Expectations and the Meaning of Institutions: Essays in Economics

Ludwig Lachmann. Edited by Don Lavoie. New York: Routledge, 1994.

Essay collections typically contain simply too much on too many diverse topics to be given a proper treatment in a brief review such as this. Don Lavoie's collection of papers and essays by the late Austrian School economist Ludwig M. Lachmann, *Expectations and the Meaning of Institutions*, is no exception. Thus, after a few introductory remarks, this review will focus solely on the more controversial of the book's passages -- i.e., those that deal with Lachmann's methodology of "radical subjectivism."

The book is the latest in Routledge's Foundations of the Market Economy series, edited by Mario J. Rizzo and Lawrence H. White, and it collects many of Lachmann's more important papers on economics and methodology -- papers written over a span of more than fifty years. Lavoie divides the book into four sections: "Uncertainty, Investment and Economic Crisis;" the repercussions of uncertainty for capital and investment; the history of the Austrian School's debates with other schools of economics; and subjectivist methodology. The overarching theme of all of Lachmann's work is brought into focus in Lavoie's introductory essay, which characterizes Lachmann's thought as a hermeneutical challenge to the positivist strains of mainstream, neoclassical economics.

At first glance, Lachmann's criticisms of neoclassical economics seem merely to echo the thoughts of some moral philosophers, who note that economic models of human behavior seem to deny free will (and, by extension, the need for moral philosophy). For example, Lachmann writes:

> But what to Austrians is most objectionable is the neoclassical style of thought, borrowed from classical mechanics, which makes us treat the human mind as a mechanism and its utterances as determined by external circumstances. Action here is confused with mere reaction. There is no choice of ends. Given a "comprehensive preference field" for each agent, what is there to choose? The outcome of all acts of choice is predetermined. In response to changing market prices men perform meaningless acts of mental gymnastics by sliding up and down their indifference curves. (278)

Of course, as the Nobel Prize-winning economist James M. Buchanan (whose views on the theory of choice are quite similar to Lachmann's own) has noted, such amoralism undermines the very mission of economics, which must assume, at the very least, that some economic outcomes are better than others -- i.e., that some outcomes are morally superior. In his discussion of Carl Menger, Lachmann approvingly quotes Menger's assertion that economic laws deal, not so much with human behavior, but with the external, natural phenomena that limit human behavior. As Lachmann writes, "It seems legitimate to interpret [Menger's] statement to mean that while men are free to choose their ends, the means they have to employ are subject to many limitations, and that economic laws ultimately inhere in the scarcity and specificity of means." (216)

Lachmann's rejection of neoclassical determinism has far-reaching consequences that lead to Lachmann's "radical subjectivism." As Lachmann notes, economic knowledge is always knowledge concerning the past. Lachmann agrees with his fellow Austrian School economists that consumer preferences can only be discovered through the market process itself -- i.e., by examining the choices people have actually made given the options available to them. (Of course, one might object that there are other ways of gaining knowledge of consumer preferences. Businesses, for example, use polling as a way of conducting consumer research. Yet this objection, if valid, still does not counter Lachmann's notion that economic knowledge reflects only past preferences.) Since human beings are not, in Lachmann's view, determined in their behavior, they can change their minds about the ends they choose to seek. Thus, as entrepreneurs only know about *past* preferences, they must guess about future preferences.

Entrepreneurial guesswork about what the future holds leads to what Lachmann calls "divergent expectations." Not only do consumers subjectively place value upon economic goods and services, but entrepreneurs must subjectively evaluate economic data and use it to imagine future economic conditions. As Lachmann puts it, "the future is unknowable though not unimaginable." (220) Imagination, however, Lachmann notes, is not prediction. There is no guarantee that entrepreneurs can imagine "correctly." Thus, Lachmann rejects another neoclassical mainstay: equilibrium economics.

In his rejection of equilibrium economics, Lachmann runs afoul of even some of his fellow Austrians, most notably Israel Kirzner and Roger Garrison. Mainstream economic models tell a story of an economy headed towards (if never actually reaching) some sort of "end state" in which all markets clear. The assumption is that consumers know what they want and that entrepreneurs know what consumers want. Clearly such a notion is contrary to Lachmann's model of entrepreneurial guesswork. Garrison, however, tries to save equilibrium by arguing that, over time, entrepreneurs who establish patterns of correct guessing will come to control more and more capital, even as incorrect guessers lose control of capital. Thus, over time, more proficient guessers will come to have more influence in the marketplace, and the market will display a built-in tendency toward equilibrium (even though, of course, it still will not actually get there). So, the controversy within Austrian School economics is born.

