

ON THE LIMITS OF THE MODERN AUSTRIAN REVIVAL

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SUMMARY

The aim of this paper is to appraise the perspectives of development of the modern Austrian revival. We focus on the analyses of Rothbard, Kirzner and Lachmann; all three start from the same Austrian legacy: Mises' axiom of human action and Hayek's problem of knowledge. We first give a brief account of these two Austrian principles and examine to what extent the methodological opposition between Mises and Hayek questions the consistency of modern Austrian syntheses; we then analyse how these statements have been taken up again by modern Austrians and point out their respective limits.

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It is possible to distinguish three distinct lines of thought within modern Austrian economics, namely these led by Rothbard, Kirzner and Lachmann. Despite their obvious methodological and analytical differences, there seems to be a common ground upon which these theories are built. More precisely, we are referring to two basic tenets stated by Mises and Hayek as a consequence of their involvement in the planning debate of the twenties and thirties: Mises' principle of the purposefulness of human action (tenet 1) and Hayek's emphasis on the role of knowledge diffusion and acquisition as a coordinating process (tenet 2). It is possible to classify the three lines of the Austrian revival as follows:

- Rothbard deepens the consequences of tenet (1) in full accordance with Mises' praxeological approach. We will emphasise the limits of such methodology. Ultimately, we will show that Mises' praxeology turns up to represent the theoretical ground that Rothbard needs in order to found a libertarian politics.

- Kirzner synthesises tenets (1) and (2) in his theory of entrepreneurship. Several difficulties stem from this endeavour; first, the whole Kirznerian edifice is built upon a concept – alertness – which may appear theoretically weak; second, Kirzner's theory of entrepreneurship meets the same analytical difficulty as general equilibrium analysis, namely the problem of stability or, in Austrian terms, the problem of demonstrating the convergence of the market process towards the compatibility of individual plans; such problem arises from the fact that Kirzner explicitly positions his approach like a complement to mainstream economics; finally, as far as the Austrian essence is concerned, we will show that the price to pay for entering the mainstream framework is high indeed: Kirzner's analysis appears to be free from time dimension and uncertainty.

- Lachmann interprets the Misesian and Hayekian developments through Shackle's kaleidic view of reality. As a result, the author completely rejects the idea of convergence and determinacy of economic processes and it is not clear how far he could go beyond this apparent theoretical nihilism.

In what follows, we first give a brief representation of the two Austrian basic principles as they were put by Mises and Hayek during the forties and examine to what extent the methodological opposition between the two authors questions the consistency of modern Austrian syntheses; in a second step, we analyse the way in which these statements have been taken up again by the actors of the modern revival and point out their respective limits.

1. The foundations of the modern revival

During the inter-war period, the Austrian tradition had been facing two important theoretical defeats: on the one hand, the Cambridge-London controversy ended in a failure for the Austrian theory of business cycles; on the other hand, Mises' and Hayek's criticisms about the possibility of

economic planning did not seem to worry neoclassical beliefs in the analytic power of simultaneous equations systems. However, some shade has to be introduced as regards the consequences of the second controversy. No doubt the planning debate ended in favour of neoclassical socialists, but its analytical implications turned out to be extremely favourable to the Austrian tradition: indeed, this confrontation against neoclassical economists acted as an incentive for Austrians to assert their originality and to rediscover the Mengerian legacy.¹

During the calculation debate, Austrian criticisms and rejoinders are rather confused and not clear enough for really challenging the neoclassical logic which proves once more its great ability of adaptation. The main reason for this stems from the fact that Austrian protagonists do not seem at that time to be aware of their originality compared with neoclassical authors;² no doubt that with orthodox definitions of rationality and competition, effectively planning and market can receive a similar formalisation, as Barone already underlined in 1908. The problem is that these terms do not imply the same meaning within the Austrian logic: the market is viewed as a *process of knowledge discovery*; its thrust results from the interaction between *individual plans*; agents are conceived as *dynamic actors* by contrast with the orthodox definition of *homo economicus*, a mere reactor to external stimuli. However, it is only during the following decade (except the earlier article on knowledge from Hayek in 1937), that arguments are finally clarified in that direction and incorporated into a specific logic, offering an incentive to re-open the controversy.

1.1. The principle of *human action*

Mises' axiom of *human action* clarifies the distinction between Mengerian and neoclassical definitions of subjectivism. The principle of human action means that individuals act purposefully:

Action is will put into operation and transformed into an agency, is aiming at ends and goals, is the ego's meaningful response to stimuli and to the conditions of its environment, is a person's conscious adjustment to the state of the universe that determines its life.³

Action is distinguished from reaction. It refers to conscious choices and is oriented towards subjective ends. The Austrian concept is richer than the traditional one: the neoclassical *homo economicus* perpetually follows the same objective consisting in maximising his utility function, given the means at disposal. The Austrian agent is free to choose his objectives and the means he thinks are relevant to these ends. The means-ends framework is no more an exogenous information to which the agent has to react in an optimal way but becomes itself the result of a previous subjective choice.

The axiom of human action involves three direct consequences: the introduction of causality, real time and uncertainty.

