AN INTERVIEW WITH PETER LEWIN

INTRODUCTION

AR: Thank you Professor Lewin for this opportunity to know a bit more about yourself. Why did you become an economist?

PL: It is I who should thank you for this opportunity to be part of this wonderful project of yours and to applaud you for it.

To answer your question – it is rather strange. When I was 14 years old my best friend's mother was a local politician (in Johannesburg, South Africa where I grew up). I remember one night she mentioned in conversation the importance of knowing economics. And somehow that stuck in my mind – from that moment on I wanted to study economics and I never deviated from it. And the more I got into it the more dedicated I became. I never really gave much thought to what I would do with a degree in economics; how I would make money. I just knew I wanted to do something that involved economics.

AR: How was your experience studying in South Africa?

PL: Very interesting in many ways. It shaped the rest of my life and especially my professional life.

I went to South Africa's most prestigious university, the university of the Witwatersrand (Wits), in Johannesburg (not that there were very many universities anyway). I decided to do a joint major in economics and history – in retrospect a marvelously wise decision. I studied for a BA in economics and history and did an extra two years (part time) for a BA honors degree in economics. Starting out I knew nothing of Austrian economics.

This was the period 1966 – 1971. It was the middle of the apartheid period, before the decline set in. South Africa at that time was really a very violent police state. But this was not obvious to most of the privileged white minority who lived in a relatively free market, open society. (The parts that were obviously not free were the labor market – the employment and movement of non-white workers was very strictly controlled – and the press was severely censored concerning prisons, police, and similar subjects.) I was very politically aware from a young age. My father was an extremely liberal man – in the classical liberal sense. Wits was a very liberal institution, the center of much liberal anti-apartheid protest.

But the economics I studied at that time did not have much to do with this – at least not directly, or obviously. It was only later that I realized how important economics was to understanding what was going on, and I did my Ph.D. thesis on *The Economics of Apartheid* under the guidance of Gary Becker who had done his thesis on *The Economics of Discrimination* – it was a natural fit.

In my second year as an undergraduate (1967) I was taught by Professor Ludwig Lachmann. He was the head of the small department and he did a lot of teaching. So he taught me most of my undergraduate economics. I had some other very good teachers (and one very bad one in the first year) who taught me a lot of the technical stuff that proved to be very useful when I got to Chicago. But Lachmann was, of course, the biggest intellectual influence on me, an influence that lasts until this day.

After teaching for a year in the business school I left for Chicago (in September of 1972). That was the end of my education in South Africa.

AR: When and how did you get in touch for the first time with Austrian theories?

PL: In my undergraduate years, in Lachmann's classes, he would always bring in the ideas of the Austrian School, mostly by way of criticism of the standard theories he was explaining. But the most important early exposure to Austrian ideas was in my third year undergraduate (1968) when I attended Lachmann's course on Capital Theory, and, then his course on Growth Theory. They were both masterpieces, but the course on capital was the foundation of my understanding of economics – though I did not know it then. (I eventually published the notes from that course in a journal article in *Advances in Austrian Economics*). Of course, the Austrian Theory of Capital has always been the most well-known contribution of the Austrian School. So this gave me invaluable insights into the kernel of Austrianism, into the ideas of Menger, Böhm-Bawerk and Lachmann himself, but also into (the non-Austrians) Fisher, Knight, Clark, Kaldor, Robinson, Hicks and Solow.

Lachmann also taught a course on Monetary Theory and one on Welfare Economics. These had very heavy Austrian components as well, but were not dominated by them.

After graduating with a (three year) BA, I applied for admission to the honors program with Lachmann and was admitted to the weekly honors seminar which took place in his office. It was there that I was exposed to many of the important texts in economics and in Austrian economics in particular. It was in the seminar that I became aware of Israel Kirzner and Lachmann's respect for him and disagreement with him, and of the works of Hayek and Mises. I never knew about Rothbard until after graduate school.

AR: And what can you tell us about Ludwig Lachmann?

Lachmann was more than a teacher of economics. He was a scholar of incredible breadth and depth, and a gentleman in the old style. A man of impeccable integrity and learning, with a prodigious memory. He spoke German, French and English fluently. He also cared deeply for the students who showed any interest in the subject. He was, however, impatient with the mass of students who were just there to fulfill the economics requirement. He made no compromises in quality.

