



Review of Nicolai J. Foss, *The Austrian School and Modern Economics: Essays in Reassessment*, Copenhagen: Handelshøjskolens Forlag, 1994, 229 pp.

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Now a full 25 years after the beginning of its revival, the Austrian school seems to have reached a crucial fork in the road. Having spent much energy during the post-revival period on sorting out what the Austrian approach is all about and how it is distinct from the neoclassical mainstream, the school is now faced with the question of how that distinctive approach can be reconciled with some congenial developments in neoclassical economics. There appears to be an increasing trend within the Austrian school toward finding commonalities with these mainstream developments, rather than distancing itself from them. Nicolai Foss's recent book is in many ways an excellent and productive example of this trend. He recapitulates many major Austrian themes while finding ways to connect them to important new work in evolutionary and neo-institutional economics. His attempts to "open up" Austrians to those insights, as well as opening up these other traditions to the contributions of Austrians, are largely successful and serve as a nice model for the kind of work Austrians should aspire to.

In addition, Foss argues that Austrian economics needs to take a more explicit problem-solving approach to its work. He reiterates many of the same claims that have been made in the past about Austrians being too consumed by methodology, or paralyzed by their, in his view, overly dogmatic adherence to subjectivism, to actually get on with attempts to use their theories to explain real world phenomena. His final chapter is a quite critical examination of Austrian methodology that ends up suggesting that modern Austrian economics will die out unless it shifts its methodological ground and begins to address contemporary and historical economic problems and puzzles. This argument is more questionable than the rest of the book's attempts to find points of contact with the mainstream. Foss is not the first thinker to find such points of contact, nor is it the case that post-revival Austrians have ignored applied issues. Foss's bibliography is notable not for what is there, but for what is not: namely the significant, though not nearly sufficient, applied work of younger Austrians. His neglect of this work leads him to have a more negative assessment of modern Austrian economics than is warranted by the "data".

The two major pieces of history of economic thought in this collection are both excellent overviews of a defining debate in the Austrian tradition. Foss's essay on the Hayek-Keynes debate nicely covers the main issues, with particular attention to the role of capital theory in demarcating the differences between the two thinkers. In particular, Foss recognizes

that Hayek's own view of intertemporal coordination was "explicitly microeconomic" and based upon Austrian capital theory (p. 24). This was in contrast to Keynes, who, while also working out of a Wicksellian framework, chose to ignore the capital-theoretic underpinnings of the Wicksellian natural rate/market rate distinction. Foss is also careful to point out the particular places where Keynes's aggregation disguises the sorts of mechanisms that the microeconomic approach of Hayek was so concerned with. As is his wont throughout the book, Foss tries to find something salvageable in Keynes that should demand the attention of modern Austrians. In this case, he suggests that Keynesian questions about the stability of financial markets and problems of asymmetric information are still highly relevant and need to be tackled with Austrian analytical tools.

His essay on the socialist calculation debate is also a fine recapitulation of the issues and personalities involved. He rightly echoes the argument of so many post-revival Austrians that the calculation debate reflected a clashing of approaches to economics and that it was during the course of the debate that Austrians began to see their approach as distinct from that of the Walrasian mainstream. The problem with Foss's assessment, however, is best encapsulated by a comment he makes toward the end: "However the modern Austrian approach does not capture all aspects of Hayek and Mises' arguments such as the emphasis put by them on property rights and tacit knowledge" (p. 80). That seems an odd claim to make in light of the fact that many latter-day Hayekians have been criticized for their *over-emphasis* on issues surrounding tacit knowledge. What is striking is that nowhere in the essay does Foss refer to any Austrian work on the calculation debate or socialism after Lavoie's 1985 book. With a publication date of 1994, he surely could have consulted Lavoie's 1986 *Comparative Economic Studies* paper on the role of tacit knowledge, as well as discussions of the calculation debate in Boettke (1990, 1993), Prychitko (1991), and Kirzner (1992).¹ What is of particular interest is that some of these contributions, especially Boettke (1993), go to great lengths to place the Austrian perspective on calculation in the context of mainstream issues and to apply it to empirical problems. While it is hard to disagree with Foss's call for more and better scholarship, it is fair to say that he has sold the Austrians somewhat short on what they have already done.

Some of the best essays in the book are those where Foss illustrates the ways in which Austrian ideas can be cross-fertilized with emerging developments in the mainstream. Chapters 5 through 8 all do so with very positive results. Chapter 5 is, as Foss admits, somewhat of a rational reconstruction of Mises's work from the perspective of property rights economics. Foss compellingly shows that Mises's approach to property rights and economic organization can be understood as a precursor to modern day property rights economics. He anticipated modern discussions of "economic organization . . . the agency problem and the role of capital markets in checking managerial shirking. Furthermore, he pioneered the use of comparative institutionalism" (p. 97). Chapter 8's discussion of the theory of the firm (a topic Foss has written extensively on) offers ways in which Austrian work can be combined with transaction costs approaches to obtain a

¹ Since Foss's book was published, essays by Horwitz (1996, 1998), Boettke (1998), and the debate over socialist calculation that appeared in this journal over the last few years have also pursued the themes of property rights and tacit knowledge.

more full-bodied understanding of economic organization. In particular, he suggests that transaction costs approaches are incomplete without Austrian concepts such as spontaneous order, the market process, the entrepreneur, and incomplete or tacit knowledge (p. 167). By bringing in these Austrian themes, we will have a much richer theory of the firm.

