third issue, the Keynesian tripartite division of the demand for money into transactions, speculative and precautionary demand. A strong objection to these categories was that they overlap. Since a transactions demand is for an uncertain future, it must have both precautionary and speculative motivations inextricably bound up in it. In principle the economist may analyze hypothetical cases where a particular motivation is dominant. However, such an investigation might more appropriately be classified as market research, analogous to discovering the inner motivations of a peanut consumer, rather than as economic theory *per se*. A recurring theme of AES discussions has been the dispute over the scope of economic theory. The praxeological view of economics as the logic of action recognizes psychology and history as separate disciplines. In contrast much of modern economics has tended to blur psychological matters (e.g., estimations of aggregate consumer demand) and historical matters (e.g., econometric studies) with economic theory.

The second meeting of the AES (January 14, 1976) began with a discussion of the Dallas AEA sessions on the economics of F.A. Hayek. Ludwig Lachmann, one of Hayek's best students at the London School of Economics led the discussion with a summary of the proceedings. The main topic of discussion, however, was the paper: "A Theoretical and Empirical Analysis of the Spatial Diffusion of Inflation" by Murray Sabrin. A major point of Austrian monetary theory has always been that inflation will cause relative prices to change, with some prices moving before others. In a modern market economy the exact sequence of price rises (separated out from noninflationary price adjustments) is a bewilderingly complex matter. In the discussion of Sabrin's paper the main question was the interpretation to be given to the empirical data, and whether meaningful empirical results are even possible. Since markets are integrated through high speed data communications we would not expect inflation to smoothly ripple through the geographic landscape. Although one might observe prices rising earlier near the sources of new money (for example, near Federal Reserve Banks) than in the remote countryside, this need not be the case. Most participants concurred that this empirical work would at best illustrate and not test Austrian inflation theory. The possibility of measuring Hayekian distortions in the capital structure (resulting from credit expansion) was also raised. Would one find capital goods prices in general rising in advance of consumer goods prices? That the industrial commodities index is not disaggregated by regions (in contrast to the CPI) makes such empirical study difficult at present. The possibility of applying Leontief's Input/Output empirical studies to Hayekian cycle theory was also considered.

The third meeting of the AES, held on February 17, 1976, discussed Walter Grinder's "An Investigation into the Problem of Misinvestment and Capital Distortion Concerning Subsidization of Research and Development", a prospectus for an (unsubsidized) research project. His intention was to "clarify theoretically and to illustrate empirically why 'Austrians' are certain that government subsidization of public or private R and D will very likely lead to a misallocation of resources, a distortion of the structure of production, and will

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Methodology Conference Held at University of Delaware

by John Kunze

To promote scholarly methods in social research, the Institute for Humane Studies recently sponsored a Symposium on Methodology in the Social Sciences at the University of Delaware. The conference was well organized by Leonard Liggio (Cato Institute) and graciously hosted by Burton Abrams (Economics; University of Delaware). About thirty-five scholars attended the four day conference (November 19-23). Participants represented such disciplines as philosophy, history, law, political science and sociology, but two thirds were economists. Likewise, half of the papers dealt with economics. The papers were distributed well in advance of the conference and this procedure greatly facilitated discussion. Indeed most scholarly discussions are more successful if the participants are familiar with the particular positions being considered.

Since conferees had already read the papers, each session began with prepared comments by the senior commentators who included Professors Neil B. De Marchi (Economics; Duke), J. Charles King (Philosophy; Pomona College), Israel M. Kirzner (Economics; NYU), Ludwig M. Lachmann (Economics; NYU), Louis M. Spadaro (Economics; Fordham), Vincent J. Tarascio (Economics; University of North Carolina) and Leonard Liggio.

Although the quality of the papers varied, each stimulated interesting discussion. Indeed this was their most valuable service. By dealing with controversial questions, they encouraged an appreciation of the complexity of the problems which must be solved.

The majority of the papers considered either the Austrian contribution to the methodology of economics, the debate on the growth of knowledge literature (Popper, Kuhn, Lakatos and others) or both. Since most conferees were familiar with these topics, the discussion proved to be progressive with arguments expressed in one session setting the stage for higher level discussion in later sessions.

The first paper considered was Samuel Bostaph's (Economics; Western Maryland College) "On the Origin of Methodological Differences Among Economists and the Resolution of the Resulting Conflicts over Methods." He argued that methodological disputes result from epistemological and metaphysical questions and developed a methodological position from a metaphysical assumption of the law of causality, and the Objectivist theory of concepts. Criticizing the Humean view of causality, he distinguished between two types of causality, the mechanistic causality of the natural world and the teleological causality of the social world. Thus he concluded the methods of the two disciplines may be expected to differ.

Robert Bradley, Jr., (Economics, University of Houston) provided the second paper: "Positivism and Praxeology: An Essay on the Philosophy of Economics." Bradley provided a thorough survey of the Austrian criticism of positivism and contrasted it with praxeology. He concluded with an examination and defense of the Austrian approach.

Mario Rizzo's (Economics; NYU) "Equilibrium and Optimality: A Methodological Investigation" explored the relationship between equilibrium and optimality to determine the value of each concept. He argued that any situation could be analyzed as a relevantly restricted equilibrium (given transactions costs, the distribution of knowledge and other relevant constraints) and thus as an equally restricted optimum. Since in this sense all situations are optimal, Rizzo questioned the usefulness of optimality as a concept. He then identified situations which, though consistent with a maximization framework, could be more fruitfully analyzed from other perspectives. he concluded by noting that only the introduction of value judgements would give "optimality" content not shared by "equilibrium."

