Austrian and post-keynesian theories of the competitive process

The Austrian School is a heterodox school of economic thought that emphasizes the spontaneous organizing power of the price mechanism, which was influential in the late 19th and early 20th century (Boettke, 2008). After the 1870s, Marxism spread rapidly in the ranks of workers, and the economic theories that defended for the capitalists went bankrupt. The Austrian economics based on three core concepts: entrepreneurship, subjectivism and market process, which became popular after that. The Post-Keynesian school of thought was developed in the debate with the neoclassical synthesis. After The General Theory of Keynes was published, some different points of view on the practical problems arose in the followers of Keynes, and gradually formed two opposing schools of thought: neoclassical and the Post Keynesian School. The theoretical foundation of Post Keynesian economics is the principle of effective demand, that demand matters in the long as well as the short run, so that a competitive market economy has no natural or automatic tendency towards full employment (Arestis, 1996). The objective of this paper is comparing and contrasting Austrian and Post-Keynesian theories of the competitive process. The similarities and differences between these two theories will be stated orderly.

Although Austrian and Post-Keynesian theories are two different schools of thought, they still have some degree of similarities. First, they both advocate uncertainty. Next, they both cannot be regarded as profit maximizers. Last, the competitive process is seen as a dynamic process by both theories.

First of all, for the Austrian approach uncertainty is pervasive. One of the Austrian’s core concepts is entrepreneurship. Austrian school thinks that the community is a collection of individuals. Individual’s economic activity is a microcosm of the national economy. Through the interpretation of individual economic activities, reasoning illustrates the complexities of real economic phenomena. Entrepreneur is the individual here in the real economy. They are all different in each other. Therefore entrepreneurs in particular always face fundamental uncertainty. Kirzner (1973) emphasized the uncertainty present in all human decision-making, has primarily focused on the entrepreneurial market process. For the Post-Keynesian approach firms’ pricing behaviour is determined by a ‘ mark-up’ rule. This behavioural approach to pricing is partly in response to the imprecision of price setting in conditions of uncertainty. Uncertainty is the fundamental element of Keynes’ theory, and Post-Keynesian followed and developed it. In the Post-Keynesian theory of agency, agents are non-optimisers due to fundamental uncertainty. According to Fernando Ferarri Filho (2001), in a context in which time is historical, economic agents do not decide future actions on the basis of statistical series analyses or beliefs justified by experience. To the contrary, decision-making is classified as an environment of true uncertainty. They are not the rational calculators of standard theory. This suggests some overlap with Austrian theory.

Second, in Austrian’s term, entrepreneurs display purposeful pursuit of profit in the competitive process, which provides market order. It cannot be regarded as profit maximizers due to fundamental uncertainty. However profit is still therefore important in motivating agents. Neoclassical theory assume that manufacturers pursuit profit maximization, but we all know there is another voice in society requiring manufacturers to take social responsibility. Social responsibility will increase the company's operating costs, which is not conducive to their competition in the market. So, non-profit-maximizing firms will be sustained by the loss of profits and investment capacity and continuous losses, and finally be forced out of the market. Austrian school advocates idealism and they do not believe that firms select the behaviour of pursuit profit maximization. In post-Keynesian economics, firms are not assumed to maximize profits as well, as is clear in Lavoie (1992, p. 105), " The standard critique of the neoclassical theory of the firm is that profit maximization is not possible because of the lack of pertinent knowledge due to an uncertain environment. Profit maximization is then replaced by profit satisfying. Firms are assumed to set themselves threshold levels of profits; that is, minimum levels of profits or of rates of return." Furthermore, the firm's overall objective is the pursuit of ' power'. This involves attempting to control its environment. To become powerful, firms must be big; to become big, firms must grow. Growth is the subjective and profits are the means to realize this objective. However, maximizing growth does not equal to maximizing profits. Firms maximize the rate of growth, subject to various finance and expansion constraints.

Last, both school of thoughts believe that there is no absolute equilibrium in the competitive process. The Austrian school views competition as a dynamic process, and sees the market process is driven by entrepreneurial activity. Continual change comes from uncertainty gives rise to the process of market activity. This process provides a more ' fluid' account of market activity, than is typical of standard or neoclassical theory. The equilibrium approach of standard theory, it is claimed, cannot capture the dynamics of the competitive process. “ The dynamic competitive process of entrepreneurial discovery is one which is seen as trending systematically toward, rather than away from, the path to equilibrium (Kirzner, 1997).” In contrast to the equilibrium dynamics of standard theory Austrian economics advocates ‘ process dynamics’. The process of competition is ever changing and open-ended, and cannot be represented by equilibrium. Furthermore, Hicks, who first introduced the term ‘ traverse’ into economics, characterized it as ‘ the path which will be followed when the steady state is subjected to some kind of disturbance’ (Hicks, 1973, p. 81). In other words, the traverse defines the movement of the economy outside equilibrium. It plays a particularly role in Post-Keynesian theory, as most Post-Keynesian economists have serious doubts about the relevance and usefulness of equilibrium analysis (King, 2003, p. 355). Therefore, Post-Keynesian economists analysis the economic phenomenon based on a dynamic competitive process as well as Austrian school.