(1) For an individual to act, a condition is needed: present action must be thought to have a positive influence on his well-being, that is to say action will cause a modification of the future state of affairs which is supposed to be preferred. Agents act according to their knowledge of causal

¹ Cf. for instance, the interpretations of VAUGHN (1980), LAVOIE (1985), KIRZNER (1988).

² Mises asserts in 1933, in his *Epistemological Problems of Economics*, that: "Within modern subjectivist economics it has become customary to distinguish several schools. We usually speak of the Austrian and the Anglo-American Schools and the School of Lausanne ... [The fact is] that these three schools of thought differ only in their mode of expressing the same fundamental idea and they are divided more by their terminology and by peculiarities of presentation than by the substance of their teaching."

³ MISES (1949, p. 11).

relationships between economic elements of the system.⁴ Without any knowledge of causal relationships and regularities, there is no room for action.

(2) Action is oriented towards the improvement of individual well-being, i.e. towards change. Action thus takes place in time; Mises follows Menger in his adoption of a specific (Bergsonian) view of time, that is to say a subjective view of temporality, by contrast with a mechanical (Newtonian) conception. In this connection, time is synonymous of change and human action is the propeller of change.⁵

(3) Uncertainty is introduced along the same tautological method: action, defined as real choice, can only take place in an uncertain environment as regards future, otherwise it is replaced by mere reaction.⁶

Mises' ambition is to build the whole edifice of economics upon the single axiom of human action, by logical deduction of the direct and indirect implications, without turning to any other empirical or analytical assumptions. This approach, namely *praxeology*, is rigorously pursued by Rothbard. Notice however that it is possible to adopt the Misesian view of individual behaviour without following a praxeological approach. This is the position of Kirzner and Lachmann.

1.2. The problem of knowledge

Hayek's focus on knowledge flows from his criticism of what he calls in his 1937 article "the pure logic of choice". It is a set of tautological assertions stemming from the assumption of perfect knowledge. Given all the data and without uncertainty, it is possible to figure out formally what the coordinates of the optimal configuration are. Hayek's objective is, on the contrary, to make economics an empirical science. More precisely, the author proposes to give economics an empirical content by taking into account the dispersed and tacit nature of knowledge among agents. The problem faced by theoreticians is then to understand how individual plans, formed on the basis of diffused and incomplete knowledge, can be coordinated in an efficient way. Competition, analysed as a knowledge discovery procedure, is the solution put forward by the author: the price system resulting from individual confrontations in an unhampered market provides relevant signals for plan adjustments. They are not necessarily equilibrium prices, the market order is built precisely upon negative feed-backs that agents extract from these magnitudes.⁷ Coordination failures stem from the diffuse nature of knowledge upon which agents rely to form their plans; competition, through the role of the price system, thus plays a coordinating function.

1.3. The compatibility between Hayek and Mises

The paradox of the relationship between Mises and Hayek lies in the fact that, as Kirzner observes, Hayek is definitely sceptical about some fundamental aspects of Mises' system.⁸ It appears essential at this point to question the nature of the disagreements between the two authors in order to appraise to what extent modern Austrian attempts at merging Mises' principle of human action with Hayek's problem of knowledge are consistent.

⁴ "In a world without causality and regularity of phenomena there would be no field for human reasoning and human action... Where man does not see any causal relations, he cannot act." MISES (1949, p. 20).

⁵ "Action aims at change and is therefore in the temporal order. Human reason is even incapable of conceiving the ideas of timeless existence and of timeless action." MISES (1949, p. 99).

⁶ "Every action refers to an unknown future. It is in this sense always a risky speculation." MISES (1949, p. 106).

⁷ Cf. HAYEK (1978, p. 184).

⁸ KIRZNER (1992a, p. 119).

There are a certain number of points on which the loyalty of Hayek to Mises are in no doubt: Hayek's theory of cycles is an elaboration of the monetary theory of Mises; both authors emphasise the negative role played by banks, whose credit activity explains in part why entrepreneurs are encouraged to make bad investments thereby creating crises and structural imbalances; the debate on planning is another area where Hayek clearly positions himself in the perspective of Mises, despite the fact that one may wonder to what extent Hayek tones down the asserted more radical position of Mises. In fact, the loyalty of Hayek to the ideas of Mises is of no consequence until the end of the 1930s. Problems emerge with the famous article of 1937, "Economics and Knowledge", often considered as the intellectual turning point in Hayek's career.

The interpretation of the 1937 article is at the heart of the question of "Hayek's transformation".⁹ Our aim here is not to analyse the overall question of Hayek's transformation but rather to identify his position as regards the theses of Mises. Our position is slightly different from that of Hutchison who interprets the 1937 article as a conversion to falsificationism; we interpret the 1937 article as a conversion to empiricism rather. In both cases, the breaking with Mises's apriorism is evident. As far as Hayek's eventual falsificationism is concerned, our position is cautiously restricted to the three following propositions:

(1) Hayek believed himself to be close to the conceptions of Popper. The affinities are there for all to see as Hayek frequently refers to Popper in his writings from 1937 onwards. The extent of the affinities are for instance clearly revealed during the Nobel speech of 1974, "The pretence of Knowledge".¹⁰ In his biography also, Hayek states his adhesion to Popper's criterion immediately following his meeting with 'Sir Karl' in Vienna.¹¹