The first session on Monday considered David M. Levy's (National Planning Association) paper, " 'False' Theorems or 'Mistaken' Choices in the Study of Human Action." Levy drew on the ideas of Mises, George Stigler and Gary Becker ("De Gustibus Non Est Disputandum," *AER*, March, 1977), John Locke, and Bernard Mandeville to explore the problems which "arise for a theory of choice which allows individuals to to make 'mistakes'." He concluded that the concept "mistake" is useful only when defined ex post in a means-end framework. An "ex ante mistake" would merely mean that the actor held a belief (theory) that was false.

Randy Barnett's (District Attorney's Office, Cook County, IL) "Toward a Theory of Legal Naturalism" offered a sympathetic, but critical analysis of Lon L. Fuller's *Morality of Law*, a theory of legal process. He urged that natural law theorists integrate the insights of the Reformist Legal Realists into an organic theory of law.

Monday's sessions concluded with an ambitious paper by Frederic Jennings, Jr., (Economics, Stanford University). In "The Rand-Polanyi Synthesis and its Methodological Relevance to Economic Theory" he began with a critical summary of the debate on the methodology of Austrian economics. He then argued that this approach would benefit greatly from a reformulation based on a synthesis of Ayn Rand's theory of concepts and Michael Polanyi's emphasis on the personal element in concept formation. Jennings saw the approach as empirical in nature.

The first paper on Tuesday was Craig Bolton's (Economics; Denison University) "Methodological Individualism: An Appreciation and Clarification." Bolton explored the meaning and implications of methodological individualism, a key concept in Austrian economics. He sought to "indicate the proper scope and limits of methodological individualism, the different implications attendant upon its various interpretations, and the ties, if any, between methodological individualism and public policy questions." He contrasted Mises' Kantian epistemology, Rothbard's Thomist-Aristotelian views and the ideas of Karl Popper.

Gary Short (Economics; University of Virginia) provided a survey of the theories and problems of the "growth of knowledge" literature as they relate to the social sciences, and in particular to economics. The emphasis was on examining *Method and Appraisal in Economics* (edited by Spiro J. Latsis), a volume of essays which considered the application of Lakatos's Methodology of Scientific Research Programmes (MSRP) to economics. Short concluded that the growth of knowledge theories do not provide valid proscriptive statements about the social sciences since they were developed from the natural sciences and are not applicable to the different nature of the subject matter in the social world. As descriptive theories, however, they recognize the role of values in the evolution of science and are thus important for the social sciences.

"Incommensurability and Demarcation," a paper by John T. Sanders (Philosophy; Rochester Institute of Technology) was the subject of the last discussion on Tuesday. Sanders focused on Thomas Kuhn's thesis that scientific theories are incommensurable. He began with an examination of Kuhn's

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The NYU Conference—Austrian Perspectives on Contemporary Economic Theory (Continued)

and offered the x-efficiency paradigm as an alternative framework where, contrary to the accepted approach, it is not assumed that all behavior is maximizing behavior.

Commenting on the Leibenstein paper, Professor Kirzner agreed that the entrepeneur does not fit within the world of general equilibrium since the entre-

Professor Harold Demsetz

preneur is driven by the desire for pure profits which exist only in disequilibrium. Kirzner stressed the importance of the entrepreneur as the driving force behind the economy and noted that this is a much stronger role than Liebenstein assigns the entrepreneur within his x-efficiency model. He was also critical of Leibenstein's contention that some firm behavior does not fit the maximization hypothesis. Kirzner, citing Stigler's critique of x-efficiency, argued that non-profit maximizing behavior is not inefficient, but merely behavior aimed at goals other than monetary profit.

Following Kirzner's comments, Professor Harold Demsetz of UCLA presented his paper, "Ethics and Efficiency in Property Rights Systems." In this paper Demsetz argued that our notions of ethics and efficiency are closely related. His ideas are closely allied with the recent work on the relationship between economics and biology which attempts to relate the survival properties of efficient behavior to ethical views. Demsetz also took some libertarians to task for their insistence on treating property rights as sacrosanct rather than relative to efficiency criteria. In the course of his discussion, Demsetz demonstrated that Walter Block's criticisms of his work with Ronald Coase on private property rights depended on the

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Austrian Economics Seminar, Part I: 1975-76 (Continued)

necessarily lead to economic inefficiency in terms of satisfying consumer welfare.". The discussion surrounded the question of how analogous the subsidized lengthening of the structure of production in the "knowledge industry" is to normal Hayekian cycle theory: would such malinvestments be unsustainable, to what extent would specific capital be stuck in abandoned projects, and more fundamentally, can we speak of an optimal structure in the production of knowledge (as Lachmann noted, "Knowledge not yet had is unknowable before its time")?

It was argued that government subsidy of R and D would distort the market signals which suggest how much to invest in R and D and at what appropriate level of abstraction. Coordination requires that the individual entrepreneur spot the gaps in his own knowledge and select fruitful avenues for research investigation. Through government subsidy such decisions are taken out of the entrepreneur's hands and this is likely to lead to research which is unconnected to the production process.

While some of the fundamental internal controversies inherent in the various Austrian wings had come to the fore in minor skirmishes, it was with the fourth session (March 9th) that these issues were directly addressed. Lawrence White, then an undergraduate in economics at Harvard, presented a challenging paper entitled "Entrepreneurship, Imagination, and the Question of Equilibrium." Here the "nihilism" vs. "Ricardianism" issues emerged in the context of an inquiry into the nature of equilibrating forces. The Misesian approach performs a *ceteris paribus* mental experiment to observe the entrepreneur's coordinating role in pushing the market toward equilibrium. Yet this process of reaching an equilibrium, Lachmann argued, must itself change the distribution of resources, a datum supposedly frozen. It was not clear that "other things being equal" was meant to exclude the very consequences of the entrepreneur's actions. But, it was argued, the changes emanating from the actions of entrepreneurs move the equilibrium point towards which the coordination is headed. This coordination activity never comes to rest in the real world; however, White was asking whether it would come to rest *even if there were no other changes.*

As with many issues, apparent disagreement proved on further discussion to be more matters of terminology than of substance. In Mises' approach there is one force operating, the entrepreneur's coordinating actions, which are described as equilibrating. Lachmann speaks of two forces, equilibrating and disequilibrating. The allegedly "nihilistic" tendency seems to derive, at least in part, from this apparently unpredictable balance between equilibrating and disequilibrating forces. Only where the former is "stronger" do we tend toward equilibrium. The charge of mechanistic Ricardianism is leveled against the Misesian approach for only concentrating on one of these forces and leading one to suppose we must usually be in equilibrium. But for the Misesian, Lachmann's disequilibrating forces are described as *movements* of the unattainable equilibrium toward which the equilibrating actions tend. Thus each approach deals with both kinds of forces, though in different ways. This is not to say that there is complete agreement underlying these terminological differences or that the approaches are equally fruitful in comprehending the market process.

