

REVIEW OF *THE ESSENCE OF MARKET: THE PERSPECTIVE AND METHOD OF HUMAN ACTION* BY ZHU HAIJIU

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This book is the first masterpiece of the Chinese economist Professor Dr. Zhu Haijiu on the economic analysis from the perspective of praxeology (the Austrian School of Economics). In this book, Dr. Zhu Haijiu expounds on the methodology of neoclassical and Austrian economics, comparing the two schools on subjects including price, order, capital, property rights, and entrepreneurs, specifically pointing out the shortcomings of neoclassical economics. In the last part of the book, the author also analyzes China's market reform process from the praxeological perspective and proposes theoretical innovations, including how China should reform its institutions. This book covers both the micro and macro aspects of economic theory, philosophy, and the applied economics on China. We also consider that Zhu's theories on China can be expanded as the *a priori* theories of the *Austrian theories of development economics* are applied to all the developing countries.

The book is composed of three parts: the first part addresses human action and methodology. The second part concerns the coordination problem of the market (knowledge, price, and order). The third part discusses some fundamental issues of the market including capital, property rights, and entrepreneurship.

In chapter 1, from a macro perspective, Dr. Zhu Haijiu compares the different views of human actions between the Neoclassical School and the Austrian School. He highlights that neoclassical economics assumes that the rational man has sufficient information to make the optimal choices based on several steps including "stimulus-reaction-maximization". Zhu argues that the neoclassical economics implicitly assumes that the human being is omnipotent and has a stable set of preferences. He criticizes this analysis, arguing that the Neoclassical School ignores that the preference of

man *may change*. In contrast, the Austrian School deducts economic theories from *the axiom of human action*, which states that all human actions are *purposeful*. By quoting Mises, Zhu says that the opposite of an action is not *irrational behavior*, but *stimuli*. Zhu also points out that the Austrian School emphasizes the incompleteness of individual knowledge, the endogeneity, and instability of individual choice, and the universality of entrepreneurship. We argue that Zhu clearly and accurately grasps the fundamental differences in methodology between neoclassical and Austrian economics. From Zhu's arguments, we can see that too many assumptions of neoclassical economics do not conform to real human actions, while the underlying theoretical framework of the Austrian economics are deducted from the *true* axioms of human actions. From the discussion of the author we can observe that the neoclassical theories deviate significantly from the correct economic theories, while the Austrian school conforms to real human action.

In chapter 2, the author compares the neoclassical concept of equilibrium and the Austrian theory of market process. He points out that in their equilibrium theory, neoclassical economists implicitly believe that the market is in a state of general equilibrium *at all times*. If there is no equilibrium, neoclassical economics considers the people's response to the equilibrium signal to be irrational. We argue that only the acting man *per se* can make the value judgment for himself and the economists cannot go beyond their own duties to meddle with the acting man's valuation. Furthermore, the equilibrium theory lays the foundation for the abusive use of mathematics in neoclassical economics. Zhu summarizes the methodologies of neoclassical economics as *the hypothesis of the abstract individual* (抽象個體假設), *general or partial equilibrium* (一般或局部均衡), and *experience-positivist method and hypotheses-deductive method* (經驗-實證主義的方法與假設-演繹的方法). Zhu points out that, in contrast, the Austrian school understands human action from the perspectives of *knowledge process* (知識過程) and *time process* (時間過程). He argues that the methodologies of the Austrian school (praxeology) are subjectivism and individualism, which emphasize the understanding of the *purposeful* actions of men. For Zhu, the theories of human action are object to mechanical positivism. Zhu also compares the differences in research methods

among the Austrian school economists (from the more emphasis on theory to the different dimensions of empirical methods): L. von Mises, L. Lachmann, C. Menger, F. A. von Hayek, and I. Kirzner. We argue that by comparing the equilibrium theory of the neoclassical economics and the theory of market process of the Austrian economics, Zhu has described the fallacies of neoclassical theory.