(2) Within the field of economics such an approach appears hard to reconcile with the criticism of scientism and constructivism, two spearheads of Hayek's position. Hayek (1942) distinguishes between two types of phenomena: simple and complex phenomena. The former rests upon a limited number of variables and may be correctly represented by statistical formula. The latter, reflecting social phenomena, cannot be classified in this way and may only receive an "explanation of principle" as opposed to an "explanation of detail". However, it appears from *The Poverty of Historicism* that Popper himself limits the applicability of the falsification test to explanations of detail, drastically restricting falsificationism to the field of natural sciences. Finally, the fact that Hayek adheres to a strict methodological dualism, a position to be found in Popper's work, is a serious obstacle to the setting up of a true falsificationist approach in economics.¹²

⁹ This question is synthesised in the debate between HUTCHISON (1981) and CALDWELL (1988). Whereas Caldwell's interpretation is centred around the meaning and the role attached to the concept of equilibrium in the Hayekian logic, Hutchison's argumentation is based on a methodological argument.

¹⁰ "We cannot be grateful enough to such modern philosophers of science as sir Karl Popper for giving us a test by which we can distinguish between what we may accept as scientific and what not ..." HAYEK (1974, p. 31). Moreover, Hayek explains how he realised the need to establish an empirical criterion of scientificity following the long and unsatisfactory discussions he had with the members of Freudian circles. Hayek in KRESGE and WENAR (1994, pp. 50-51).

¹¹ "To a very large extent I have agreed with him [Popper], although not always immediately. Popper has had his own interesting development, but on the whole I agree with him more than with anybody else on philosophical matters". Hayek in KRESGE and WENAR (1994, p. 51).

¹² Hayek's criticism of constructivism, i.e. the idea that human understanding is capable of reproducing social institutions, based upon the problem of knowledge dispersion, corresponds to what Popper calls "naïve rationalism".

(3) Ultimately, Hayek only uses the criterion of falsification in the shape of criticism directed at rival theories. This endows him with a sort of indirect verification of his own positions. For instance, the collapse of Eastern European economies is the opportunity to denounce the falsification of the efficiency of planning; the failure of Keynesian theories in the 1960s to eliminate inflation and regulate unemployment is the chance for Hayek to have his revenge on Keynes.¹³

According to us, the article of 1937 is more a reflection of the break with the extreme apriorism of Mises than the revelation of a possible adhesion to Popper's falsificationism. As said above, Hayek criticises in this article the relevance of the "pure logic of choice", refusing the strictly tautological nature involved by such an approach and offering to replace it with an empirical perspective. This attack is traditionally seen as a criticism to neoclassical theories of general equilibrium which are based on the assumption of perfect information. In reality, the 1937 article is also a rather subtle but nevertheless obvious attack on the apriorism of Mises. As Hayek himself explains:

... the problem of my relation to Mises, which began with my 1937 article on the economics of knowledge, which was an attempt to persuade Mises himself that when he asserted that the market theory was a priori, he was wrong; that what was a priori was only the logic of individual action, but the moment that you passed from this to the interaction of many people, you entered into the empirical.¹⁴

Here is the overt admission of his refusal of the praxeological approach. Along with Mises, Hayek supports a dualistic position enabling scientists of the social sciences to set forth from intuitive pre-suppositions which are empirically obvious or even a priori, the axiom of human action falling into this category. Hayek, however, refuses to build the entire edifice of economics with this principle as its sole cornerstone, thereby arriving at a set of irrefutable tautological propositions, devoid of any informative empirical content, reflecting the status Mises has granted to the laws of praxeology. Therefore, the extreme version of Misesian apriorism falls under the influence of the same criticisms as those Hayek directs at the "pure logic of choice". The outstanding theme of the criticism expresses the regret that no empirical content is to be found in the propositions advanced by the praxeological approach. Taking the logic of human action as his starting point, Hayek lays the foundations of a so-called empirical approach as from 1937. On the one hand, the problem of knowledge stems from empirical thought on the dispersed and subjective nature of knowledge used by agents to construct their plans. On the other hand, after having defined the concept of equilibrium in terms of inter-individual compatibility, Hayek introduces the empirical assumption of an existing tendency of the economy towards equilibrium.

It is only with this assertion [the supposed existence of a tendency towards equilibrium] that economics ceases to be an exercise of pure logic and becomes an empirical science; ... In the light of our analysis of the meaning of a state of equilibrium it should be easy to say what is the real content of the assertion that a tendency towards equilibrium exists. It can hardly mean anything but that under certain conditions the knowledge and intentions of the different members of society are supposed to come more and more into agreement ... In this form the assertion of the existence of a tendency towards equilibrium is clearly an empirical proposition, that is, an assertion about what happens in the real world which ought, at least in principle, to be capable of verification.¹⁵

¹³ Hayek offers two reasons to explain his theoretical defeat in the face of Keynes during the 1930s: his book, *The Road to Serfdom*, helped to discredit him in the eyes of the profession and the death of Keynes was a factor turning any attack on his writings into a sacrilege. Hayek, in KRESGE and WENAR (1994, p. 143).

¹⁴ Hayek, in KRESGE and WENAR (1994, p. 72).

¹⁵ HAYEK (1937, p. 44).

