ECONOMIC ORGANIZATION AND ECONOMIC KNOWLEDGE: ESSAYS IN HONOR OF BRIAN J. LOASBY. EDITED BY SHEILA C. DOW AND PETER E. EARL. CHELTENHAM, U.K.: EDWARD ELGAR. 1999

It is a rare individual who is able to draw from many disparate traditions in economic thought and combine these into a coherent research program. Brian J. Loasby, longtime professor of economics at the University of Stirling, United Kingdom, is one such individual. This first of two volumes of essays written in his honor demonstrates the diversity of thought inspired by his work. Professor Loasby has been a persistent critic of mainstream approaches to the issues of knowledge, entrepreneurship, and organization in economics—issues that stand at the forefront of the Austrian research agenda. In fact, contributions from Austrians and Marshallians (another nonmainstream school emphasizing dynamic rather than static analysis) to this volume show a surprising degree of complementarity, and serve as a forceful challenge to Walrasian orthodoxy.

The volume is divided roughly into three parts: the first set of essays deals primarily with theories of markets and entrepreneurship; the second with consumer demand; and the third with knowledge and information in the history of economic thought. The most interesting pieces, in this reviewer's opinion, are in the first section, highlighted by Israel Kirzner's powerful essay entitled "Rationality, Entrepreneurship, and Economic Imperialism." The essay shows Kirzner at his best, providing a rigorous refutation of the idea that the methodology of economic science can be applied *ad hoc* to nonmarket institutional arrangements such as the "marriage market" (as proposed by Gary Becker) and the political process (as emphasized by the Public Choice School). The argument bears some resemblance to that made in Mises (1944), namely that decision processes which do not provide for the *systematic* exploitation of pure profit opportunities (as markets do) will not exhibit the tendency toward coordination (efficiency, if you will) that market processes exhibit. In other words, the incentives for entrepreneurial discovery that are present in a market setting are absent in nonmarket situations such as political bureaucracies, so the application of economic reasoning *as if* those incentives exist is a mistake.

THE QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS VOL. 3, NO. 2 (FALL 2000): 89–94

Kirzner does more, however, than merely attack the basis of economic imperialism. He also uses the essay to discuss the proper use of equilibrium analysis and to explode the myth of "perennial optimality." Once again, the idea is not entirely original—Kirzner acknowledges the similarity between his own argument and that of Olson (1996) concerning the significance of unrealized opportunities for gain in a multi-institutional setting. But Kirzner does an excellent job of tying the discussion to the Misesian view of universal rationality, a view that doesn't entail any unrealistic assumptions of perfect information or foresight. The result is a thorough refutation of the notion that economists should conduct their analyses as if the world is in a state where no misallocation of resources exists and all opportunities for net gains from trade (so-called Pareto moves) have been exploited.

Kirzner's article sets the stage for three more articles dealing with the relationship between markets, entrepreneurship, and uncertainty. Richard Arena in "Austrians and Marshallians on Markets: Historical Origins and Compatible Views" examines the compatibility of the Austrian and Marshallian views of markets. Beginning with the idea that market institutions and business organization are "social devices which help to improve market efficiency" rather than "imperfections which are introduced into the universal model of a pure competitive exchange economy," Austrian and Marshallian economists are able to offer "a view of markets which is fresh, consistent and provides new insights" when compared to that of the neoclassical mainstream. This view arises by way of the recognition, on the part of both traditions, that markets generate uncertainty and that market institutions—such as money and credit arrangements, speculators and arbitrageurs, forms and methods of organization, etc.—serve to mitigate this uncertainty.