A difference in emphasis emerged in the discussion concerning the description of entrepreneurship. In Kirzner's classic presentation of market process *(Competition and Entrepreneurship)* he concentrated on the arbitrage aspect of the entrepreneurial function and referred to spotting gaps in the market almost as if they were objectively present. Lachmann (and Mises) have always emphasized the futurity inherent in all action, and it does sometimes get awkward, as White pointed out, to discuss the spotting of an opportunity that does not yet exist. But Kirzner agreed that he had abstracted from the problems of time in that book and had intended to later extend his analysis to these problems (as he has done recently). While admitting some difficulty in speaking of the grasping of a future profit opportunity, it is nonetheless useful to see the arbitrage element in all entrepreneurship, just as it is useful to point out that all real world action is forward-looking into an uncertain future.

On April 6, 1976, the fifth session of the AES was honored to have Dr. Robert Nozick of Harvard present his extensive paper "On Austrian Methodology". This paper proved to be a rather ambitious task for a two hour discussion that ranged from methodological individualism to Darwinian evolution to time preference. Particularly interesting was

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The Monetary Approach to the Balance of Payments: New and Old

by Joseph Salerno

In the early 1970's, there emerged a formidable challenger to the reigning post-Keynesian orthodoxy in the realm of balance-of-payments theory. "The Monetary Approach to the Balance of Payments," as it was dubbed, counted among its most eminent and vocal proponents Robert Mundell and the late Harry Johnson. And if today the four post-Keynesian approaches to the balance of payments (the elasticities, Keynesian multiplier, absorption, and Meade-Tinbergen policy approaches) have not been abandoned, the partisans of the monetary approach have at least forced the consideration of an alternative theory.

Briefly, the monetary approach is based on a simple, though fundamental, insight: the balance of payments is, in its essence, a monetary phenomenon. Thus, the monetary approach emphasizes the supply of and demand for money or, in Misesian terms, the "money relation" as the central theoretical relationship in the explanation of balance-of-payments phenomena. For the monetary approach, then, net outflows or inflows of international reserves under a regime of fixed exchange rates (e.g., the classical gold standard) are symptomatic of monetary disequilibrium domestically or abroad. For instance, an excess domestic supply of money is "cleared" through international purchases of goods, services, securities, etc., creating a net deficit in the nation's balance of payments. This deficit is financed by an outflow of international reserves which effects a contraction of the domestic money supply to its equilibrium level.

Thus, the central implication of the monetary approach is that balance-of-payments disequilibria constitute a phase in a stock adjustment process which operates automatically to equate the levels of actual and desired cash balances. This central implication carries in its wake two subsidiary implications. First, surpluses and deficits are not to be regarded, as they are in the various post-Keynesian approaches, as intractable "flow equilibria" which will persist until remedied by deliberate policy measures. Rather, they are a manifestation of and a response to stock disequilibrium in the "money market" which will disappear when the disequilibrium has been adjusted. In other words, deficits and surpluses are merely transitory concomitants of a stock adjustment process.

Secondly, the automatic nature of the stock adjustment process implies that the effect upon the domestic money supply of net inflows or outflows of international reserves cannot be sterilized by the monetary authority in the long run. Any attempt to do so will cause the flows to persist until the attempt is abandoned and cash balances are permitted to adjust to desired levels. for example, the undertaking of domestic credit expansion to prevent the contractionary effect on the money supply of a balance-of-payments deficit will only serve to transform the deficit from a transient to a chronic phenomenon. The deficit will continue until either the offsetting credit expansion is terminated or the stock of international reserves is exhausted.

The monetary approach, therefore, has definite implications for government monetary and balance-of-payments policies. In the first place, under a system of fixed exchange rates, a nation's monetary supply is "endogenous." That is, monetary policy is incapable of exercising more than a temporary influence upon the domestic money supply. The supply of money in the economy will tend towards that level which, given the world price level, is consistent with stock equilibrium in the money market, i.e., an adjustment of the actual to the desired level of cash balances. Any action of the monetary authority which causes the supply of money to diverge from this level will activate a stock adjustment process. This process will restore the original level of money balances through balance-of-payments disequilibria and the attendant flow of international reserves. It is thus impossible for the monetary authority to pursue an "independent" monetary policy.

Secondly, if the monetary approach implies that monetary policy cannot have a long run impact on real economic variables, it also implies that balance-of-payments deficits and surpluses are part and parcel of the monetary stock adjustment process, their disappearance inevitably attends the termination of the adjustment process and the corresponding achievement of stock equilibrium in the money market. Thus, the tools fashioned to alleviate payments disequilibria, e.g., export subsidies, import restrictions, exchange controls, devaluation, etc., can be dispensed with. The more radically consistent exponents of the monetary approach have also found Milton Fried-

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Methodology Conference Held at University of Delaware

(Continued)

treatment of W.V.O. Quine's doctrine concerning the indeterminacy of radical translation. Quine argued that we can find no single translation of one language into another to be the most correct and that, in fact, no fully correct translation is possible. Sanders then attempted to show that Popper and Kuhn can be reconciled to some degree by admitting that Kuhn is right that scientific theories are indeterminate, but that Popper correctly notes that there is a mechanism which provides for a consensus in science. Sanders argued that that mechanism provides a foundation for Kuhn's "normal science."

