

PETER J. BOETTKE

Living ECONOMICS

YESTERDAY, TODAY, AND TOMORROW



Living Economics: Yesterday, Today, and Tomorrow

Copyright © 2012 by The Independent Institute

Published in cooperation with Universidad Francisco Marroquin

All Rights Reserved. No part of this book may be reproduced or transmitted in any form by electronic or mechanical means now known or to be invented, including photocopying, recording, or information storage and retrieval systems, without permission in writing from the publisher, except by a reviewer who may quote brief passages in a review. Nothing herein should be construed as necessarily reflecting the views of the Institute or as an attempt to aid or hinder the passage of any bill before Congress.

The Independent Institute

100 Swan Way, Oakland, CA 94621-1428

Telephone: 510-632-1366

Fax: 510-568-6040

Email: info@independent.org

Website: www.independent.org

Cover Design: Keith Criss

Interior Design and Composition by Leigh McLellan Design

Library of Congress Cataloging-in-Publication Data

Boettke, Peter J.

Living Economics : yesterday, today, and tomorrow / Peter J. Boettke.

p. cm.

Includes bibliographical references and index.

ISBN 978-1-59813-075-1 (pbk. : alk. paper)—ISBN 978-1-59813-072-0

(hbk. : alk. paper)

1. Economics—Study and teaching. 2. Economics. 3. Economics—History. I. Title.

HB74.5.B64 2012

330—DC23

2012008378

Preface

It is no crime to be ignorant of economics, which is, after all, a specialized discipline and one that most people consider to be a “dismal science.” But it is totally irresponsible to have a loud and vociferous opinion on economic subjects while remaining in this state of ignorance.

—Murray N. Rothbard¹

MY LOVE AFFAIR with economics began in the fall of 1979. The summer prior to that I had experienced the long lines for gasoline, and I was confused and frustrated by the experience for a variety of reasons. Economics erased my confusion and targeted my frustration on the cause of the shortages. I was hooked.

In many ways, the logic of economic reasoning came naturally to me once I started studying. My first readings in the field were Henry Hazlitt’s *Economics in One Lesson*, and Bettina Bien Greaves, ed., *Free Market Economics: A Basic Reader* (which included Leonard Read’s “I, Pencil”). These were followed by various essays and excerpts from books by Ludwig von Mises related to the problems of socialism and interventionism and the benefits of the free market economy, and then Milton and Rose Friedman’s *Free to Choose*. By the time I finished *Free to Choose*, I would never think about the world around me the same way. I saw everything through the economic lens—from the most mundane human activities to the most profound. To me, economics is simultaneously

1. Murray Rothbard, *Egalitarianism as a Revolt Against Nature* (Auburn, AL: Ludwig von Mises Institute, 1974, 2000), 202.

the most entertaining discipline in the human sciences and the most important discipline in the policy sciences as it ultimately answers fundamental questions about human life and death.

It is my hope that the following essays capture not only my thirty-plus year love affair with economics as a discipline, but also the sheer joy I get from economic inquiry and inviting my students to join me in that inquiry. I believe that much of modern economics has lost its way, and I am actively engaged in trying to get the teaching and doing of economics back on track. Following one of my teachers—Kenneth Boulding—I use the term “mainline economics” to describe a set of propositions that were first significantly advanced in economics by Thomas Aquinas in the thirteenth Century and then the Late Scholastics of the fifteenth and sixteenth centuries at the University of Salamanca in Spain (especially the Christian clerics, Francisco de Vitoria, Martin de Azpilcueta, Diego de Covarrubias, Luis de Molina, Domingo de Soto, Leonardo Lessio, Juan de Mariana, and Luis Saravía de la Calle).² These insights were further developed in economics from the Classical School of Economics (both in its Scottish Enlightenment version of Adam Smith and the French Liberal tradition of Jean-Baptiste Say and Frederic Bastiat), to the early Neoclassical School (especially the Austrian version of Carl Menger, Ludwig von Mises, and F.A. Hayek), and finally with the contemporary development of New Institutional Economics (as reflected in the property rights economics of Armen Alchian and Harold Demsetz; the new economic history of Douglass North; the law and economics of Ronald Coase; the public choice economics of James Buchanan and Gordon Tullock; the economics of governance