Arena spends much of the article discussing types of uncertainty and how they arise in the context of market exchange. He makes use of G.W. Richardson's conception of strategic uncertainty to explain how market institutions might assist actors in dealing with situations that require extensive information about what other economic agents *plan* to do. If one can envision an uncertainty spectrum that ranges from full knowledge of the probability distribution describing all the possible future actions of others (in which case the economic problem is merely reduced to one of risk) at one end and complete ignorance at the other, strategic uncertainty may be said to bear on the myriad real-world decisions that take place between the two extremes. As Arena reminds us, the recognition by Menger and the Austrians that means and ends are *always* subjectively evaluated ensures us that such uncertainty will *always* be part and parcel of the market process. Uncertainty relative to the "goods-character"

of produced commodities and to the opportunity costs (and thus prices) of the resources used in production "increases the probability of divergent entrepreneurial expectations" in the market economy. Institutions have therefore evolved to facilitate the flow of information between market participants, thereby limiting the level of uncertainty they must encounter. Arena provides a number of examples from both Marshall and Menger demonstrating how specific institutional arrangements have been developed toward this end. Included among these arrangements are what might be termed market *routines*, particular ways of bargaining, organizing, and carrying out exchanges that are adopted by large numbers of market participants. These routines lend themselves to a high degree of certainty in day-to-day economic affairs by virtue of a network effect associated with their widespread use.

The other two articles in this first section also warrant a brief mention. Jack Birner's article entitled "Making Markets" examines Hayek's "network" theory of markets and provides an interesting glimpse into the underlying philosophical issues it raises. Young Back Choi's "Conventions and Learning: A Perspective on the Market Process" does an excellent job of identifying the major weaknesses of the neoclassical theory of decisionmaking. Choi also pays necessary attention to the use of conventions in the economic process and to the role of entrepreneurs as innovators that deviate from conventional behavior in order to exploit perceived opportunities.

Economists with an interest in dynamic theories of demand and marketing strategy will find the second part of the book intriguing. The articles in this section focus on what might be broadly termed "evolutionary" economic analysis of consumer demand, drawing from the Austrian, Marshallian, and Institutionalist perspectives. One article in particular that may draw the reader's attention is Dosi et al. "Cognitive Processes, Social Adaptation, and Innovation in Consumption: From Stylized Facts to Demand Theory." A thoroughly behaviorist treatment of the subject, the article stands out as the only empirically-based article in the entire collection. Beginning with an assessment of the standard theory of economic decisionmaking, the authors point out various weaknesses and inconsistencies in the microfoundations of mainstream theories of consumption. It is found, for instance, that the "coherence criteria prescribed by decision-theoretic models are systematically violated" by economic agents in experiments; that "the choice process is often guided by heuristic criteria which might not bear any rigorous mapping into any coherent underlying structure" of agent preferences; and that "habits, routines, and explicit deliberative processes" that coexist as determinants of consumption acts "are embedded in the processes of socialization and identity-building."

None of these criticisms of standard decision theory would surprise or trouble a researcher working in the Austrian tradition. Of course, the standard coherence criteria are experimentally inconsistent. One reason for this lack of conformity with real-world results is the faulty assumption that the level of "wealth" or "utility" the agent is seeking to improve upon can be objectively determined and quantified. Austrian economists, following Menger, have always maintained the subjective nature of utility; it is only in an agent's actions that we can see preferences demonstrated. And what we know from such a demonstration is that, at the moment of choice, the agent *perceived* the chosen action as the most appropriate use of the means at the agent's disposal toward the achievement of his or her own subjectively determined ends. These ends may certainly go beyond material well-being and encompass goals such as identity-building and a sense of belonging to (identification with) particular groups.

Another, more subtle, reason for the lack of realism in standard decision theory is its failure to properly account for the nature of uncertainty. Mainstream economics has settled for a theory of choice that treats all decisionmaking as risk analysis, whereby an agent is able to form complete subjective probability distributions describing *all* possible future outcomes and, therefore, must merely choose the course of action that maximizes his or her expected utility based on those distributions.[1] Austrian economics rejects such a narrow conception of decisionmaking by giving prominence to situations of true (*fundamental*) uncertainty. These are situations in which agents don't have sufficient knowledge to form complete outcome distributions, but nonetheless perceive themselves to have *some* knowledge about what may happen under various circumstances. Decisions on the basis of heuristics, routines, intuition, and plain old habit become part of the "toolbox" (so to speak) of the economic agent dealing with fundamental uncertainty in day-to-day affairs. The "social embeddedness" of such methods is also well noted—Hayek and other Austrians have dealt extensively with the idea that social phenomena such as imitation and learning are an important part of the market process of discovery.