The conference concluded Wednesday morning with David Osterfeld's (Political Science; University of Cincinnati) "Group Theory and the Economic Approach to Politics: A Methodological Critique." Osterfeld examined the political philosophy of pluralism which "depicts a self-regulating order which automatically harmonizes political utilities." He found this theory deficient in that it rests on a false analogy with the voluntary exchange model of classical economics. He argued, first, that pluralism is based on the methodologically holistic group theory of politics, whereas the economic concepts of pluralism are methodologically individualistic and thus do not fit a holistic framework. Secondly, since economic analysis assumes voluntarism, or the right to property, and government entails the violation of property rights, politics is *ipso facto* coercive.

While conference attendees expressed dissatisfaction with the incomplete and unrefined nature of many of the papers, most participants entered into the spirit of critical evaluation of arguments which is necessary for progress. As a result the conference must be deemed successful in provoking valuable discussion.

The NYU Conference—Austrian Perspectives on Contemporary Economic Theory (Continued)

existence of income effects which Coase and Demsetz had explicitly assumed away.

In his comment, Professor John Egger of Goucher College raised an objection to the belief that the ascertainment of costs and the allocation of property rights are independent of each other. Egger argued that since costs (like pref-

Professor Leland Yeager

erences) can only be revealed in action, the particular property rights assignment which affects behavior also influences costs. Hence costs cannot be analyzed as if they are independent of the existing property rights allocation.

Professor Yeager of the University of Virginia ended the conference with his paper, "Capital Paradoxes and the Concept of Waiting." The paper is an outgrowth of his September, 1976 article in *Economic Inquiry* which won the award for the best article of the year in that journal. Professor Yeager demonstrated that the Cambridge capital paradoxes dissolve when waiting is viewed as a factor of production. He also demonstrated the usefulness of this view when examining several different analytical problems, but cautioned against believing that this is the *only* valid way of approaching all questions concerning capital and interest.

Roger Garrison, also of the University of Virginia, commented on Yeager's paper. In general agreement with Yeager's analysis, he emphasized the meaninglessness of the Cambridge paradoxes pointing to the fact that they are derived by using comparative static rather than dynamic analysis. Garrison argued that the Cambridge theorists have not demonstrated that reswitching can take place in a given economy *over time*. To do so they cannot assume, as

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Austrian Economics Seminar, Part I: 1975-76 (Continued)

Nozick's critique of methodological individualism; if Austrians object to macroeconomic aggregation because it has failed to reduce variables to their constituent parts in human action, then why stop there? Why not reduce human choices to the cell interactions that explain them, and the cells to the molecules? In other words, how do we oppose the arguments for reductionism? The answer, given with characteristic eloquence by Professor Lachmann, referred to the importance of *meaning* in the understanding of human action. We are methodological individualists because it is only at the level of the individual that we can attach meaning to human actions. Wider groupings such as institutions are meaningful only as they are guideposts in individual plans. More narrow analysis could at best only explain how a mind comes to form its purposes (neurology has a long way to go before it can even begin this analysis) and the *logic* of the interaction of purposeful beings would be no less valid and useful if these purposes *could* be explained by cell interaction.

In a year's discussion which so often dealt with the "nihilistic" vs. "Ricardian" issues it was only fitting to end with a discussion of the controversial Lachmannian, G.L.S. Shackle. On May 11th the AES discussed Don Lavoie's paper, "Shackle: A Critical Sampling". The discussion began with a point by point review of written criticisms submitted by Gerald O'Driscoll. Discussion soon gravitated toward a key "nihilist" vs. "Ricardian" issue, the "unknowability" of the future. Lachmann and Shackle insist that "the future is unknowable, but not unimaginable". Some found this statement a bit strong since it seems to imply that our knowledge is *only* historical, that we have no general knowledge that applies to the future, for example laws in the natural sciences or general economic laws. Yet Shackle agrees that we can "eliminate the impossible" and rank our anticipations of possible events according to how surprised we would be if they were to occur. Some participants were inclined to go further and assert that it isn't *entirely* subjective whether we would be more surprised by one event or another, but that there is an element of skill involved in the entrepreneur's ability to understand his fellow's purposes.

From the foregoing it can be seen that the AES has been not merely a stimulating atmosphere for fellow Austrian theorists, but also, given the nature of our methods, an indispensable organ for the development and refinement of economic theory. Austrian economists employ a deductive method which spins out the meaning of economic concepts by the formation of mental experiments. The assumptions of such experiments are often either implicit or not yet clear and must be brought out by critical discussion, by specifying alternative assumptions and deducing their various implications. Austrians reject methods whereby theories are tested with the "facts" and argue that the very interpretation of facts presumes an underlying theory according to which the data are classified. It is the province of the social historian to coordinate the various classificatory knowledge supplied by political science, economic theory, sociology, anthropology, psychology, ethics, etc. to interpret the actual concrete events of a particular period of the past. Social theorists, or as Hayek would put it, theorists of complex phenomena, are denied the simple physical experiment for the isolation of causal forces. Economists must rely on discursive reasoning to break down the multiplicity of causes that occur in market phenomena. Since this makes our theories immune from experimental falsification it is all that much more necessary that our speculations be subjected to intense logical criticism, that our implicit assumptions be challenged into the open, that the full implications of our concepts be relentlessly pursued.

Such has been the product of the Austrian Economics Seminar. No person could attend one of these heated sessions without realizing that modern subjectivism is infused with a rich variety of approaches, is enlivened by controversies and is an open field of research where much work has yet to be done. It is the demanding work of creative imagination, scrupulous logical analysis and rigorous cataloging of the many diverse possibilities of human action which the first year of the Austrian Economics Seminar has begun. The seeds have been planted for the flowering of a new approach to economics in our time.