From Zhu's viewpoint, it is argued that more attention should be paid to the attitude of learning of the Austrian school economics, where scholars must pay attention to *understand* theories, rather than *rigidly memorizing theory*. We have observed that there are many students interested in Austrian economics and libertarianism who are eager to learn mathematical formulas and modeling due to the influence of positivist abuse from the mainstream neoclassical dogmatism. However, these students do not grasp that learning economics *requires understanding*, and instead study the wrong method which consists on memorizing mathematical formulas. The cognitive bias of these students is problematic and may reduce future development of economic science. We argue that the use of wrong economic theories will lead to interventionism, causing potential harm to freedom. Young students' misunderstanding of economics needs to be emphasized and they need to be guided by Austrian scholars.

In chapter 3, Zhu further explores a better economic theory from the aspects of human action, complex phenomena, and economic theory. This chapter pays more attention to the study of philosophy relating to economics. Zhu points out that neoclassical economics emphasizes *the assumptions and tests of theoretical models*, where the test models are complex phenomena that are artificially screened and simplified. From Zhu's view, the analytical methods of neoclassics are not correct. Similarly, we also argue that the methods of neoclassical economics will bring the subjective bias of the economist in the analysis of the acting men. The *modeling — using the model to find the data — revalidation model* is also a circular argument; this methodology of neoclassical economics is not scientific. Zhu points out that, in contrast, Austrian economics states that men generate axioms through introspection of human action and behavior. They then use logic to deduce

other theories through these axioms and apply the theories to explain complex phenomena. Further, Zhu criticizes the problems of neoclassical economic theory from the aspects of *the infeasibility of the falsification method* (證方法的不可行性), *the unrealistic assumption of maximization* (最大化假設的非現實性), *the contradiction between the constant empirical hypothesis and the uncertainty in human preferences and knowledge* (不變的經驗性假設同人類偏好和知識的不確定性的矛盾), and *the other imaginary assumptions and imaginary conclusions of the neoclassical economics* (新古典經濟學想象的假定和想象的「」). Zhu also argues that Austrian theories are lacking of the analytical paths to connect the concepts of the will, the axiom and the complex phenomenon. We argue that the theoretical system of the Austrian school is not a *closed logic system* but is obtained through *the deducted theories based on the axioms of real human action*; thus, the theory itself should contain an understanding of dynamic human actions. We observe that there is not a contradiction between the praxeological theory and complex phenomena. The correctness of a theory can be judged by verifying whether the logic of the theory is valid or not, as human beings are logical creatures and can use their logic to evaluate theory. The lack of the *formalization model* in the Austrian school, which Zhu proposes as a problem, has been significantly improved in recent years. Rothbard's *Man, Economy and State* published in the 1960s is an excellent example of the Austrian's efforts of using the formalization model to understand the praxeological theories. Similar textbooks have emerged in recent years, such as the American Austrian scholar Roger Garrison's Austrian macroeconomics textbook *Time and Money*, and the Spanish scholar Jordi Franch Parella's *Economía*.

In chapter 4, Zhu criticizes that neoclassical economics replaces the correct concepts with the wrong ideas: coordination is substituted with equilibrium; knowledge is displaced by rationality; dynamic pricing process is superseded by static equilibrium price; and subjective knowledge is supplanted by objective knowledge. He argues that the Austrian School considers knowledge and price to be *subjective, dispersed and practical*; it is the entrepreneurs who discover business knowledge and prices through market competition, calculating the price, and coordinating the market.

In chapter 5, Dr. Zhu further analyzes that it is the misunderstanding of price and knowledge in neoclassical economics that leads to interventionism. He states that prices are *endogenous* in human action (which is explained by the theory of consumer sovereignty) and are characterized by non-equilibrium, subjective and dynamic; artificial currency intervention (from the Keynesian perspective) can make the market unstable, influencing the market coordination negatively. Zhu argues that pricing is a creative process which is essential to market coordination. During the pricing process, acting men can use their entrepreneurship to understand and adjust price, which is opposite to the position of neoclassical economics where people passively and mechanically react to price.