From this point on, the problem of economics, endowed with an empirical content, is reduced to concentrating upon "... (a) the *conditions* under which this tendency is supposed to exist, and (b) the nature of the *process* by which individual knowledge is changed".¹⁶

The majority of modern Austrians appears to be aware of the disagreements at the heart of the relationship between Hayek and Mises and more generally of the explosion of the Austrian methodology.¹⁷ Excepting Rothbard (1976) and his disciples who define praxeology as *the* unifying methodology of Austrian thinking, commentators overall attempt to reconcile the methodological positions of Mises and Hayek by putting the apriorism/empiricism conflict to one side with the intention of emphasising the similarities of the subjective dimension in their analyses.¹⁸ In this perspective, Kirzner endeavours to go beyond the apparent paradox brought to light regarding the methodological disagreements separating Mises and Hayek as from 1937.¹⁹ Kirzner's aim, despite this inescapable conflict, is to highlight the continuity linking the contributions of the two writers and subsequently placing himself within this continuity. At the heart of this unity is a support for a dynamic conception of subjectivism as introduced by Menger in 1871.

Kirzner quotes Hayek who qualifies in 1952 progress in economics as the ever-widening and stringent application of subjectivism, thereby paying a tribute to the work Mises has accomplished in this field. In this perspective, Kirzner locates the origin of progress at the point where the static conception of subjectivism summarised by Robbins in 1932 was replaced by a dynamic version of subjectivism to which both Hayek and Mises contributed in a different but complementary manner. More especially, Mises, using the axiom of human action, replaces Robbins' *homo-economicus* by a creative actor who decides on the decisional means-ends context within which he will make his decisions and Hayek emphasises the difficulties brought about by the recognition of the subjective nature of knowledge and of its diffusion and acquisition through the market process.

2. The modern revival

Even though the three lines of the Austrian revival we are considering here are rigorously built upon the same statements, they aim at distinct objectives, they provide various degrees of potential development and they undoubtedly present specific limits.

2.1. The limits of Austrian praxeology

We will focus at this level on a methodological criticism of praxeology.²⁰

Rothbard's developments are in perfect continuity with Mises' approach, that is praxeology.²¹ Praxeology refers to the set of sciences which stems by logical inference from the axiom of human action and exclusively from it, without turning to the adoption of any empirical assumption. Economics as Mises conceives it, is part of praxeology and as such, is only constituted by

¹⁶ HAYEK (1937, p. 44).

¹⁷ Cf. HUTCHISON (1981) who examines the methodological positions of the major figures in Austrian thinking from Menger to the present day.

¹⁸ Cf. DOLAN (1976, ed., preface).

¹⁹ KIRZNER (1992a, chap.7).

²⁰ For a decisive analytical criticism it is sufficient to report to COWEN and FINK (1985); the authors point out the inconsistencies of Mises' and Rothbard's analysis of the market process based on the equilibrium construct of the Evenly Rotating Economy.

²¹ In particular, see ROTHBARD (1962).

apodictically true statements which are not empirically testable. It aims at elaborating universal principles – praxeological laws – which relevance is independent from any empirical condition. It is a purely conceptual science, free from any consideration of space and time.

Praxeology enters in direct opposition with the dominant methodology in economics, namely positivism: praxeological statements cannot be submitted to any test, be it a verificationist or a falsificationist one. This rather dogmatic position involves violent reactions from the orthodox side. Consider for instance the well-known comments from Blaug:

Mises' statements of radical apriorism are so uncompromising that they have to be read to be believed... In the 1920s, Mises made important contributions to monetary economics, business cycle theory and of course socialist economics, but his later writings on the foundations of economic science are so cranky and idiosyncratic that we can only wonder that they have been taken seriously by anyone.²²

We share the dissatisfaction felt by Caldwell (1984) with these kinds of methodological criticism to praxeology and more generally with all dogmatic comments about a position which is itself dogmatic. In order to sting Mises' followers, a fruitful criticism of praxeology should start from the same logical ground of praxeology itself. According to Mises, no empirical test, whatever its nature be, can question the truthfulness of praxeological principles; there are nevertheless two sorts of criticism which can prove effective: external criticism concerning for instance the relevance of the human action axiom itself and internal criticism about the rigorousness of the logical chain of deduction unrolling from the axiom of human action to praxeological principles.

As far as external criticism is concerned, two arguments are of particular relevance. The first one concerns an example of non purposeful action, the operant action as Nozick (1977) defines it:

... processes of operant conditioning by use of rewards and punishments, positive and negative reinforcements, on various contingencies of reinforcement, [that] raise and lower the probability of various behaviours and introduce various patterns of extinction.

The second argument flows from the comparison with alternative praxeologies. Indeed, other authors have tried to build economics on the same method although starting from different axioms than human action. Prychitko (1994, p. 81) blames Mises' neglect for alternative praxeologies like those developed by eastern Europe economists (Eugen Slutsky, Oscar Lange) whose normative conclusions, albeit sharing the same statute, are opposite to Mises' praxeological principles. More precisely, the question Caldwell addresses to Mises is the following: how is it possible to choose between two competing axiomatic systems, both of them stemming from rigorous logical deduction, founded on unquestionably true axioms but reaching opposite conclusions?²³ Ideology certainly enters for part of the answer.