The first year of the AES benefitted immeasurably from the presence and efforts of its first secretary, Roy A. Childs, Jr., from whose notes this article was in great measure written. Participation in the AES is by invitation and

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The Monetary Approach to the Balance of Payments: New and Old (Continued)

man's scheme of freely floating exchange rates among national fiat currencies to be superfluous.

Finally, according to the monetary approach, payments disequilibria are transformed from short-lived to chronic phenomena only by the continuous recreation of stock disequilibrium in the money market via government monetary policy. In this case, balance-of-payments policy can do no more than *temporarily* alleviate one of the symptoms of the monetary disequilibrium. Thus, all government need do is abstain from disequilibrating monetary policy and the balance of payments will take care of itself. Harry Johnson has aptly characterized the monetary approach as "Humean in spirit."

The essentials of the monetary approach are set forth in the following articles:

Michael Mussa, "A Monetary Approach to Balance-of-Payments Analysis" *Journal of Money, Credit and Banking* (August, 1974), pp. 331-51.

Donald S. Kemp, "A Monetary View of the Balance of Payments," *Federal Reserve Bank of St. Louis Review* (April, 1975), pp. 14-23.

Harry G. Johnson, "The Monetary Approach to Balance of Payments Theory," in idem, *Further Essays in Monetary Economics* Cambridge, Mass.: Harvard University Press, 1973), pp. 229-49.

________, "The Monetary Approach to Balance-of-Payments Theory: A Diagrammatic Analysis," *The Manchester School* (September, 1975), pp. 220-74.

P.D. Jonson and H.I. Kierkowski, "The Balance of Payments: An Analytic Exercise," *The Manchester School* (June, 1975), pp. 105-33.

The Mussa and Kemp articles are especially recommended for their clarity.

The following book is a collection of seminal articles on theory and policy and empirical studies penned by writers laboring within the framework of the monetary approach including Johnson and Mundell:

Jacob A. Frenkel and Harry G. Johnson, eds., *The Monetary Approach to the Balance of Payments* (Toronto and Buffalo: University of Toronto Press, 1976).

For a defense of fixed exchange rates by the radical wing of the monetary approach or the "global monetarists," see:

Arthur B. Laffer, "Two Arguments for Fixed Rates," and Robert A. Mundell, "Uncommon Arguments for Common Currencies," in Harry G. Johnson and Alexander K. Swoboda, eds., *The Economics of Common Currencies* (Oxford: Allen and Unwin, 1973).

Jude Wanniski, "The Mundell-Laffer Hypothesis—A New View of the World Economy," *Public Interest* (Spring, 1975).

Harry Johnson has illuminated the differences between the monetary approach and the orthodox post-Keynesian approaches in:

"Money and the Balance of Payments," *Banco Nazionale Del Lavoro Quarterly Review* (March, 1976), pp. 3-18.

"Elasticity, Absorption, Keynesian Multiplier, Keynesian Policy and Monetary Approaches to Devaluation Theory: A Simple Geometric Exposition," *American Economic Review* (June, 1976), pp. 488-52.

A comprehensive overview and mildly favorable critique of the literature on the monetary approach with critical commentaries by a number of orthodox balance-of-payments theorists is provided by:

Marina V.N. Whitman, "Global Monetarism and the Monetary Approach to the Balance of Payments," in Arthur M. Okun and George L. Perry, eds., *Brookings Papers on Economic Activity 3* (Washington, D.C.: Brookings Institution, 1976), pp 491-555.

An unfavorable view of the monetary approach is taken by Gottfried Haberler, a strong proponent of the elasticities approach, in his review of Frenkel and Johnson's ***The Monetary Approach to the Balance of Payments in the Journal of Economic Literature* (December, 1976), pp. 1324-28.**

It was only a matter of time before the monetary approach made its debut in textbooks on international trade and balance-of-payments theory:

Charles P. Kindleberger, *International Economics*, 5th ed. (Homewood, Ill.: Richard D. Irwin, Inc., 1973), pp 338-86.

Leland B. Yeager, *International Monetary Relations: Theory, History and Policy*, 2nd ed. (New York: Harper & Row Publishers, 1976), pp. 182-200.

Herbert C. Grubel, *International Economics* (Homewood, Ill.: Richard D. Irwin, Inc., 1977), pp. 391-409.

It is only natural that Austrians should welcome with some enthusiasm an approach which not only recognizes the existence of a mechanism operating smoothly and automatically equilibrating the balance of payments but also perceives the essentially monetary nature of the latter. Nevertheless, in welcoming the monetary approach, Austrians must not permit their enthusiasm to overwhelm their critical judgement. For the monetary approach, following the methods of "macro-formalism", employs as explanatory variables macro aggregates and averages such as national money supplies, national demands for real balances, national incomes and expenditures, the world price level, etc. Austrians have often expressed their dissatisfaction with "explanations" in terms of macro aggregates. Since market phenomena are the outcome of individual plans, a complete explanation must be in terms of these plans. Furthermore, the proponents of the monetary approach admit to concentrating upon the "long run behavior of the balance of payments" while downplaying the "short run process of adjustment" in their analysis. In other words, the monetary approach puts in the place of an analysis of market processes, a comparative static analysis of the adjustment of macro variables.

As its adherents have begun to realize, the monetary approach has had a long and respectable history which reaches back to the early 18th century:

Jacob A. Frenkel and Harry G. Johnson, "The Monetary Approach to the Balance of Payments: Essential Concepts and Historical Origins," in idem, *The Monetary Approach to the Balance of Payments*, pp. 21-45.

Jacob A. Frenkel, "Adjustment Mechanism and the Monetary Approach to the Balance of Payments: A Doctrinal Perspective," in E.M. Claassen and Pascal Salin, eds. *Recent Issues in International Monetary Economics* (Amsterdam: North Holland, 1976).

