Tomáš Otáhal: **Introduction**

This paper introduces a text called **THE TOPICS IN APPLIED AUSTRIAN MICROECONOMICS: A COLLECTION OF ESSAYS**.

**Key Words**

Introduction, The Topics in Applied Austrian Microeconomics: A Collection of Essays

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Introduction

In this text, I collect essays written from 2005 to 2012, which together apply Austrian and neo-Austrian microeconomic principals in an economic analysis. Some of the essays were either published in Czech and are translated and revised in English and some are working papers deserving revisions. The three of those unpublished working papers were co-authored with my very nice colleagues Radim Valenčík and Petr Wawrosz from FES University of Finance and Administration, Prague, and my very nice colleagues, members of the Entrepreneurship, Economic History and New Political Economy research group at the Research Centre of the Faculty of Business and Economics, Mendel University in Brno, Ladislava Grochová and Milan Palát. For the patient translations and proofreading of several essays, I thank Katarína Lexová from NEWTON College, Brno.

The entire collection can be divided into four relatively separated parts. The first part applies basic neo-Austrian microeconomic principles to explain parts of the neo-Austrian perspective unexplained social phenomena. More precisely, in the first essay I present and analyze selected theoretical definitions of corruption, to point out its implicit characteristics, and to incorporate these characteristics into a Misesian positive theoretical apparatus. Within this analysis, I argue that Ludwig von Mises was the first to recognize the importance of distinguishing among different institutional frameworks where human action, referred to as corruption, may take place. Then I present a critical reflection on the implementation of the market’s “auto regulation mechanisms” into bureaucratic management in order to eliminate corrupt actions. In the second essay of the first part, I set the agency problem into a broad context of New Institutional Economics with an emphasis on historical connections to the old Chicago school that again was largely inspired by the Misesian positive theoretical apparatus. In the first section, I explain the historical evolution of basic theoretical concepts like the theory of firms, the theory of market processes and the theory of property rights. The second section is dedicated to an explanation of the general concept of agency problems extended with the problem of asymmetric information leading to adverse selections and the problems of moral hazard, in the context of previous historical connections. In the last section, I provide some suggestions for further theoretical and empirical research.

The second part of the collection is dedicated to the explanation and application of entrepreneurial market process theories. In the first essay of the second part, I ask the question what are the historical foundations of entrepreneurial market process theories? Marginal revolution economists laid down rigorous microeconomic foundations for market analysis. While the Cambridge school and the Lausanne school attempted to provide a theoretical apparatus that would explore the market mechanism within a static partial equilibrium market analysis and implicitly dynamic general equilibrium market analysis, the Austrian school attempted to provide a theoretical apparatus that
would explore the market mechanism in a more dynamic way. The Austrian school, unlike the Cambridge school and Lausanne school, provided a sound theoretical background for the development of entrepreneurial market process theories that reject the Mengerian theory of imputation. In the second essay of the second part, I interpret the theory of entrepreneurial discovery from the perspective of the theory of property rights. I analyze pure entrepreneurial profit and the logical construction of the theory as an extension of the neo-classical microeconomic analysis and I argue that they key motivation for entrepreneurial discovery, the opportunity to discover pure entrepreneurial profit, is given by the structure of property rights. The structure of property rights determines entrepreneurial claims for pure profit, the level of protection against the conflict of interest, costs of exclusive production means, and social order. And in the third essay of the second part, I develop the new theoretical classification of productive and destructive institutional entrepreneurship that explains institutional change as a result of entrepreneurial decision-making. I argue that William Baumol’s (1990) classification of entrepreneurship productive, unproductive, and destructive can be transformed into the more general theoretical concept of productive and destructive institutional entrepreneurship. More precisely, I argue that William Baumol’s theoretical explanation of destructive entrepreneurship in essence describes a destructive institutional change, which is result of destructive entrepreneurial decision-making. Therefore, I argue that productive institutional change can be explained on similar bases within the context of a more general theoretical framework.