From the perspective of price and market, Zhu investigates the issues related to the macro order. In chapter 6, he first introduces Hayek's theory of spontaneous order and then explores whether Hayek's theory of cultural group selection (群體選擇理論) conflicts with individualism. Zhu points out that an essential feature of Hayek's theory of cultural evolution is subjectivism, including the subjectivity of knowledge. At the end of this chapter, Zhu argues that Hayek's explanation of cultural evolution is not sufficient, as Hayek does not explain whether the preconditions of evolution (i.e., individual liberty, justice, rationality, and the compliance with rules) can also evolve. We argue that if Hayek were to use a Misesian perspective of praxeology, it would be possible to derive a clearer and logically consistent evolutionary theory. For example, from the perspective of praxeology, there is *no* such thing as non-rational. If the acting man can achieve his goal by following and imitating the rules, these rules are effective means for him. We argue that because knowledge is subjective, creative, tacit, practical, and dispersed, it is impossible for an acting man to scientifically understand all the knowledge he uses. If he believes that this knowledge is useful to him, then the knowledge will be subjectively valid for him. As to whether using this knowledge can help the acting man achieve his goal, he needs to conduct a subjective evaluation after he uses the knowledge. The economist *cannot* impose his own evaluation on the value preference of the acting man. We find that learning from experience, imitation of other

people, and following the rules are *all* the embodiment of rationality in a human being. Therefore, from this perspective, if neoclassical economists make remarks about the means of acting man, accusing him of making a wrong choice being “irrational”, they implicitly assume that economists themselves can have some objective criteria to judge what means are “rational” to the acting man. This can lead to government interventionism. Thus, *we argue that the praxeological definition of rationality contradicts Hayek’s concept of non-rational*. We consider that either Hayek’s perspective of rationalism does not entirely follow the theory of subjective value, or that Hayek does not fully understand the praxeological definition of rationality.

In the third part of the book, from the micro point of view, Zhu analyzes the Austrian theories of capital, property rights, and entrepreneurship, comparing them with the corresponding neo-classical theories. Zhu begins his analysis of E. Bohm-Bawerk’s theory of capital in chapter 7. According to Zhu, Bohm-Bawerk’s theory of capital is divided into two contradictory systems: *the time preference theory of interest* and *the exploitation theory of interest*. The latter theory says that interest rate depends on the average production time, and the average production time depends on the nation’s subsistence fund and labor. Zhu finds that the neoclassical economists who inherited Bohm-Bawerk’s theory of productivity interest further believe capital is a kind of physical fund and time is one-dimensional; Austrian school scholars, such as F. Fetter, Mises, and Hayek, who inherited Bohm-Bawerk’s theory of time preference, believe that the *only* factor that determines the interest rate is that people prefer current products to future products. Zhu further illuminates that for the latter group time in the physical sense is meaningless in the production process, considering that time is a subjective concept in human action, and thus time is not a single dimension in the production process. Zhu argues that from the perspective of entrepreneurs, capital is *heterogeneous* and *complementary*, and capital has the structure subjectively recognized (which is not just an *objective* form) by entrepreneurs. However, in a recent paper “The rise and fall of the subsistence fund as a resource constraint in Austrian business cycle theory”, E. Braun and D. Howden argue that the traditional Austrian School

economists may have neglected Bohm-Bawerk's concept of subsistence fund limiting it to just a metaphor. The paper states that the concept of the subsistence fund can help the Austrian Business Cycle Theory (ABCT) better explain the turning point of economic boom and bust, as the concept is related to the resource constraint that the capitalists can impose on production when interest rate decreases artificially by central banking. We consider that the viewpoint put forward by Braun and Howden deserves the attention of Austrian school theorists in further detailing the ABCT.

