

Action, Time, Knowledge and the market process

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Abstract

The paper presents a summary of my book Action, Time and Knowledge: the Austrian School of Economics, published in 2011 by Mises Institute Brasil. and use the Austrian understanding of market process to demonstrate the importance of the basic triad and the propagation elements as essential foundations of the Austrian School.

The tradition initiated by Carl Menger with the publication in 1871 of his Principles of Economics is a vast, fascinating and formidable field of human knowledge that transcends economics by reaching the broader spectrum of the social sciences. It has been continuously nourished with philosophical debate and has permeated humanist culture permanently. Hayek was precise when he stated that an economist who thinks only within the strict limits of economic theory would never be a complete economist, even if he or she possesses technical expertise.

The main feature of the book is to show that the concepts of action, time and knowledge are the main elements of EAE and that the concepts of marginal utility, subjectivism and spontaneous orders its elements are the propagators. The book seeks to show how this vision can be applied to the fields of epistemology, political philosophy and economics, with emphasis on the latter.

I. The basic triad or fundamental core

The Austrian School is founded on a concurrent and complementary triad, formed by the concepts of a) human action, b) dynamic time, and c) the hypothesis about the limitations of human knowledge. These three concepts form the cornerstone of the monumental Austrian School of Economics' theoretical edifice. By analogy with biology, the triad represents the essential elements necessary for the development and maintenance of the organism, i.e., it represents both the *macro* and *micronutrients* of the system.

Certain elements emanate from the triad. They are: a) marginal utility, b) subjectivism, and c) spontaneous orders. From these *propagation elements*, every proposal of a practical nature may be logically deduced. I refer to these as *propagation elements* for they bring implications for various fields of human knowledge, such as political philosophy, epistemology and economics proper.

(a) action

Action, for the Austrian School, means any voluntary act, any choice made intentionally to move from a less satisfactory state to another considered more satisfying, at the moment of choice. Praxeology (from *praxis*) is the general science dedicated to the study of human action, considering all its formal implications. Every economic act, without exception, can be reduced to choices made in accordance with the seminal concept of human action. And the basic proposition, the first axiom of praxeology, is that the motivation for any action is dissatisfaction, since nobody acts unless one feels some dissatisfaction and considers that a particular action will improve satisfaction, comfort, joy or feeling of accomplishment, thus decreasing discomfort, frustration or dissatisfaction.

This axiom is universal: wherever there are people, there are *actions*. Therefore, that economics which is built on praxeology is, by corollary, universal. There cannot be specific or particular economic theories valid only for certain country or regions, but only an epistemologically correct economic theory valid everywhere, assembled piece by piece from observation and the systematic study of the action. Mises called the concept of human action the *praxeological axiom number one*, in the sense that the main laws governing economics proper may be deduced from it.

(b) the dynamic conception of time

The second component of the triad is the *dynamic conception of time* or *subjective time*, or even *real time*, in which time ceases to be a static category described by a single horizontal axis, to be redefined as the continuous flow of new experiences, which is not *in time*, as in the static or Newtonian concept, but *becomes* time proper. When we consider dynamic time, we are implicitly accepting that something new is continuously occurring. We also must recognize dynamic time's three characteristics: dynamic continuity, heterogeneity and causal efficacy, as pointed by Mario Rizzo and Gerald 'O Driscoll, in their interesting book *The Economics of Time and Ignorance*.

The real-time dynamic is irreversible and leads to a *creative evolution* process, which implies unpredictable changes. The concept of real time is essential to the understanding of human action: acting individuals continuously accumulate new experiences, which generate new knowledge, which, in turn, often leads them to change their plans and actions.

c) limitation of knowledge

The third element of the triad is the epistemological treatment of the undeniable fact that human knowledge always contains components of uncertainty and unpredictability, which confer to every human action unintended effects that cannot be *a priori* calculated. There are, for the Austrians, limits to the ability of the human mind to fully fathom the complexity of social and economic phenomena. Formal systems possess certain operating rules that cannot be predetermined. As José Ortega y Gasset affirms: "*The eye does not see itself.*"

As it is not possible to quantify all our knowledge, the Austrian School does not analyze the markets as equilibrium states, but as processes of discovery and articulation of knowledge. Usually in the real world economy these forces remain quiet, silent, hidden, scattered and disconnected, waiting for the subjective human intelligence to wake, display, organize and articulate them. This third nucleic hypothesis of the Austrian School, for many scholars of epistemology, is the most important. However, I prefer to consider it on equal footing with the first two, believing that by doing so it is easier to highlight the interactions and interdependence among the three.