As far as the second kind of criticism is concerned, Caldwell underlines the ambiguities punctuating Mises' *Human Action* about the status of the various analytical categories needed in order to build the whole system: ultimately, it is not obvious to what extent his construction is effectively free from any empirical consideration. These problems clearly arise when Mises' followers and in particular Rothbard, recognise that a few subsidiary postulates are required in order to deduce logically the whole set of praxeological principles from the principle of human action.²⁴ This circumstance questions the apodictic truthfulness of praxeological statements.

²² BLAUG (1980, pp. 92-93).

²³ CALDWELL (1984) confronts in that connection Mises' logic against the axiomatico-deductive system developed by HOLLIS and NEIL (1975), built upon the axiom of reproduction of the system and inserted into a classico-marxian perspective.

²⁴ ROTHBARD (1962, p. xi) explicitly admits the necessity of the following postulates,

We want to add a last remark to this set of well-known criticisms to Misesian praxeology. If, like Rothbard, one aims at following Austrian praxeology as faithfully as possible, it turns out that little more can be added to Mises' statements on an analytical ground, the author finding himself limited to mere exposition and repetition of arguments previously expressed by Mises. Indeed, praxeology is built according to a strict axiomatic method; it is a closed system of analytic propositions, limited to the set of statements which it is possible to deduce from and exclusively from the axiom of human action. Hence from an analytical point of view, the only possible improvements concern the clarification of Mises' explanations or the reinforcement of its consistency through the elimination from the logical chain of inference of all eventual empirical assumptions. The alternative otherwise consists in leaving the sphere of theoretical analysis and entering the field of politics and ideology. This was for instance the road finally chosen by Rothbard.²⁵ In that perspective, praxeology represents the theoretical foundation that could justify the political libertarian principles he defended. Given the limits underlined below, this appears to be the main domain of relevance for Misesian praxeology: a theoretical basement for new right politics as Rothbard advocated it.

2.2. The limits of the Kirznerian theory of entrepreneurship

The Kirznerian view of the market process flows from the theory of entrepreneurship. Kirzner deepens a specific dimension of the Misesian concept of human action: entrepreneurship. Entrepreneurship expresses itself through the quality of "alertness". An alert individual is able to find unexploited profit opportunities. Profit opportunities consist in price discrepancies between sellers and buyers on a same market and reflect the imperfection of the economic configuration: in a perfectly coordinated world, all profit opportunities have been exploited and there is no room for entrepreneurship; in a disequilibrium world, coordination failures are the consequence of imperfect knowledge, and imperfect knowledge is precisely the source of profit opportunities. An alert agent is not an individual possessing more knowledge than the others but an individual whose incentive is, through the existence of profit opportunities, to point out new knowledge.

Entrepreneurship is a peculiar category of action which is supposed to have an equilibrating effect on the economic configuration: entrepreneurs contribute to the diffusion of the new knowledge that their alertness allows them to discover. The exploitation of a profit opportunity renders available for all agents the existence of a punctual maladjustment on the market. They can revise their plans on the basis of this new knowledge. The degree of coordination depends precisely on the amount of knowledge available to agents. From that perspective, entrepreneurship is considered as the propeller of adjustment towards equilibrium. The role of entrepreneurship is to reduce the initial ignorance of the economy through the discovery and diffusion of new knowledge revealed through the exploitation of profit opportunities.

For me the changes the entrepreneur initiates are always toward the hypothetical state of equilibrium; they are changes brought about *in response to* existing pattern of mistaken decisions, a pattern characterised by missed opportunities. The entrepreneur, in my view, brings into mutual adjustment those discordant elements which resulted from prior market ignorance.²⁶

Different kinds of criticism may be addressed to Kirzner's theory of entrepreneurship.

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- the variety of human and natural resources;
 - the fact that leisure is considered as a consumption good, that is an end, an objective for individuals whereas work is viewed as a means.

²⁵ Cf. VAUGHN (1994).

²⁶ KIRZNER (1973, p. 73).

The first one concerns the analytical weakness of the core concept of alertness. In the Kirznerian framework, problems of coordination stems from individual ignorance on the actual conditions of the economy, or, in other words, from a lack of alertness in decision making. Individual error bears up to weak alertness. An agent makes an error, in Kirzner's sense, when, through a lack of alertness, he acts on the basis of a less efficient decisional plan than that which he could indeed have developed, if only he had taken into account all the information set actually available to him. Kirzner gives the following example:

A man walks along a street, sees a store with signs offering to sell apples for \$1 but, perhaps thinking of other things, enters a second store where he pays \$2 for identical apples... Because the necessary information was available to him, it was surely an error on his part to have failed to act upon it.²⁷

Evidently, the axiom of human action makes the introduction of individual error necessarily forceful. The concept of alertness allows the author to play at will with various levels of perception – conscious or unconscious knowledge, available or unavailable information, information actually used or latent... In fact, error stems from a lack of alertness on the part of an agent who makes a decision on the basis of less information than he could have used if only he had concentrated a little more...

A second series of criticism concerns the determinist character of Kirzner's analysis. Let's first make evident this aspect and then present the criticisms.

The theory of entrepreneurship concerns a world of ignorance rather than a world of uncertainty, putting on the foreground the arbitragist nature of agents and downplaying the speculative aspect of human action.