After analyzing the theory of capital, Zhu further discusses the issue of property rights in chapter 8. He states that the concept of property rights in neoclassical economics (including new institutional economics) is *static* to reduce transaction costs and assumes that a rational human being has unlimited power to perform economic calculation. Zhu argues that compared with neoclassical economics, the Austrian school emphasizes the *ignorance* of human beings and the *uncertainty* of the environment, demonstrating that "the continuous improvement of economic efficiency is not in conflict with human ignorance; on the contrary, human ignorance is a prerequisite for the continuous improvement of economic efficiency." Zhu considers that the Austrian school's view of property rights as *dynamic*, and the goal of a dynamic view of property rights is to increase output. The way to achieve this goal is through the actions of entrepreneurs, and the basis for adjusting the property rights depends on the *entrepreneurial judgment and expectation*. Zhu here innovatively links the dynamic concept of property rights with the China's trial-and-error reform of property rights (對私有權的試錯式改革), such as the *household responsibility system* (家庭聯產承包責任制), the *Special Economic Zone* (經濟特區) and the *economic development model of Wenzhou city* (溫州模式). Wenzhou has seen many entrepreneurs after China's market reform in the late 1970s, and Wenzhou's entrepreneurs all over the world have made important contributions to the development of China's manufacturing and retail industries. These steps of the market reform all use the *judgment* method to adjust and privatize property rights dynamically. Zhu's *dynamic view of property rights* is based on strengthening and respecting private property rights, as well as expanding and respecting entrepreneurship. Zhu's theory of free

market reform and dynamic efficiency is a refinement of part of the Austrian theory of development economics and the Austrian school's Theory of Dynamic Efficiency (ATDE, J. Huerta de Soto); this is because his theory embodies the respect for equal opportunity and justice in the ethics of the ATDE when developing countries are facing free market reform. We argue that China and other developing countries can use *the dynamic and efficient concept of property rights* proposed by Zhu to judge whether various reform theories and policies are correct and good for the free market and whether these theories and policies are conducive to reform. Interventionism in property rights is likely to be used to dispute rent-seeking, jeopardizing free-market reform and harming the improvement of the individual welfare.

In chapters 9 and 10 Zhu demonstrates the Austrian theories of entrepreneurship and business cycle. He argues that although the economists of the Austrian school do not have the same opinions on the issue of equilibrium compared with neoclassical economics, Austrian scholars *all* attach importance to *entrepreneurship*. He finds that neoclassical economists only see entrepreneurs as a *static* factor of production and consider that the probability of uncertain events is *known*. Zhu states that Schumpeter has made some progress over other neoclassical economists in considering innovation as the primary function of entrepreneurs; however Schumpeter mistakenly believes that uncertainty and entrepreneurial errors treat the entrepreneur as an *exogenous* variable. Zhu posits that the Austrian school entrepreneurs should make a judgment (Mises), be alert, discover the market opportunity (Kirzner), and imagine and expect a profit (Lachmann). The Austrian theory of entrepreneurship also says that a source of profit is the entrepreneur's ability to bear uncertainty (Mises). Zhu observes that one problem with the Kirznerian theory of entrepreneurial *alertness* is that it assumes that the future price exists at present, while in the real market the future price is *not* yet available. By comparing these two chapters, the readers can obtain a relatively complete interpretation of the neoclassical and Austrian entrepreneurial theories.