2. Rodney Stark, *The Victory of Reason: How Christianity Led to Freedom, Capitalism, and Western Success* (New York: Random House, 2005); Alejandro A. Chafuen, *Faith and Liberty: The Economic Thought of the Late Scholastics* (Lanham, Md.: Lexington Books, 2003); Murray N. Rothbard, *Economic Thought before Adam Smith: An Austrian Perspective on the History of Economic Thought*, vol. 1 (Brookfield, Vt.: Edward Elgar, 1995), 51–64, 97–133; Marjorie Grice-Hutchinson, *The School of Salamanca: Readings in Spanish Monetary Theory, 1544–1605* (Oxford University Press, 1952) and *Early Economic Thought in Spain 1177–1740* (London: Allen & Unwin, 1978); Laurence S. Moss, ed., *Economic Thought in Spain* (Aldershot, England: Edward Elgar, 1993); Raymond de Roover, *Business, Banking, and Economic Thought in Late Medieval and Early Modern Europe* (Chicago: University of Chicago Press, 1976); and Joseph Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1954).

associated with Oliver Williamson and Elinor Ostrom; and the market process economics of Israel Kirzner). The core idea in this approach to economics is that there are two fundamental observations of commercial society: (1) individual pursuit of their self-interest, and (2) complex social order that aligns individual interests with the general interest.

In the mainline of economics, the “invisible hand postulate” reconciles self-interest with the general interest not by collapsing one to the other or by assuming super-human cognitive capabilities among the actors, but through the reconciliation process of exchange within specific institutional environments. It is the “higgling and bargaining” within the market economy, as Adam Smith argued, that produces social order. The “invisible hand” solution does not emerge because the mainline economist postulates a perfectly rational individual interacting with other perfectly rational individuals within a perfectly structured market, as many critics suppose. Such idealizations would be as alien to Adam Smith as they would be to F.A. Hayek. Instead, for those who “sit in the seat of Adam Smith” man is a very imperfect being operating within a very imperfect world. Sound economic reasoning, by focusing on exchange, and the institutions within which exchange takes place, explains how complex social order emerges through the aid of prices and the entrepreneurial market process.

The mainline of economics, in my narrative, is to be contrasted with the “mainstream” of economic thought. Mainline is defined by a set of positive propositions about social order that were held in common from Adam Smith onward, but mainstream economics is a sociological concept related to what is currently fashionable among the scientific elite of the profession. Often the mainline and the mainstream dovetail, but at other times they deviate from one another. It is at these moments of deviation that acts of intellectual entrepreneurship are acutely needed by those working within the mainline of economics to recapture the imagination of mainstream economics, getting the discipline back on track.

My research has primarily been in the area of comparative political and economic systems and the consequences with regard to material progress and political freedom. In addressing these questions, I have also had a particular interest in twentieth century economic thought and the methodology of the social sciences because of my judgment that much suffering throughout the socialist and less

developed worlds in the twentieth century was caused by bad ideas in economic theory and public policy and that these bad ideas were promulgated because of misguided notions in the philosophy of science as applied to the social sciences. It has become an important part of my research and teaching efforts to explore and tell the tale of this mistaken intellectual path. The Austrian School of Economics, its ideas, its historical figures, and its fate in the economics profession and public policy discourse has been a source of continued intellectual inspiration for me since my undergraduate days, and is no doubt evident throughout all my writings.

A trip I made to Universidad Francisco Marroquin (UFM) with my close colleague and friend, Chris Coyne, in June of 2011 inspired this particular book. UFM is an amazing institution of higher learning in economics. We were both impressed by the commitment of the entire intellectual community at UFM to sound economic reasoning and to high quality teaching of economics. Throughout the campus of UFM, there are images of the great economists throughout the history of the discipline and the core ideas that they sought to communicate in their writings. The various essays in this collection are my attempts to communicate those core ideas of the mainline of economic science from Adam Smith to J.B. Say to Philip Wicksteed to Ludwig Mises to F.A. Hayek to James Buchanan to Vernon Smith to Elinor Ostrom, and many others in-between, and currently practicing economists.