Perhaps the best of these integrative chapters is his discussion of Austrian economics and neo-institutionalism (chap. 6). Foss argues that neo-institutionalism is often too static and requires a more dynamic conception of the market to realize fully its potential. He further argues that of the possible dynamic theories of the market, only the market process approach of the Austrians can really address what is missing in most neo-institutionalism. Austrian economics can provide neo-institutionalism with a way to explain historically the process by which prices change, and thus avoid a kind of functionalism that plagues neo-institutionalism, as well as providing a theory of knowledge and change that is very effective in rendering intelligible the evolution of economic organizations. In general, Foss argues, neo-institutionalism requires more emphasis on process, particularly in the way in which institutions evolve through time, and Austrian insights can provide that. Rather than having “an excessive preoccupation with contracting problems caused by morally hazardous or opportunistic behavior,” a more process-oriented neo-institutionalism could explore “a much broader menu of determinants of information and transactions costs, many of which relate to the process of the division of labor and technological change” (p. 122). This combination of market process theory and concern with the role of institutions in reducing transaction costs seems to me to be an excellent research agenda in microeconomics (broadly construed) and one pregnant with applications to modern concerns, particularly as the pace of technological change continues to increase.

Foss’s final chapter, as mentioned earlier, is a critical assessment of the ability of modern Austrian economics to contribute to our understanding of the way the world works. Foss argues that Austrian methodology has made it difficult for Austrian theory to be an effective problem-solver in two ways. First, Austrian subjectivism often takes the position of saying “thou shalt not” do certain things when doing theory (aggregate, use equilibrium constructs, etc.), rather than offering a positive alternative to the mainstream. Second, overly dogmatic attempts to maintain the purity and distinctiveness of the Austrian approach prevents it from making use of congenial insights from the mainstream and other heterodox schools that could offer paths to doing more effective applied work. The result, he argues, is that modern Austrianism, particularly in comparison to the contributions of inter-war Austrians, has not shed much light on real world problems.

Again, it is hard to disagree with the general sentiment here: it is without a doubt true that Austrians need to focus more on applications to history and current issues and opening up Austrian theory to congenial insights from the mainstream and other heterodox thinkers would be an excellent way to do so. However, I do wish to make a couple of points about the particulars of Foss’s argument. As noted earlier, he cites none of the applied work done by post-revival Austrians. His argument makes it seem as though, with the exception of Kirzner’s work on the entrepreneur, Austrians have had no impact on how theory is done, what theoretical questions are being asked, and what sorts of historical explanations are viewed as valid.

I submit that while there is much more to be done, the impression Foss leaves is unfair to modern Austrian economics. As one example, he has no references to the substantial work done on monetary theory and financial history by George Selgin and Larry White, among others. White's (1984) book applied both Austrian and mainstream insights to a historical episode and arguably changed the way many in the profession viewed the history of Scottish banking. Selgin's (1988) book brought insights from Austrian economics to bear on a mainstream tradition in monetary theory and has opened up several new avenues of research in monetary theory as well as its applications in monetary institutions, policy, and history. Other work by Selgin, Horwitz, and Schuler has looked at a variety of historical episodes by applying Austrian, mainstream and neo-institutionalist insights. Austrian work on competition, monopoly, and antitrust has been very influential as well, in particular by making use of insights from other theories of the firm as well as neo-institutionalism more broadly.

Austrian work on political economy has also benefitted from opening itself up to public choice theory and then using the results to explain real world phenomena. Peter Boettke's two books on Soviet socialism, David Prychitko's work on the former Yugoslavia, and parts of Sanford Ikeda's recent book are all examples of this type of work. Other younger Austrians are off applying their insights to issues such as the environment, political competition, and economic development.² Not all of this work was available when Foss was writing, but much of it was, yet he chose to leave it out. When one takes stock of this work, as embryonic as it might be, it leaves a less negative taste in one's mouth than does Foss's assessment.

In making this last argument, I risk being accused of a certain sort of defensiveness about Austrian economics, and perhaps even being seen as saying "what's Foss so worried about? Everything looks great to me." That is not my position at all. I agree with the problems that Foss has identified. What I wish to point out is that others do as well, and that Austrians seem to be beginning to address them by doing an increasing amount of applied work that makes use of theoretical insights from beyond Austrian economics narrowly construed. Foss's charges are surely valid and he has thrown down a challenge for Austrian economics as it enters a new phase in the post-revival years. This collection of essays serves as an excellent starting point for understanding where Austrian economics has come from this century and where it must go in the years ahead in order to continue to be a living set of insights into the economic and social world.

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²One might also include the excellent work in American economic history by Vedder and Gallaway (1997) in this list.

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