After an in-depth discussion of the similarities and differences between the neoclassical and the Austrian schools from the macro,

micro, philosophical, and methodological levels, Zhu finally discusses whether the Chinese economy can continually grow from the perspective of entrepreneurship. He first argues that the institutions of protecting property rights can promote entrepreneurial innovation, while the infringement of property rights hinders innovation. By relying on the support of State-owned Enterprises (SOEs) in China's Constitution, the government of the Communist Party of China (CPC) emphasizes that the SOEs should be confidently managed as stronger, better, and bigger (理直氣壯做, 做優做大國有企業). Due to this policy the CPC government has illegally and coercively nationalized many private companies, and many entrepreneurs have even been imprisoned. These facts show that China has experienced a regression in the protection of private property rights, which can make free-market reform likely to fail. China may even have the possibility of re-entering the centrally planned economy and totalitarian politics of the Mao Zedong era. The entire country may also be *Venezuelanized* due to the destruction of private property rights.

Zhu suggests that the economic growth since China's free-market reform is based on the use of the cheap production factors (廉價要素), and the advantages brought by the cheap production factors had already existed before the 1978 free-market reform. It is only because institutional obstacles are gradually being dismantled that the cheap production factors can be used for economic growth. Zhu also refutes the view held by Chinese scholar Justin Yifu Lin, who is famous for his Keynesian government-led market economic theory. The application of Lin's theory has caused the Chinese economy to be severely distorted by central planning. It can be said that Lin must be responsible for China's current economic crisis at the legal, theoretical, and moral levels. Zhu states that China's current economy has problems with regards to entrepreneurial activities. First, foreign money is used to achieve the foreign businessmen's established plan rather than carry out creative entrepreneurial activities. Second, the existence of SOEs inhibits the development of entrepreneurial activities among private sectors. Third, entrepreneurs in private sectors are more like the Kirznerian alert and rent-collecting entrepreneurs, who lack innovation in their entrepreneurial activities. Unfortunately, Zhu's

predictions in 2009 about China's slowing economic growth in this book have become a reality; Zhu has observed that the institutional changes China has taken to promote economic growth and entrepreneurial innovation are *seriously lagging behind*; we also argue that the Chinese government has set many obstacles for entrepreneurial activities. From Zhu's viewpoint, we deduce that price control, high taxation, complex administrative approvals, credit expansion, high fiscal deficits of local governments, corruption, government-manipulated judicial system, the nationalization of private companies, the Communist Party directly interfering with the day-to-day operations of private enterprises, judicial persecution of entrepreneurs, the personality cult of the supreme leader, populism, trade protectionism and trade warfare, and other negative factors are all hindering China's economic development and entrepreneurial activities. *Finally*, Zhu argues that the Chinese government should reduce the institutional obstacles that hinder the development of entrepreneurs, respect the order formed by entrepreneurs spontaneously, and provide guarantees for the expansion of a free-market system. We agree with Zhu's viewpoint and believe that in addition to advising policy, Chinese individuals must understand the true meaning of an entrepreneurship economy and form strong beliefs and practices on the free market economy and the rule of law. *Only by being faithful and practicing free market economy can China push towards a path that respects entrepreneurship, continues to promote economic growth, and expands individual welfare and freedom.* We argue that real market reform should be the goal for all countries, especially those that are developing, so that they may grow economically and expand individual welfare and freedom. However, although China has made significant progress in conceptual and institutional changes, it can be said that China has a *long* path to achieve the goal of establishing an institution that protects and respects property rights and promotes the development of entrepreneurship. In other words, at present, China's work towards this goal has been insufficient, and there is still a long way to go to achieve a real free market reform in that country.

Dr. Zhu Haijiu's book, *the Essence of Market: The Perspective and Method of Human Action* analyzes the differences between neo-classical and Austrian theories from a very profound theoretical

perspective. From reading this book, one can conclude that the theory of the Austrian school is more logically consistent and correct compared to the neoclassical theory. Zhu talks about theoretical issues from both the macro and micro perspective with clarity and theoretical emphasis. The last part of the book uses the theory of entrepreneurship to prompt the reader to consider the theoretical, policy, and practical issues of China's reform. We believe that Zhu's theory is not only worthy of study by Chinese scholars, but also by economists of the world who want to apply the Austrian theory to development economics. We expect this book to be translated into English as soon as possible.