Economics teaches us many things, but to me the most important is how social cooperation under the division of labor is realized. This is what determines whether nations are rich or poor; whether the individuals in these nations live in poverty, ignorance, and squalor or live healthy and wealthy lives full of possibilities. If the institutions promote social cooperation under the division of labor, then the gains from trade and innovation will be realized. But, if the institutions, in effect, hinder social cooperation under the division of labor, then life will devolve into a struggle for daily existence. Economics, in other words, gives us the key intellectual framework for understanding how we can live better together.

This theme of what Mises called “the law of association” is also what animated the founder of UFM, Manuel Ayau—who in his own books stressed this idea of social cooperation under the division of labor. In the essays in this

book, I repeatedly stress the role of property, prices, and profit/loss for providing economic actors with the incentives, information, and the spur for innovation that is required to achieve the complex economic coordination and the social cooperation among anonymous actors that characterizes a peaceful and prosperous society.

It is with this shared vision of the nature and significance of economic science and the commitment to teaching that I am especially thrilled to be publishing this book with the Independent Institute and UFM Press. I want to thank David Theroux, President of the Independent Institute, and Giancarlo Iburguen, the current President of UFM, for the opportunity to do so. It is an honor to work with these two men who have dedicated their lives to the promotion of sound economic reasoning both inside and outside of the academy. I do hope this book will make a minor contribution to the goal of spreading the economic way of thinking.

I want to thank the staff at my office at GMU and the Mercatus Center for helping in the preparation of this manuscript for publication: Peter Lipsey, Liya Palagashvili, David Currie, Carly Reddig, and Matthew Boettke. I also benefited greatly from editorial suggestions from David Theroux, Roy Carlisle, and Alex Tabarrok. Responsibility for remaining errors are exclusively my own.

I also want to thank the wonderful teachers of economics I have had over the years from Hans Sennholz at Grove City College to James Buchanan, Gordon Tullock, Kenneth Boulding, and Don Lavoie at George Mason. I also was fortunate to have some established figures in the discipline take me under their wing and mentor me at a formative stage of my career: Warren Samuels, Peter Berger, and especially Israel Kirzner, who I worked alongside of for eight years at NYU. It was a dream come true for me to work at NYU (the home of Ludwig von Mises) and to work in close collaboration with Israel Kirzner.

In graduate school, I bonded quickly with two fellow students and they have traveled this entire journey with me—Steve Horwitz and David Prychitko. I don't say thanks to them nearly enough for making me a better teacher and better economist by setting a professional standard early in our careers that we have all tried to maintain. It is my sincere hope that these essays have met that standard even in the areas that they disagree most strongly with me. In one of the essays in this collection, I give the advice to students that they have to

choose their teachers wisely because you will teach as you are taught, and that they have to choose whom they read wisely because you will write like those you read. I should add that you must choose your friends wisely because it will be your friends who help set the standard of argument you strive to meet and who will honestly tell you when you are falling short of that standard. Steve and Dave have respectively been those close friends of mine since we entered this profession as teachers and scholars in the 1980s.

And finally, I would like to thank all the wonderful students I have had the privilege to teach throughout my career and especially those I have had the great honor of serving as their dissertation advisor. I don't know if they realize just how much I have learned from them and how much pride I take in their developing careers as first-rate teachers of economics, significant contributors to the development of mainline economics, and to their amazing abilities to communicate sound economic reasoning not only to their students but to the general public as well.

As I write this, we are living through particularly turbulent economic times. It is a time when we need sound economic reasoning more than ever, rather than the sort of "emergency room" economics that has dominated public policy since 2008. Armed with the truth of the mainline of economic teaching from Adam Smith to F.A. Hayek, and with the great communication skills that these former students of mine have, I am confident that high quality representatives of sound economic reasoning are growing in number and will ultimately beat back economic ignorance and special interest politics, shifting the tide of public opinion in the direction of sound economics. As Milton and Rose Friedman argued in *Free to Choose*³ (1980, 272): "A tide of opinion once it flows strongly tends to sweep over all obstacles, all contrary views."

We all have a lot of work to do to get economics back on track. Let's go to work.

3. Milton Friedman and Rose Friedman, *Free To Choose* (New York: Harcourt, Brace & Jovanovich, 1980), 272.