My discussion of entrepreneurial alertness has deliberately avoided emphasizing its speculative character. I have of course recognised that in a world of uncertainty, every entrepreneurial decision, no matter how much alertness it reflects, must to some extent constitute a gamble. But it has been my purpose to point out that the entrepreneur's decision – despite its unavoidable speculative character – represents his judgement that an opportunity for profit does exist.²⁸

In a Kirznerian world, i.e. a world of mere ignorance, action is limited to *discovery* of *existing* profit opportunities. The economic configuration is defined by a set of objective data waiting to be revealed through entrepreneurship. The determinism of this theory stems from the fact that a precise equilibrium situation corresponds to the underlying state of affairs and the market process is supposed to tend towards this equilibrium.

My theory of entrepreneurship has sometimes been criticised as viewing the future as a kind of tapestry waiting to be unfolded: it is already there. It is simply behind the screen; it only has to be unrolled and when the future will come into the field of vision, whereas the truth surely is, the critics point out, that the future does not "exist" in any philosophically valid sense. It must be created so that the notion of alertness in the sense of seeing what is out of there in the future is a mistaken notion. I recognise the philosophical validity of this kind of criticism.²⁹

The determinist nature of Kirzner's theory is not a problem *per se*. It becomes a problem when associated with two other circumstances:

(1) It becomes a problem when the main analytical issue of the theory is precisely to justify the convergence of the market process towards a predetermined final equilibrium state and that such justification is ultimately missing. Remember that Kirzner (1973) explicitly positions his

²⁷ KIRZNER (1978, pp. 67-68).

²⁸ KIRZNER (1973, pp. 86-87).

²⁹ Kirzner interviewed by BOEHM (1992).

contribution as a complement to neoclassical economics. The problem with mainstream economics is the overemphasis on the conditions of general equilibrium and Kirzner proposes to counterbalance this tendency by providing an analysis of the process by which the economy may reach the final state of rest. But, what is this endeavour if not an attempt to come to grips with the problem of stability of general economic equilibrium? The problem is that Kirzner does not provide any analytical demonstration of the equilibrating power of the entrepreneurial action.³⁰ In Kirzner's view, the theory of the entrepreneur as arbitragist is sufficient to guarantee the tendency towards general equilibrium.

Consider the simple theorem that predicts a market tendency towards achieving a single price for a given good in a given market... This tendency obviously rests upon the economist's confidence in the speed and success with which entrepreneurs will pounce upon the pure profit opportunity created by any price discrepancies... A little reflection must surely convince us that economist's confidence in this powerful tendency supports not only their understanding of this tendency itself, but also ... their confidence in equilibrating tendencies in general, both in the context of the Marshallian single market and in that of the Walrasian system of inter-linked markets.³¹

Passing from a Marshallian to a Walrasian framework is far from being an unquestionable task. The problem of equilibrium stability exists for both of them but it is in the Walrasian context that neoclassical theory has had the least encouraging results.³² One may then wonder how the Austrian analysis deals with the problem. In Kirzner's opinion, the contribution of Austrian theory (especially of entrepreneurship theory) has been to provide an explanation of the mechanisms through which changes in information and in expectations give rise to behaviours which move the system towards equilibrium.³³ Two cases then need to be distinguished: a first case in which agents become aware of the complexity of the system through the market process; they understand that it is in their greatest interest to move towards the solution of equilibrium. In other words, by functioning on the market, they learn to solve the model of general equilibrium. What at first appeared to be an impossible task for a planner is, in fact, seen in this light, an easy operation to accomplish for all the actors on the market. This implies that the supposed advantages of the price system as an efficient system of signals should be cancelled out. In the second case, the diffusion of knowledge does not enable agents to acquire a systemic awareness of how market functions. This obviously appears to be more compatible than the previous case with the Austrian analysis of the specificity of knowledge. In this case, the likelihood of perverse reactions of the price system due to market interdependencies cannot be eradicated and the stability of general economic equilibrium remains an open question.

³⁰ According to RICHARDSON (1960), the neoclassical theory of competition does not provide agents with sufficient elements to enable them to construct decisional patterns guaranteeing a tendency towards equilibrium. See PALERMO (1997) and GLORIA-PALERMO (1999) for an application of Richardson's criticism to the Austrian market theory developed by Kirzner.

³¹ KIRZNER (1992a, p. 56).

³² As HAHN (1982, p. 746) explains, 'in a single market context DIAMOND (1971) has studied adjustments as a search process with firms setting prices. But it does not seem possible to extend this approach to the multi-market case'. The conclusion of the neoclassical leader on the question of stability is that '[...] we still lack a satisfactory descriptive theory of the invisible hand'.

³³ KIRZNER (1976a, p. 117).