Rather than follow these more fruitful avenues of incorporating realism into decision theory, however, Dosi et al. interpret the evidence to warrant the disposal "of any notion of 'utility' as the basic driver of observed choices" in favor of an approach where consumption patterns "socially co-evolve with preference structures . . . in a process ridden with decision inconsistencies and cognitive dissonance" and "in ways possibly independent from any change in relative

[1]As Choi points out, this is really not a theory of "choice" because it ignores the crucial aspect of assessment of alternatives which, once settled upon, makes "the course of action rather obvious" (p. 60).

prices" (pp. 156–58). This approach involves modeling consumer behavior as a discrete, stochastic process where consumption acts in each period are determined by random mutation in the individual's goods basket (which the authors call "innovation") along with a mechanism that provides for imitation of others' consumption patterns. This admittedly "unrealistically simple structure" generates, according to the authors, consumption patterns that are broadly consistent with the "stylized facts" of observed market demand, including "the familiar negative elasticity to prices, notwithstanding the absence of any notional 'demand curve' within the decision algorithm of individual consumers" (p. 162).

The authors acknowledge that their model of consumer behavior is abstract and rudimentary, but nonetheless believe that they have improved upon the standard theory of consumer decisionmaking. Most Austrians, however, will find little that they would describe as improvement. If neoclassical theory suffers from being unable to explain how decisionmakers arrive at their subjective assessments of the reality with which they are faced, this model suffers more so. Not only does the model fail to provide a mechanism by which actors make such assessments, apart from merely assuming that consumers (a) rank goods[2] and (b) imitate each other, but it represents consumer "innovation" as a *random* process with no basis in the consumer's desire to improve upon his or her existing situation. In other words, it is a model of a choice process without any corresponding basis for choices. This is not to say that the model might not prove useful as a *nontheoretical* representation of the evolutionary process of innovation in consumption.[3] Such a use is clearly not what the authors intended, however, based on their assertion that they mean to examine the "behavioral microfoundations" that are missing from the "agnostic" approach to aggregate demand analysis (p. 145).

The third and final section of this volume contains a diverse set of articles exploring issues of knowledge and uncertainty in the thought of various writers, from well-known economists (Menger, Smith, etc.) to lesser-known figures such as Allyn Young, Bernard Mandeville (*The Fable of the Bees*) and John Rae. Peter Groenewegen's article "Perfect Competition, Equilibrium, and Economic Progress: That Wretched Division of Labor and Increasing Returns" addresses an important issue among all schools of thought that stress dynamic analysis—that of the conflict between equilibrium analysis, on the one hand,

[2]The authors assume in the model that all participants rank goods on a scale from basic needs to "luxury" items. Thus, there is no evaluation of "goods-character" on the part of the subject; classification of something as a good is an objective phenomenon, in direct contrast to the view of Menger and the Austrians.

[3]In this regard, one might view it in much the same way as time-series analysis that attempts only to depict the historical realization of a decision process.

and economic progress on the other. Then, perhaps more importantly, the last part of the article ties the analysis to a discussion of the "wrong turning" in economics lamented by Loasby, the Austrians, and others inclined to a dynamic view of the economic process. The value of a collection of articles such as this one lies in its capacity for inspiring others to take up enlightened research and be part of a "right turning" in which the excessive reliance on perfect competition and equilibrium theorizing might be reversed. Time will tell whether such a reversal will be accomplished; but if it is, we will have scholars such as Brian J. Loasby to thank for it.

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