What has thus far not been realized by its modern supporters is that the monetary approach has been formulated within a "micro" framework primarily by economists of the Austrian School. Ludwig von Mises gave the monetary approach a firm basis in the marginal utility theory of money in his classic work, *Theorie des Geldes und der Umlaufsmitel*, published in 1912. Mises also unveiled his purchasing power parity theory of exchange rates in this work. It should be noted that the Misesian version of the theory bears little resemblance to the better known though flawed version formulated later by Gustav Cassel. Mises' contribution to balance-of-payments theory can be found in the English translation of his work, which first appeared in 1934:

***The Theory of Money and Credit*, new ed. (Irvington-on-Hudson, N.Y.: The Foundation for Economic Education, Inc., 1971), pp. 170-86.**

The fullest expositions of the market

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Comment on Shackle's Notion of Opportunity Costs

Richard Ebeling's piece, "On the Theory of Costs," (*AEN* vol 1, no 1) is a terrific idea executed very well. As a student of Shackle's works, however, I feel it my duty to point out that Shackle does *not* endorse the concept of opportunity costs. His theory of decision differentiates between gains and losses, which is contrary to the doctrine of defining cost on an opportunity basis only. (Arrow pointed this out in "Alternative Approaches to the Theory of Choice in Risk-Taking Situations," *Econometrica,* vol. 19, no. 4 (Oct. 1951), p. 432.) The decision-maker in Shackle's system does *not* choose a course of action because he *believes* that when its outcome is reaped his benefits will outweigh his opportunity costs. He does not have a positive belief in any of the imagined outcomes of any action, chosen or foregone. Rather he chooses that course of action which enables him most to enjoy, at the moment of decision, the prospect of future gain tempered by the prospect of loss. It is this distressing prospect of loss which Shackle identifies as the cost accompanying choice. In *Time and Choice,* the 1976 Keynes lectures in Economics of the British Academy, Shackle writes: "What the choosing of an action-scheme can do, is to make some desired imagined paths of history possible, in my subjective sense, at the *cost* of making some counter-desired imagined path also possible." (p. 13; my emphasis).

In sum, Shackle rejects the notion of opportunity cost because he denies the existence of well-defined opportunities in the decision-maker's imagination. A close reading of pp. 132-33 of *Epistemics and Economics* will show that Shackle is restating the doctrine of opportunity cost in order to discuss its inconsistency with the deterministic overtones of standard microeconomic theory. While the subjectivist interpretation of opportunity costs set forth by Ebeling is entirely reasonable, it cannot be found in *Epistemics and Economics* and should not be ascribed to Shackle.

Lawrence H. White

Gerald P. O'Driscoll, Jr. *Economics as a Coordination Problem: The Contributions of Friedrich A. Hayek.*

J. Hummel review (Continued)

assumptions, making his conclusions at best tangental to business cycles as they occur in the real world. In addition, Hayek changed the terms of the argument by introducing, for the first time in *Profits, Interest and Investment,* the Ricardo effect. In doing so, he managed to confuse many of his critics, particularly Kaldor, and convince them that he had inverted his entire theory. Hayek bears much of the responsibility for this misunderstanding because his text was often unclear and invited confusion.

Third and most important, *Profits, Interest and Investment* contained an error that not only opened Hayek up to devastating criticism but also ran counter to the basic thrust of the Austrian analysis of business cycles. Hayek wanted to show that the monetary disturbances which caused the business cycle were self-reversing even if the rate of interest did not rise. Thus, his fourth assumption was to fix the rate of interest. But when Hayek made his assumption, he forgot to specify what was happening to the supply of credit. Is the supply of credit infinitely elastic, or does something other than a rise in the rate of interest cut it off? Kaldor and others found it very easy to demonstrate that if the supply of credit was infinitely elastic, the Ricardo effect would not operate because new credit would equalize the rates of return throughout the economy. This should not surprise any student of Austrian economics; it is just another way of stating that there is *some* rate of credit expansion which will keep the boom fueled and prevent readjustment, a proposition which Hayek himself readily admitted. Unfortunately, Hayek abstracted the entire argument in *Profits, Interest and Investment* from what was happening to the supply of credit, so that his readers were forced to conjecture about what he thought the supply of credit was doing. By implying that the depression will occur even with an infinitely elastic supply of credit and no change in the rate of interest, Hayek treaded dangerously close to renouncing the basic Austrian tenet that credit expansion is crucially important in generating the cycle in the first place.

That Hayek himself became uneasy about this very point is evident from the fact that he returned to discuss it in two subsequent journal articles, "The Ricardo Effect" and "Three Elucidations of the Ricardo Effect." However, the major contribution of these articles to this particular issue was merely the argument

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R. Ebeling review (Continued)

lucid and long overdue restatement of Professor Hayek's monetary and trade cycle theories. The peculiarity of a monetary economy consists in the fact that what would be one transaction under barter becomes two transactions when a medium of exchange is used. This "loose-joint" in the exchange process opens the possibility that an increase (decrease) in monetary expenditure at one point may not be matched by an equivalent decrease (increase) somewhere else.

Since all price signals in a market economy are, in fact, *money* price signals, a possible source of *discoordination* exists within the very institutional mechanism by which the vast number of individual human plans are brought into alignment with one another. Hayek tried to explain this discoordinative element by analyzing the results that follow from a credit expansion that lowers the money rate of interest. By distorting the relative price relationships that govern the production of consumer and investment goods, monetary disturbances could result in malinvestment and maldistribution of labor between sectors of the economy.

But as O'Driscoll correctly points out, Hayek's "theory is in the Cantillon tradition, which broadly speaking, emphasizes distribution effects. Hayek's hypothesis concerns where and how the injections of money and credit enter the economy." And, he further notes, "It would not be surprising if since 1931 there had been important changes in the paths taken in the inflation process."