Ultimately, the only arguments punctuating Kirzner's demonstration of the convergence of the market process refers to a disputable appeal to evidence: "Markets do work. They work so obviously well that our scientific curiosity is aroused to seek understanding of the counter-intuitive phenomenon of this success".³⁴ Kirzner thus considers as obvious the very problem that has been addressed by Walrasian economists since the end of the nineteenth century. Indeed, it appears that the stabilising tendency of the competitive process is not the result of any investigations but simply an assumption derived from observation. Notwithstanding the successive attempts to improve the concept of alertness, the theory of entrepreneurship remains based on the assumption of the convergence of the market process. Consequently, it flows that the analytical ambition of this theory cannot be to prove the efficiency of competition but rather to try to give a theoretical description of this observed tendency of the market process towards plan coordination. The problem is that this tendency is in turn explained on the basis of another empirical assumption, the supposed equilibrating action of entrepreneurs. Ultimately, little has been added since the first versions proposed by Kirzner: "As an empirical matter ... opportunities do tend to be perceived and exploited. And it is on this observed tendency that our belief in a determinate market process is founded".³⁵

It is obvious that such an empirical justification of the equilibrating tendency of the competitive process is not satisfactory. Kirzner's theory of the market process conveys too many inaccuracies: what arguments support the idea that the quality of alertness enables information to be diffused among agents? Could not one argue to the contrary that the interest of the entrepreneur who unearths a non-exploited profit opportunity would be to keep this information private and confidential as long as possible and to exploit information asymmetries? What are the theoretical arguments, other than simple belief, put forward by Austrian authors to demonstrate that entrepreneurship has positive effects on the degree of plan coordination? Admitting that competition enables information to be diffused, is it a sufficient condition in itself to ensure that plans converge? Too many questions left unanswered.

(2) The determinist nature of Kirzner's theory becomes problematic as far as the Austrian character of the theory is concerned.

Since its birth in the work of Carl Menger, the Austrian tradition has been facing a constant problem, that of asserting its originality with respect to marginalism and later on to neoclassical economics. In particular, one central distinctive feature of the Austrian tradition has been to introduce the temporal dimension in the analytical framework. As soon as the neutral neoclassical conception of time is substituted with a real conception of time, not only the focus naturally shifts from the equilibrium reference to the analysis of the economic process but the equilibrium reference itself loses its relevance. As a matter of fact, it is possible to give an account of the evolution of Austrian economics by listing the successive alternatives to the neoclassical concept of equilibrium: Menger's theory of price does not come up with *equilibrium prices* but with an interval of possible values aiming at explaining the *process of formation of prices*; Mises elaborates the concept of *evenly rotating economy* and Hayek ultimately abandons equilibrium for the notion of *order*, emphasising the idea of compatibility between individual plans; Lachmann borrows to Shackle a *kaleidic* view of economic reality characterised by continuous unexpected change.

It is easy to understand why the reference to equilibrium is rejected. It conveys a determinist view of the market process which is hard to conciliate with the Austrian conception of dynamic subjectivism and in particular with the Austrian conception of the economic agent flowing from it.³⁶ Determinism flows from a mechanical conception of individual decision-making. By introducing

³⁴ KIRZNER (1992b, p. 60).

³⁵ KIRZNER (1976b, p. 121).

³⁶ See the definition of dynamic subjectivism provided by O'DRISCOLL and RIZZO (1985).

real time, the marginalist vision of the individual as mere maximiser, reacting to external data, is definitely replaced by a dynamic conception of the economic actor granted with an active mind. Kirzner focuses on the economic process but the final outcome, when all profit opportunities have been exploited, is pre-determined by the underlying economic data leaving little space in the analysis for the creative activity of individuals. The theory of entrepreneurship describes a world of ignorance but not a world of uncertainty, getting rid of the speculative character inherent in every human action in Mises' sense, that is to say, ultimately replacing action with reaction.

2.3. The limits of Lachmann's analysis

The logical founding of Lachmann's view of the market process is similar in all points but one with Kirzner's conception. The splitting point concerns the definition of individual plans. Lachmann goes back to the essence of the principle of human action as Mises defined it, re-introducing the speculative dimension traditionally attached to this principle. The concept of individual plan allows us to emphasise the distinction between Kirzner's and Lachmann's conception of human action.

According to Kirzner, plans are conceived on the basis of a subjective interpretation of past experience. Lachmann introduces a second dimension, plans being the outcome of the interaction between two elements: knowledge as Hayek puts it, i.e. a diagnostic of the economic situation understood as interpretation of experience – the arbitragist dimension of action; expectations, i.e. an interpretation of future situation, understood as imagination – the speculative dimension of human action.³⁷

Given this enlargement of the concept of plan, the resulting view of the market process sharply contrasts with the traditional Austrian one. Market is described as a continuous process, characterised by unexpected change and inconsistency of plans. This latter feature is the direct consequence of the introduction of subjective expectations. Plans are divergent because subjective expectations are based on the image that agents form about an “unknown though not unimaginable” future.³⁸ Competition could lead to the diffusion of relevant knowledge, but appropriate expectations cannot be diffused by any ways, for once they revealed themselves pertinent they already are obsolete and need to be revised; no *ex ante* criterion of success exists. Inconsistency of plans challenges the traditional view of a tendency towards equilibrium. Market is an undetermined process governed by the interaction of equilibrium *and* disequilibrium forces. Inconsistency of plans is the rule and reflects the fact that plans are built up not only from subjective knowledge but also from subjective expectations. As a result, the economic configuration emerging from the interaction of individual plans is definitely one of discoordination. Divergence of plans is the consequence of the extension of subjectivism to expectations and represents, within the Lachmannian view, the propeller of change.

