Book Review


Roger Koppl’s book is a major contribution to the Austrian theory of expectations and markets. It is insightful in its theoretical approach, erudite, and grounded in a solid methodological discussion. In addition, it deals with important issues and leads us to a frontier that is just beginning to be explored. Although economists have paid a lot more of attention to institutions and to cognition in recent decades, only a small minority has worked where these two lines of research cross. This book, which puts together work done over several years, marks Koppl’s presence in this frontier.

The book is very well organized. Part I introduces and summarizes the main arguments. Part II deals with methodology, devoting a chapter each to Mises, Hayek, and Schutz. Part III is theoretical. It opens with a chapter that develops the language-games framework formulated by Koppl with Richard Langlois. It then applies this framework to the issue of expectations, on which Koppl had already published very interesting work with William Butos. The last theoretical chapter contains the theory of Big Players, again benefiting from previous joint work, namely with Leland Yeager. Part IV applies the theory of expectations and Big Players to monetary and financial markets. It includes a chapter on the ruble market in Czarist Russia, another chapter on the angular distribution of asset returns, and a third one on money demand in the United States. A coda closes the book, relating it to an emerging new orthodoxy and indicating directions for further work.

I cannot hope to do justice to the broadness and richness of Koppl’s book in such a short space. I shall therefore highlight only a few points that are, in my opinion, especially interesting for future debate and research.

Regarding methodology, one of the main points made in the book is about methodological individualism. Although Koppl uses this expression, he recognizes that it often makes communication difficult. More importantly, Koppl’s version of methodological individualism does not imply that individuals are prior to society, but rather acknowledges that they are shaped by it. This view should facilitate an agreement with other heterodox approaches in economics, particularly the ‘old’ institutional economics, as currently represented by Geoff Hodgson and others.

This methodological stance is reflected in important parts of Koppl’s theoretical analysis of language games. A language game is a set of rules that tell us how to talk, how to think, and what to do in different situations. Agents thus have a rhetoric, a theory, and a practice of the language game. The rules of a language game constrain individuals, but go beyond this. In particular, Koppl argues that these rules have a cognitive function, guiding our thinking through categories and hierarchies, a set of typical thoughts, like what Arthur Denzau and Douglass North call a shared mental model. I take this to imply that these
rules and shared mental models (a type of institution) have a deeper cognitive function than the mere transmission of information and influence individuals in profound ways. This general aspect of Koppl’s work can thus be aligned with recent advances in new institutional economics and converges with the ‘old’ institutionalist tradition (Dequech forthcoming).

Koppl relates the distinction between the theory and the practice of a language game to a distinction between cognitive and acognitive expectations. The former are thoughts about the future; the latter are propensities to act, implicit in people’s actions, which reveal that people act as if they expect something to happen. While I agree with Koppl on this relevant distinction, I would not go as far as saying that all implicit expectations are more objective than explicit thoughts and emerge from natural selection (p. 5), even if the description might apply to Koppl’s main examples of acognitive expectations, namely rational expectations, in the as-if interpretation, and Hayekian expectations. I would distinguish between implicit expectations in general and the particular cases in which these expectations are prescient or “rational”.

Koppl’s discussion of expectations must be praised for highlighting entrepreneurship and interpretation. It attempts to enrich the theory of entrepreneurship with some elements of a theory of learning borrowed from Schutz and from Hayek’s cognitive theory.

Koppl uses Schutz when dealing with cognitive expectations. Schutz’s “typifications” or stereotypes may be thick, very detailed and thus closer to a unique individual or thin, very anonymous. Schutz does not explain, however, when thin typifications are good enough. For Koppl, this depends on the institutional system, with tighter constraints producing more prescient expectations. More specifically, he identifies stability of the rules of the game and atomism of competition as the two conditions that promote prescient expectations.

Koppl sees a similarity between Keynes and Schutz regarding the adoption of a convention that projects the recent past into the future. For Koppl, however, Keynes, followed by many Austrians and Post Keynesians, neglected “the relativity of plan futurity”, i.e., “the idea that our planning horizons are subjectively determined and our plans grow more open-ended as the goal is more temporally distant” (p. 108). Moreover, the future should not be seen as a sequence of events, but as a field of action, where people try to influence results. I strongly agree with Koppl that people are not mere passive observers and sometimes innovatively break with conventions. I also agree that uncertainty comes in degrees, but would argue that several Post Keynesians share this view, while Keynes did not always treat uncertainty as complete ignorance (Dequech 1999). Furthermore, agents plan for the future when breaking with a convention not only by innovating but also by preferring liquidity.

In Koppl’s analysis of acognitive expectations, stability of the rules and atomism again promote prescient expectations, through natural selection of the different language games. Koppl refines the notion of acognitive expectations with Hayek’s theory of mind, which stresses the role of the evolutionary environment in shaping people’s knowledge. Experience causes changes in the system of abstract rules that constitutes the mind. Expectations correspond to the social rules governing action, which are the product of social and biological evolution. “In this evolutionary view there is no reason to see in the uncertainty of the
future a special cause for discoordination of action” (p. 118). There is a tendency to coordination, which may be blocked by other factors. As Koppl acknowledges, the environment may change rapidly (p. 116). Another issue to consider in this respect is the presence of Big Players.

Koppl’s Big Players have three defining characteristics: they influence the market where they operate, are largely insensitive to the discipline of profit and loss, and their actions are based on discretion. Given this definition, only governments and government-protected monopolists may be Big Players in the long run (p. 123). For Koppl, the discretionary actions of Big Players create instability and increase uncertainty. In financial markets in particular, attention is diverted from the fundamentals, which Koppl finds easier to predict, to the Big Player’s actions. Big Players prevent a selection mechanism from keeping prices in line with fundamentals.

As far as Austrian economics is concerned, my assessment of Koppl’s work is extremely positive. So is my opinion of Koppl’s interest in, and respect for, traditions other than his preferred one. Like Koppl and some of his collaborators, I believe that the debate between Austrian economics and other schools of thought should be extended and reinforced. Moreover, in the case of Austrian, institutional, neo-Schumpeterian, and Post Keynesian economics, for example, some aspects of different approaches may be compatible and complementary.

I should make it explicit, however, that my own views on the stability of a market economy and on the role of the State are much closer to other schools than to Austrian economics. Thus, where I disagree with Koppl on these issues, I probably disagree with most Austrian economists. Although Koppl does refer to the possibility of rapid changes in the environment, his characterization of the working of a market without Big Players does not seem to emphasize that possibility. In contrast, I believe there is a great deal of uncertainty and potential instability in any capitalist economy, even without disturbing actions by the government. The major reason for this is the inherent competitive pressure for the introduction of innovations or, in other words, Schumpeterian entrepreneurship, which, incidentally, often means an absence of atomism among private agents.

As for the government, I have a more positive view of its potential effects on stability. Admittedly, it can indeed change rules too much and too often, creating instability and uncertainty. This is something to which Post Keynesians, for example, need to pay more attention. Austrians, on the other hand, could benefit from the Post Keynesian discussions of the need to create or reinforce institutions that promote stability, including market makers, whose proper action requires a buffer stock of the asset or good in question, as well as a stock of money.

Despite these disagreements, I consider Koppl’s book full of merits. Both Austrians and non-Austrians should read and learn from it.

References

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David Dequech
Institute of Economics
University of Campinas
Campinas, São Paulo, 13083-970, Brazil
E-mail: dequech@eco.unicamp.br