The third part of the collection is dedicated to the application of basic neo-Austrian microeconomic principles in an economic analysis of public organizations. Alternatively, in the third part of the collection, I present an Austrian microeconomic approach to Public Choice. In the first essay of the third part, I ask the question why is rent-seeking highly relevant for recent economic theory? I argue that the common criticism of rent seeking theory is not new and relevant. First, I explain the basis of rent seeking and the main contributions to this theory, including the theory of bureaucracy. Then I explain the criticism of this approach, which attacks the static grounds of this theory stemming out of the perfect competition equilibrium model and the normative concretizing of rent-seeking actions. I argue that the rent-seeking theory had already abandoned the static perfect competition model in the eighties and that arguments using dynamic rent-seeking theory remain normative until they explain the institutional causes of economic development, which has been the centre of the economic profession for centuries. In the second essay of the third part, we ask the question if corruption can improve economic efficiency. Classical political economists argue that corruption undermines the rule of law (Smith 2001, chap 5). The modern Public Choice proponents argue that corruption and lobbying might influence the efficiency of the rule of law. While Chicago Public Choice
scholars model how legal lobbying improves the efficiency of the rule of law and thus overall economic efficiency, the Virginia Public Choice models explain how corruption and lobbying reduces the efficiency of the rule of law and thus overall economic efficiency. In this essay, we present a brief survey distinguishing the arguments of the Chicago Public Choice and Virginia Public Choice schools on how corruption and legal lobbying influence economic efficiency. We argue that the Virginia Public Choice explanation is more realistic because it includes the influence of bureaucratic rent-seekers. This essay is co-authored by Ladislava Grochová from the Faculty of Business and Economics, Mendel University in Brno. In the third essay of the third part, I classify three possible interest group motives for the establishment of the Federal Reserve System. At the beginning, there is a short description of the National Banking Era. I argue that while (i) the professional community quite truthfully recognized the problems with National Banking, motives of (ii) the political leaders and (iii) interest groups for the establishment of the Federal Reserve System were stronger. The historical situation characterized by the deepening capital concentration and globalization brought politicians to enforce interventionist public policy followed by imperialism. These reasons significantly contributed to a tighter centralized political control of the money supply by the Federal Reserve System.

Finally, in the fourth part of the collection, I extend applied neo-Austrian microeconomic analysis with the application of the theory of contextual games. With co-authors Milan Palát from the Faculty of Business and Economics, Mendel University in Brno, and Petr Wawrosz from FES University of Finance and Administration, Prague we ask the question what is the contribution of the theory of redistribution systems to the theory of corruption? Scholars making economic policy recommendations to resolve corruption problems use several approaches, the most dominant of which are principal-agent theory and rent-seeking. In this paper, we argue that the principal-agent theory has problems accounting for the environment in which agents offering and accepting corruption operate as well as explaining the importance of agents for the survival of their environment. The rent-seeking theory, on the other hand, finds it difficult to establish socially effective legislation and ways to determine the barriers to entry that motivate agents to behave corruptly. Both problems, however, are central to solving the corruption problem. Lacking the knowledge of the agent’s environment (system) and their significance to the survival of the system, the theory cannot define incentives that would discourage the agent from corrupt behavior. If the rent-seeking theory does not identify the barriers to entry that motivate agents to behave corruptly, it cannot identify the proper legislation that would deter corrupt behavior and lead to economic development. For these reasons, we investigate whether both problems can be explained and solved within the alternative theory of redistribution systems and its partial theory of parallel redistribution.
games. In the second essay of the fourth part, we, together with my co-author Radim Valenčík from FES University of Finance and Administration, Prague ask the question how can errors in decision-making by rationally behaving individuals be explained? The concepts of bounded rationality proposed by H. Simon and of imperfect information in complex reality by F. Hayek attack the over-restrictive assumption of perfectly informed individuals or organisms in neo-classical microeconomics. Since this assumption excludes erroneous decision-making, some results must be explained by questioning the rationality assumption. In this paper, we show that the erroneous decision-making of individuals and organisms is not necessarily erroneous if we look at the contextual games that individuals and organisms play in a complex reality. This helps to explain errors in the decision-making of individuals or organisms, while maintaining the assumption of rational behavior. At the same time, we show that the errors observed in the contextual analysis of games in the decision-making of individuals or organisms can only be apparent.

Even though some of our microeconomic theoretical concepts can be hardly classified as hardcore neo-Austrian, including the theory of uncertainty invented by Frank Hyneman Knight (1885 - 1972) and the theory of bounded rationality invented by Herbert Alexander Simon (1916 - ), we believe that our application of presented microeconomic principals is original and fully consistent with the Austrian and neo-Austrian microeconomic theoretical concepts understood in a bit broader sense.