The market process consists of a sequence of individual interactions, each denoting the encounter (and sometimes collision) of a number of plans, which, while coherent individually and reflecting the individual equilibrium, are incoherent as a group. The process would not go otherwise.³⁹

The enlargement of subjectivism to expectations has got overwhelming consequences on the analysis of market process. There is no theoretical reason for conserving the assumption of an existing tendency of the market towards equilibrium: the market is the outcome of a constellation of divergent forces and this is strictly speaking all that can be theoretically deduced from the analysis.

³⁷ “... plans are products of mental activity which is oriented no less to an imagined future than to an experienced past”.

LACHMANN (1969, p. 95).

³⁸ LACHMANN (1976a, p. 59).

³⁹ LACHMANN (1976b, p. 131).

Traditional Austrians underline the indeterminist result of this view of the market; their attitude is rather ambiguous. This comes from the fact that Lachmann's conclusions, quite embarrassing for anti-interventionist supporters, are built upon a deductive framework which foundations are, in our view, the expression of the purest Austrian essence: the enlargement of the subjectivist dimension cannot be criticised for it represents an improvement in Hayek's sense, towards a deeper understanding of complex socio-economic phenomena and the introduction of expectations in the definition of plan do nothing but making explicit Mises' assertion of the speculative dimension inherent to every human action.⁴⁰ As a result, what is criticised is not the issue of subjective expectations, i.e. the full recognition of freedom of choice, but its logical implications, namely the view of market as a non convergent process. More precisely, the criticism usually addressed to Lachmann's developments is one of theoretical nihilism.⁴¹

Conclusion

To recap, the perspectives of evolution of the Austrian tradition appear to be rather limited: on the one hand, the praxeological line of developments provides dogmatic and rather problematic principles; on the other hand, the Kirznerian theory of entrepreneurship offers an analysis in which the stabilising role of entrepreneurs is hardly demonstrated and the fundamental Austrian tenets of time and uncertainty have been definitely assumed away. Finally, the approach advocated by Lachmann seems to question the power of abstraction by developing a non deterministic – nihilistic – view of the market process. At first glance indeed, the indeterminacy of the market process seems to be the logical outcome of the assumption of radical uncertainty.

Now, if radical uncertainty is accepted as being one of the basic tenets of the Austrian approach, one then might wonder which direction could this tradition take. This question goes well beyond the scope of this paper and it is possible here only to indicate a possible avenue of development of the Austrian analysis of the market process.

We think that it is possible to deepen Lachmann's approach in order to go beyond this apparent nihilism and develop a more precise analysis of individual interaction within a decisional context of radical uncertainty. The idea here is that between the pure determinism of an analysis of the market in a perfect information context and the pure indeterminism of an analysis ruled by radical uncertainty, there is room for a positive investigation of market interactions which allows to make precise the evolution of the degree of coordination between individual plans. Individual choices which direct the market process are the result of neither purely reactive behaviours as regards a given environment, nor purely arbitrary actions stemming from the uncertainty attached to future and to other agents' actions.

The theoretical element that could permit to develop a middle-ground approach between these two extreme visions refers to the influence of institutional phenomena upon individual behaviours. More precisely, an Austrian approach of the market process would benefit from the analysis of the influence of institutional contexts upon individual interactions. If radical subjectivists want to overtake the limit of nihilism they are addressed, one solution consists in introducing a relevant theory of institutions within their analysis of the market process. Such endeavour would aim at showing that the alternative does not stand between determinism and chaos.

Actually, this orientation has been given by Lachmann himself, aware of the limits of the theory he develops. According to Lachmann, economists should provide different theories of "market

⁴⁰ According to HAYEK (1952, p. 31), "it is probably no exaggeration to say that every important advance in economic theory during the last hundred years was a further step in the consistent application of subjectivism".

⁴¹ Such criticism may seem a priori totally justified by the kind of sentences punctuating Lachmann's argumentation: "Any force from anywhere may at any time affect our process, and forces that impinged on it yesterday may suddenly vanish from the scene." LACHMANN (1976a, p. 131).

processes” rather than an abstract and general theory of *the* market process.⁴² The author refers to an ideal-typical method of analysis as it is advocated in the works of Max Weber. More precisely, his general theory of market should be enriched by the specification of the institutional set-up that characterises the typical process under analysis. Lachmann’s theory of institutions is an attempt of appraising the role of institutions in the formation and revision of individual plans.⁴³ Unfortunately, Lachmann never provides an explicit and complete articulation of his theory of the market process with his view on institutions. This seems to be the task for another generation of authors, whose work has already begun.⁴⁴

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⁴² Cf. LACHMANN (1986, chapter 6).

⁴³ LACHMANN (1970).

⁴⁴ For instance, O’DRISCOLL and RIZZO (1985) propose the concept of pattern coordination as an alternative to equilibrium; it allows to identify different levels of coordination according to the kind of institutions – unique or typical – that reduces the genuine uncertainty in which agents take their decisions; LANGLOIS (1986) studies the influence of organisations upon market mechanism and clarifies, through the use of game theory, Lachmann’s definition of internal and external institutions; see GLORIA-PALERMO (1998) for the methodological and analytical difficulties stemming from an eventual Austrian theory of institutions.

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