It is less important to the economist whether Hayek's particular exposition of a trade cycle is the one most commonly found in history (that is a matter that must be left to the historian). What *is* important is the theoretical understanding of the possible consequences of monetary expansions or contractions which disturb the relative price structure and prevent market price signals from serving their coordinating role in a complex economy.

Dr. O'Driscoll has done more than just reawaken interest in the valuable contributions of Friedrich A. Hayek. He has also helped reopen an important chapter in monetary theory, a chapter long ignored by the economics profession, but one that offers a key to analyzing monetary dynamics.

Notes

UCLA Study Group Left to right: Tom Hazlett, John Lott, Bob Topel, Larry White.

The Austrian Economics Study Group at UCLA is well underway. They have completed discussion of *The Positive Theory of Capital* by Bohm-Bawerk, and have now begun a study of Hayek's *Pure Theory of Capital*. Group members include Tom Hazlett, Jack High, Joe Kalt, John Sell, Harry Watson, and Larry White, all graduate students in the economics department at UCLA. John Lott, a promising UCLA undergraduate, also attends regularly, and Ted Earle, an economic consultant from San Luis Obispo, attends whenever his schedule permits. This quarter the group will meet Monday afternoon at UCLA. For more information, contact Larry White (213) 478-3808, or Jack High (213) 479-7082.

Lecture Series at University of Colorado

"The Austrian School of Economics: An Alternative to the Neoclassical and Marxist Paradigms" is a lecture program currently being sponsored by the Department of Economics at the University of Colorado in cooperation with the William I. Koch Foundation and the Economic Institute for Research and Education. The first lecture was delivered in October by Professor Ludwig Lachmann, "History of Austrian Economic Thought." Other lectures in the series include: March 6, Israel Kirzner on "Austrian Approach to Competition and Market Process;" March 10, Steven Swiff of Metropolitan State College on "Austrian Economics and the Rule of Law;" March 17, Richard Wagner from Virginia Polytechnical Institute on "Austrian Economics and the Theory of the Public Sector." The final lecture in the series will be presented by Gerald O'Driscoll of Iowa State University on March 24, "Austrian Theory of the Business Cycle." The program is patterned after a similar and very successful series of talks given last year at the University of Chicago (also sponsored by the William I. Koch Foundation). Additional information is available from Professor Fred Glahe, Department of Economics, University of Colorado, Boulder, CO 80302.

Summer Fellow Program

The Center for Libertarian Studies, with financial support from the Schultz Foundation, has recently established a Summer Fellows Program in Free Market Economics. The program will be held in New York City from June 5 through August 26, 1978. Six graduate students and/or young professors in economics will be selected as Fellows, and applications are being accepted through April 1. Fellows will be provided with housing, work space, and a travel allowance. In addition each Fellow will receive a weekly stipend of $200. Inquiries should be addressed to Dr. Mario Rizzo, Program Director, Center for Libertarian Studies, 200 Park Avenue South, Suite 911, New York, NY 10003.

Hayek Works Available

Among its many endeavors to encourage scholarly treatment of Austrian economics, the Cato Institute has recently made available several of the works of Friedrich Hayek. The books (all Augustus M. Kelly hardcover editions) are being sold at significant discounts from the Cato Institute, P.O. Box 2256, Wichita, KS, 67201. Available are: *Collectivist Economic Planning*, $6.00; *Monetary Nationalism and International Stability*, $4.00; *Monetary Theory and the Trade Cycle*, $5.50; *Prices and Production*, $5.00; and *Profit, Interest and Investment*, $6.00.

In the last *Newsletter* a new book of Mises essays was announced, *Money, Inflation and the Trade Cycle*. The book is now available from Free Market Books, P.O. Box 298, Dobbs Ferry, NY 10522, but the correct title is *On the Manipulation of Money and Credit*. It is edited by Percy Greaves and contains translations by Bettina Bien Greaves of three excellent Mises articles. Mrs. Greaves has also been involved in several other projects. She has written a highly critical review of *The Economics of Ludwig von Mises*, edited by Laurence Moss. Entitled "Mises Misunderstood," the critique appears in *The Occasional Review*, Summer 1977. She has also recently published a fascinating interview with Henry Hazlitt in the November, 1977 *World Research Ink*. Finally, in an ambitious and long-term project, Mrs. Greaves is compiling and editing nearly twenty years of lecture notes taken during the Mises Summer at NYU.

The Monetary Approach Continued

process by which the balance of payments is adjusted to a change in the money relation was provided by F.A. Hayek and F.W. Paish later in the 1930's:

F.W. Paish, "Banking Policy and the Balance of International Payments," *Economica* (November, 1936), pp. 404-22; rep. in Howard S. Ellis and Lloyd A. Metzler, eds. *Readings in the Theory of International Trade* (Homewood, Ill.: Richard D. Irwin, Inc., 1966), pp. 35-55.

F.A. Hayek, *Monetary Nationalism and International Stability* (1937; rep. ed. New York: Augustus M. Kelley Publishers, 1971), pp. 17-35.

In his work, Hayek also provides a masterful demonstration of the flaws of the fractional or "classical" gold standard and of its necessary inferiority to the 100% or pure gold standard. Unfortunately, in the same work, Hayek rates as theoretically superior to both types of gold standard, a pure fiat money controlled and manipulated by a supranational Central Bank. However, in his most recent work in monetary theory, Hayek proposes a controversial free market banking system with competing currencies and argues it provides a stable monetary framework:

F.A. Hayek, *Denationalisation of Money* (London: Institute for Economic Affairs, 1976).

IHS Sponsorship of Austrian Economics

by Richard M. Ebeling

Over the past four years, the revival of the Austrian school has been assisted by programs sponsored by the Institute for Humane Studies of Menlo Park, California. The Institute was founded in 1961 by F.A. Harper as an independent center to encourage basic research and advanced study in the humane sciences.