II. The propagation elements

In overview and because you all know it already, what I call propagation elements are:

(i) marginal utility

The first propagation element of the Austrian School is not unique to it. This is the concept of marginal utility. As we know, it was the answer proposed in 1871 to the so-called *question of value*, which was challenging scholars from St. Thomas Aquinas in the thirteenth century. About six hundred years after the *Summa*, Carl Menger, Leon Walras and William Stanley Jevons, respectively in Vienna, Lausanne and London, realized that the value of a good or service is determined by its marginal utility at each moment in time, i.e., value depends on a simultaneous combination of scarcity and utility.

Although the concept was introduced by these three economists, each one worked independently: Menger adopted a subjective approach, while Walras (the forerunner of so-called *school of general equilibrium*) and Jevons (who influenced Marshall, the father of the *school of partial equilibrium*) adopted a mathematical treatment, since the concept of marginal or additional units of goods and services fit in perfectly with the apparatus of differential calculus. To the Austrian scholar, the principles of marginal utility, action, dynamic time, and subjectivity are inseparable.

(ii) subjectivism

The subjectivism of the Austrian School is not limited to the subjective theory of value or to the perception that theories dealing with humans are personal and therefore not subject to testing. It refers to a basic assumption: that the content of the human mind - and therefore the decision-making processes that characterize our choices and actions - is not rigidly determined by external events.

Thus, subjectivism emphasizes creativity and autonomy of individual choices and, for that reason, shall be subject to methodological individualism, the notion that market outcomes may be explained in terms of individual acts of choice. For the Austrian scholar, economic theory should consider primarily the web of factors that explain choices and not be limited to simple interactions among objective variables.

Subjectivism then presupposes that action always takes place under conditions of immeasurable and genuine uncertainty, and also that it occurs over dynamic time. When an agent chooses a course of action, the results of his choice will depend on the courses of action taken and to be potentially performed by other individuals. Autonomy prevails in individual decisions, hence the future cannot be known and cannot be learned.

(iii) spontaneous orders

Spontaneous orders are intermediate classes of phenomena that are specific to the science of human action or praxeology. They are institutions that fall between instinct and reason, as a result of human action but not the execution of human design or planning. Indeed, for the philosophers of ancient Greece, there were two types of phenomena, corresponding to the terms - introduced by the Sophists of the fifth century *Physei*, which means "by nature" and *Thesis*, which means "by deliberate decision."

For Austrians, however, this dichotomy is not consistent with the social sciences. In the words of Hayek in *The Counter-Revolution of Science: Studies on the Abuse of Reason*

(Collier-Macmillan, New York-London, 1964, p. 39): *"some kind of order appears as a result of individual action, but without being intended for any individual"*. Typical examples of these orders are the monetary system, markets, cultural events and language.

III. Combining the elements of the Austrian School

The attached PowerPoint presentation is an attempt to present a general view of the extraordinary complexity that is the Austrian School of Economics. Of course, this is a simplified attempt to show its component parts, the respective role each one plays, and how they fit together. The great task of economists is to build theoretical models that can reasonably explain the reality of the economy, formed by the action over time of billions of human beings of flesh and blood, with all their characteristic desires, aspirations, motivations, strengths and weaknesses.

It is not my purpose here to discuss the implications of the core and propagation elements in the fields of epistemology and political philosophy. I will just mention briefly that, in the epistemological field, the implications should be:

(a) methodological individualism; (b) the differences between models and facts in the social sciences; (c) the recognition that the social sciences have their own characteristics, which differentiate them from the natural sciences, and (d) the rejection of forecasting methods in social sciences.

And, with regard to political philosophy, the implications should be:

(a) criticism of the mixed systems; (b) evolution in the social sciences; (c) democracy and separation of powers; (d) limitations to power, and (e) rejection of constructivism in the social sciences.

IV. The market process

I would like to emphasize that my concern here is about the importance of the concepts of action, time and knowledge, as well as the marginal utility, subjectivism and spontaneous orders in the theory of the Austrian School and, particularly, in the market process theory. In fact, the economics of the Austrian School, as well as epistemology and political philosophy, also derives from those we call the basic triad - action, time and knowledge - and spreads

through the concepts of marginal utility, subjectivism and spontaneous orders, their elements of propagation.

Based on these core elements and seminal propagators, the Austrian economists, from Menger, erected a remarkable and rich structure from the scientific point of view. It works perfectly, at least as “perfect” as one can to explain the real world in the social sciences.

The six fields of economic theory that I believe are essential to the understanding of the Austrian thought are:

1. The market process
2. The role of the entrepreneur and its function in the markets
3. The debate about the impossibility of economic calculation in socialist economies
4. The monetary theory
5. The capital theory
6. The Austrian Business Cycle Theory (ABCT)

Today, I will present the graphics for the first one of them - the market process - made from the basic triad and the propagation elements.