For equilibrium to be possible, entrepreneurial expectations must be at least somewhat accurate. Lachmann writes:

> In the works of Hayek, I.M. Kirzner and Mises the market as a process, not as a state of rest, is of fundamental importance. Its main economic function here is to co-ordinate existing knowledge scattered over many parts of the economic system and to disseminate the market knowledge thus gained. Nobody can profitably exploit his knowledge without conveying hints to others. But can the market process diffuse expectations in the same way it diffuses knowledge where this exists? (236)

Lachmann's simple answer is "no." He goes on to note that "[t]he dissemination of superior knowledge is entailed by the fact that men can judge it by success. But how successful an expectation is we can know only when it is too late for others to embrace it." (236)

In light of Garrison's criticism, however, it may well be that Lachmann overstates his case. If one entrepreneur establishes a pattern of successful market anticipations, other entrepreneurs may profitably follow the first's lead. Furthermore, even assuming free will, there is no reason to assume that consumer preferences are chaotic. In the aggregate, humans are creatures of habit -- even if it can be said that, historically, they have chosen to be such creatures. Thus, by-and-large, it is safe to rely on knowledge of past preferences when imagining the future. Guesses can be educated guesses.

Yet, even assuming there is historic evidence to suggest that entrepreneurs who guess about future consumer preferences in one instance tend to guess correctly in others (and vice versa) is true, and that there is, in fact, some historic pattern of equilibrium-approaching economic activity within the market, this is not quite the same as saying that the market has some built-in tendency toward equilibrium. It would seem to require some sort of deterministic postulate -- rejected by both sides in the Austrian debate -- to maintain that entrepreneurs *who* do guess correctly will likely do so in the future. There is, simply, a difference between theory and history.

It is at the level of theory -- the pure theory of choice, praxeology -- that Lachmann's radical subjectivism comes into play again, this time in another form. Among some Austrian School economists (i.e., the orthodox followers of Ludwig von Mises), Lachmann's methodological views are even more controversial than his views on expectations and equilibrium. Lachmann clearly rejects Mises's contention that all economic theory can be derived *a priori* from the so-called "action axiom," i.e., from the undeniable premise that humans act purposefully. (The denial of the axiom would itself be a purposeful action.) Instead, Lachmann agrees with Don Lavoie's attempt to reinterpret Mises as "an 'interpretive' thinker." (284) This interpretive reconstruction of Mises tries to clarify the confusion "between form of thought and its empirical content." (232)

Ultimately, however, Lachmann's attempt at clarification is sketchy at best. He never explains exactly what is wrong with the old, non-interpretive version of Misesian apriorism. Instead, he leaves that task to his students. There are, nevertheless, hints as to Lachmann's view. The aforementioned passage in which Lachmann agrees with Menger that economic laws stem from the constraints reality imposes upon choice is certainly a contrast to the Misesian contention that economic laws can come from an understanding of choice itself. Lachmann's thought is, ultimately, more empirical. This seems to indicate that perhaps Lachmann agrees with the view that Mises's axioms are mere tautologies -- i.e., true by definition and, thus, only linguistically true. In this sense, even the action axiom is a tautology. When we use the term human, we use it to denote a being that is, as part of its definition, capable of action. Thus, to say that humans act isn't an *a priori* synthetic truth, but merely an analytic truth.

Lachmann's alternative to non-interpretive apriorism also suffers from the defect of sketchiness. In defense of his hermenutics, Lachmann speaks a great deal about how we must interpret texts and, subjectively, form an impression of meaning in our minds (280-281). But, unlike, say, Thomas Kuhn, Lachmann has little to say about how we choose between different interpretations of whatever phenomena is in question. Lachmann notes that the rules of logic come into play in understanding a particular interpretation

(281), but, given different premises, logic alone is insufficient to choose between alternative interpretations of the same subject.

Taken separately, Lachmann's rejection of equilibrium theory and his hermeneutics are somewhat foggy starting points. Together, however, the two pose a major challenge to traditional Austrian School methodology as outlined by Mises. Taking Mises *a priori* starting point, Lachmann shows that pure economic theory cannot demonstrate the coordinating, equilibrating functions of the Market assumed by both neoclassicals and most Austrians. At most, equilibrating aspects of the market can only be shown, if they do exist, as empirical patterns that need not always obtain.

Lachmann's legacy, as contained in the essays Lavoie collects, is a lesson to economists, both Austrian and neoclassical. That lesson is that economic requires more than mere blackboard logic. It requires its practitioners to actually study and interpret the world around them.

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