On the other hand, there are also many differences between Austrian theory and Post-Keynesian theory of the competitive process. It is mainly reflected in three aspects, basic principles and methodology, views on competition, theories of agency.

First, Austrians are concerned with how a whole economic system works. The ‘ individualism’ and ‘ subjectivism’ of theoretical assumptions is a major concern. They avoid tunnel vision and investigate how the specialized activities of millions of persons, who are making their decisions in a decentralized manner, can be coordinated. The relevant knowledge, such as resources, technology, human wants, and market conditions, is inevitably fragmented among millions, even billions, of separate human minds (Yeager, 2001). Therefore, in Austrian terms there would be no competition in perfect competition as there is no role for entrepreneurial activity. Because entrepreneur will not stay in a market which cannot make abnormal profits. However, Post-Keynesian economists are typically more concerned with explanation than prediction as well as distribution, particularly at an aggregate and systemic level, but not with standard welfare economics. The ‘ realism’ of theoretical assumptions is a major concern. They believe that oligopoly is the normal state of affairs in most markets and oligopolists will typically hold some degree of excess production capacity. The degree of monopoly will vary across different markets. These are different from Austrian economics.

Next, the second difference is the views on competition. In the Austrian school, competition is redefined in terms of entrepreneurial rivalry. Entrepreneurs play a crucial role by noticing missed opportunities and discover an act upon new pieces of information. The Austrian school of economics argues that true competition is a process rather than a static condition. For competition to be improved and sustained there needs to be a genuine desire on behalf of entrepreneurs to engage in competitive behaviour, to innovate and to invent to drive markets forward (Riley, 2006). In an uncertain environment entrepreneurial activity is characterised by error and errors lead to change. In contrast, Post-Keynesian economics argues that competition is inherently about dominance. Dominance here indicates dominant firms set the price in the market. The Post-Keynesian economics believe that market cannot determine the prices. Prices are administered in accordance with firms’ objectives and are not typically market-clearing prices due to the pursuit of ‘ power’. Therefore, firms use a ‘ mark-up’ pricing rule, which is price equals average cost plus mark up. The Post-Keynesian school of economics argues that market dominance is merely perfect and markets are prone to reinforcing dominance over time.

Finally, theses two school of thoughts advocate different theories of agency. On the one hand, Austrian theory is strongly individualist. All theory is based on individuals, which are entrepreneurs instead of firms or industries or other higher-level agents. But some Post-Keynesian theories are concerned with the social and historical ‘ location’ of economic actors. On the other hand, because of fundamental uncertainty, agents in Austrian theory are broadly rational but they are not the rational calculators of neoclassical theory. But agents do behave with intent. They engage in ‘ purposeful action’ and can make ‘ qualitative’ judgements. This ‘ radical’ subjectivism leads to an interest in individual rights over welfare considerations. “ These diverse activities are interdependent; yet no particular agency takes charge of coordinating them, and none would be competent to do so (Yeager, 2001).” However, agents in Post-Keynesian theory are central to understanding how markets work. King (2003, p. 1) argued that since agents make choices, they must possess a capacity that enables them to accomplish this. The idea of making a choice involves more than just a random or capricious action. To make a choice is to engage in an intentional act based upon reasons and beliefs, which must be possessed by agents. Furthermore, agents cannot be optimisers because they have to deal with uncertainty in attempting to establish their dominance. The role of uncertainty is perhaps less positive than it is in Austrian theory.

In conclusion, this paper compared and contrasted Austrian and Post-Keynesian theories of the competitive process. First, the three similarities between these two theories of the competitive process were stated. Both Austrian and Post-Keynesian theories advocate uncertainty in the competitive process. Both these two schools cannot be regarded as profit maximizers. And the competitive process is seen as a dynamic process by both theories. Then the differences between these two theories been shown. The differences are mainly reflected in three aspects, basic principles and methodology, views on competition, theories of agency. Austrians are concerned with how a whole economic system works. The ‘ individualism’ and ‘ subjectivism’ of theoretical assumptions is a major concern. Competition is redefined in terms of entrepreneurial rivalry. And Austrian theory is strongly individualist. All theory is based on individuals, which are entrepreneurs instead of firms or industries or other higher-level agents. However, Post-Keynesian economists are typically more concerned with an aggregate and systemic level, but not with standard welfare economics. The ‘ realism’ of theoretical assumptions is a major concern. Competition is inherently about dominance. And they are concerned with the social and historical ‘ location’ of economic actors.