Unlike mainstream economics, the Austrian School does not study markets in equilibrium. Neither does it adopt the famous classification of markets according to its "form" (perfect competition, oligopoly, monopolistic competition and monopoly). It assumes instead that markets are processes that tend towards equilibrium processes (because agents are rational and learn from mistakes), but that, at each instant of dynamic time have not reached their “equilibrium positions”.

To understand this, it suffices to mention the main elements of the theory. First, markets are moved by the actions of its participants, both on the demand and the supply sides. Second, human action takes place over dynamic time, where each moment is a learning opportunity. Third, market transactions are carried out under conditions of limitation and dispersion of knowledge. Fourth, markets are spontaneous orders, subject, therefore, to permanent changes. Fifth, human action is subjective.

How can it be expected, therefore, that real world markets be at "equilibrium" at a given point in time? This is one of the central tenets of the Austrian theory. Markets are reflections of trials and errors, in a permanent process for finding new opportunities, and whose dynamism does not provide room for balance or equilibrium.

Consequently, markets tend to cushion against uncertainty and to systematically coordinate the plans formulated by economic agents.

As the various circumstances surrounding human action are continually evolving, it follows that the state of full coordination is never fully achieved, even as markets tend towards it.

An attempt of illustrating the market process: Austrian cones

The PowerPoint is my attempt to illustrate the market process as a system that moves toward equilibrium, without ever reaching it, due to the aforementioned characteristics. Even acknowledging that the Austrian methodology considers improper the use of graphic representation of demand and supply and admitting that time, to be represented by a straight line - as in the Newtonian apparatus - assumes the undesirable characteristic of static time (when we know that only real time is relevant to economic theory), we shall for a lapse leave aside the Austrian economist's criticisms, and without compromising use some of the "mainstream economics".

The idea here is to view the market process over time as a succession of diagrams of supply and demand, each representing a specific moment. Each ellipse at any given point in the time line represents the set of possibilities that are then interacting in the market, including the equilibrium point. As time flows the market moves towards equilibrium, i.e., to the apex of each cone. But, instead of reaching the equilibrium point, ever changing market conditions "redesign" the curves of supply and demand, therefore bringing the market to a new cycle. Then supply and demand will progress to the vertex of a new cone, restarting the process without ever reaching the equilibrium, and so on and so forth.

V. Concluding remarks

I would like to emphasize that there are plenty of elements proving the importance of studying the Austrian School. And I would like to point my choice.

First, a natural consequence of the economic theory of the Austrian School is the question of monopoly of money by governments. Why should governments alone print money through central banking? Why should central banks alone control the credit? Why is the instability of

fractional reserve system not questioned? Why should central banks exist, given their history of failures? Why are people generally against monopolies, but when we discussing the most nefarious of all, the monopoly on money, only Austrians suggest its elimination?

Second, the current crisis represents a great opportunity for the advancement of Austrian theory and the abandonment of the wrong approaches of mainstream economics, such as the various forms of keynesianism and monetarism. Keynesianism is an error, neokeynesianism, the insistence on error, and new keynesianism the persistence in error. And monetarism is nothing more than keynesianism with flexible prices and stability of the demand for money. Finally, it should be mentioned that the Austrian school has proven far superior to the different branches of mainstream economics.

Clear evidence of this statement are the crises and bubbles, starting from 1920-21, continuing with the Great Depression of the 1930s, and extending to the current crisis. The first ended without government intervention; the second, whose "solution" to this day is attributed to the application of Keynes' ideas, was ending by itself, with the economy giving clear signs of recovery before the New Deal.

As far as the current crisis, we have been once again in a bubble process since 2008 precisely because central banks issued currency and credit in the absence of changes in temporal preferences, and because governments have behaved as doctors who prescribe sugar to someone who suffers from diabetes.

Third, when we look at the six elements of the Austrian economic theory, we realize how much the mainstream economics got wrong. Definitely, the economic theory that has been taught in universities for decades is wrong. I hope the world learns the truth.

Finally, I'd like to mention that I have prepared this speech to sum up the themes that I described in my book *Action, Time and Knowledge: the Austrian School of Economics*. I emphasize the multiplicity of factors that altogether constitute the Austrian School of Economics, stressing the importance of each in the development of the school and also how they fit together.

To the core triad, formed by the concepts of *human action*, *dynamic conception of time* and the recognition that *knowledge has limitations*, we have added what we call *propagation elements*, namely, the doctrine of *marginal utility*, *subjectivism* and the concept of *spontaneous orders*. I advise the reader to pause at this point and question whether each of the propagation elements actually follow the core triad, and to which degree.

Armed with this apparatus, in the book I attempt to describe the implications of the triad and

propagation elements to the fields of political philosophy, epistemology, and mainly the economy.

Action, time and knowledge: this is the fascinating universe of the Austrian School of Economics!

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