The Institute held three major conferences on Austrian economics since 1974, the first two in the United States and the third in England. In June, 1974, South Royalton, Vermont served as the rustic location for the first of these conferences. Fifty students and professors were invited to attend and participate in a series of lectures delivered by Professors Israel M. Kirzner, Ludwig M. Lachmann, and Murray N. Rothbard exploring the foundations of Austrian theory. Held for six days, the conference offered the opportunity for personal contact among economists from several countries. The proceedings have been published as *The Modern Foundation of Austrian Economics*, edited by Edwin Dolan. (For an extended account of the conference, see Richard M. Ebeling, "Austrian Economics on the Rise," *Libertarian Forum*, Oct., 1974.)

The South Royalton success stimulated another conference in June, 1975, which was held at the University of Hartford. Papers were delivered by both professors and graduate students including Gerald P. O'Driscoll, D.T. Armetano, John B. Egger, Roger W. Garrison, Joseph Salerno, John Hagel III, Walter E. Grinder, Mario Rizzo, Sudha Shenoy, William Campbell, John Blundell, J. Huston McCulloch, Edwin Dolan, Gary North and Art Carol. A set of informal lectures were given in the evenings by Professors Kirzner, Rothbard and Leland B. Yeager. During the week-long conference, the extended and frequent comments of Friedrich A. Hayek provided a rich source of insights on various problems in Austrian theory. (See Ebeling, "The Second Austrian Conference," *Libertarian Forum*, July, 1975).

The third conference was held at Windsor Castle during August, 1976. Since the focus was the advancement of Austrian theory at the frontiers of economic science, participation was quite restricted. Papers were delivered by Kirzner, Lachmann, Rothbard, O'Driscoll, Rizzo, Garrison, Egger, Lawrence Moss, and Louis Spadaro. The proceedings, edited by Dr. Spadaro, will be published this year under the title, *New Directions in Austrian Economics*, in the *Studies in Economic Theory* series.

The Interest generated by these successful conferences led to a series of regional gatherings. Attempting to acquaint students and professors with Austrian insights, the well attended conferences presented the Austrian positions and contrasted them with other points of view. They were sponsored by the Charles Koch Foundation, and were held in the fall of 1975 at Hasbrook Heights (New Jersey), Charlottesville, Milwaukee, and London. Lectures were presented by Kirzner, Lachmann, Rothbard, Armentano, O'Driscoll, Garrison, Rizzo, Grinder, Walter Block, James Buchanan, Salerno, and (in London) Hayek and Lord Robbins.

The Institute also holds a series of two-week instructional seminars which are intended to provide intensive and extensive introduction to Austrian economics for graduate students and young professors who have had little formal exposure to Austrian ideas. The first, held at the University of Delaware in June, 1976, included lectures by Gerald O'Driscoll and Lawrence Moss. Roger Garrison and John Egger served as seminar assistants. Guest lectures were given by Kirzner, Rothbard, Spadaro and Yeager. The second instructional seminar was held at Mills College in Oakland, California, with lectures by Kirzner, O'Driscoll, Egger and Garrison (see an extended account by Richard Fink, "Conference Generates Interest in Austrian Economics," AEN, Autumn, 1977). A third seminar, under the direction of Professor Fred Glahe, is planned for June-July, 1978, in Boulder, Colorado, with lectures by Garrison, O'Driscoll and Egger.

With grants from the Liberty Fund of Indianapolis, the Institute has sponsored two summer fellowship programs at Menlo Park. From June to August, 1975, five economics students and young professors worked on various topics in Austrian theory. During June they benefited greatly from the presence of Professor Hayek who was available for individual and group consultations. In 1977 (June through August) the program was greatly expanded to accommodate twenty-five economists. As before, Professor Hayek participated during June. Weekly sessions were arranged at which the fellows presented working-papers for helpful criticism. Also, a number of guest speakers delivered talks during the summer, including Thomas Sowell of UCLA and Martin Anderson of the Hoover Institute at Stanford.

The Austrian resurgence has in many ways been a spontaneous reaction to the unsatisfactory state of orthodox economics. Nevertheless that revival has benefited greatly from the support of the Institute for Humane Studies.

The NYU Conference Continued

they have done, that interest rate changes are exogenous. Garrison concluded his talk by recommending that both Austrians and Cambridge reswitchers could benefit from studying Professor Yeager's view of the concept of waiting as a factor of production and pointed out that this view complements rather than challenges Bohm-Bawerk's treatment of capital and interest.

The conference must be deemed a great success in presenting Austrian perspectives on contemporary economic issues to a large group of professional economists. It is through such opportunities that the Austrians can hope to influence the economics profession. For those unable to attend the conference, arrangements are presently being made to have the proceedings published as a book, edited by Dr. Rizzo.

Austrian Economics Seminar Continued

limited to scholars and students with a research interest in Austrian economics. All members receive copies of the papers, and those living in the New York area may attend the monthly meetings at New York University. For further information contact John Kunze (62 Pierrepont #1-D, Brooklyn, NY 11201).

Gerald P. O'Driscoll, Jr. Continued

that an infinitely elastic supply of credit is highly unrealistic, because each particular firm, even at a fixed rate of interest, faces credit rationing.

In short, *Profits, Interest and Investment*, far from being the culmination of Hayek's thought as O'Driscoll seems to believe, is probably Hayek's worst book, almost an aberration from Hayek's other work. Of course, one might argue that even if it is as poor as I claim, O'Driscoll's task involves displaying Hayek's mistakes along with Hayek's achievements. That is true, but nothing required O'Driscoll to give such prominence to Hayek's mistakes and parade them as if they were achievements. By treating *Profits, Interest and Investment* as Hayek's paramount work, O'Driscoll greatly mars the value of his own book.