His lectures were works of art, mastery in prose and logic. I have to admit I was an immature student. I was awed by him, but I did not fully comprehend the substance of his lectures until much later in my life. Still, I was a diligent student and did well and I retained a memory of those lectures so that the message matured as I did.

Lachmann was a passionate soldier of the Austrian school. He believed strongly that neoclassical economics was methodologically bankrupt. He believed that the Austrians, particularly Menger, had it essentially right (not in every respect, but overwhelmingly so) and he was pursuing a dual mission – to advance the cause of Austrian economics and to extend and develop Austrian economics to fulfill the project implied, but not yet completed, by Menger's foundational work.

Menger made a huge advance in perceiving the subjective nature of value. The logical and compelling next step was to investigate as fully as possible what this meant for expectations, which are an essential part of the valuation process and of actions based on it. So he believed that Mises and especially Hayek had not gone far enough along the road of subjectivism. This became the leitmotif of his life from the late 1940's (at the London School of Economics) when his work on capital led him to think deeply about expectations (provoked also by the challenging influence of Keynes). Most importantly, it was the implications for the concept of equilibrium that preoccupied him.

AR: What have you found in the Austrian tradition that was absent in other schools of thought?

I am convinced that subjectivism has a lot to do with it. Austrians use what we may call the method of subjectivist-individualism. They proceed always from the conviction that value is subjective – contextual, a phenomenon of the individual mind, though reflected in many ways in the world. This leads naturally to a skepticism of neoclassical formalism which treats price and value as the same thing. The neoclassicals (the economic mainstream) lack an awareness of the implications for theory, for empirical investigation and for economic policy, of subjectivism. Methodological subjectivism also implies methodological dualism. The methods of the social sciences cannot be the same as the methods of the natural sciences. Mental phenomena (not neurological phenomena) are not the subject of natural science. Natural science does not involve an analysis of how individuals understand, value and impute meaning to their world. In its imitation of natural science the economic mainstream has veered off course.

Other heterodox schools share things in common with the Austrians – some more some less. I think specifically of evolutionary economics, post-Keynesian economics, public-choice economics and (maybe) behavioral economics. The

Keynesians use subjectivism selectively. They abandon it when it suits them – for example when they need to assume that market participants are radically ignorant but government policy-makers are all-knowing. Behavioral economists pay great attention to what individuals know and don't know and how they actually make choices, but some of them think that this gives them the power to know what makes people happy and what people "really need" though there is no methodological basis for this turn. I think evolutionary economics and Buchanan-style (as opposed to Chicago-style) public-choice economics cohere pretty much with Austrian economics though their idiom and sometimes their subject matter is different. (Hayek of course thought very much in evolutionary terms.)

AR: How was studying in Chicago being an Austrian economist?

Actually it was a non-issue. Lachmann was not pleased that I was going to Chicago. He was afraid I would be corrupted ☺. And when I got there I was so overwhelmed by the place that I pretty much shelved the Austrian part of my identity and focused on coping with the program. Let me explain.

The Ph.D. program at Chicago was incredibly competitive. Also I was in culture-shock. I had never been around so many smart, serious young people before. And very focused. It was as if everything was speeded up. They had no time or interest in hearing about obscure economic theories. I doubt any of the professors would have been interested either, but, in any case, I did not have the courage to confront them. They held my future in their hands. So the answer to your question is that while studying at Chicago I was not an Austrian economist as far as anyone knew.

The truth is I was never really completely comfortable at Chicago. Looking back I realize that I learned a tremendous amount and that I reached a peak of mental agility. But I never really found my voice as an economist until I rediscovered Austrian economics after moving to Dallas. And later, as is evident from my book on capital, I saw an opportunity to apply Chicago insights in an Austrian framework.

AR: What can you say about Gary Becker? How was your experience with your dissertation?

It was not a good experience. Some of it, maybe most of it was my fault. The rest I have to say was beyond my control. Becker was always distant. He was obviously incredibly busy. He agreed to supervise the thesis because it was close to his own work. But timid students like me did not do well with him. It was the aggressive, opinionated students that he seemed to like. So, while I benefitted immensely from his courses, and from his work, I never really got to know him very well personally and did not receive a lot of guidance for the dissertation.

The two other members of my committee were more helpful. Jim Heckmann (who later won a Nobel prize) was always very kind and really paid attention when I was able to apply some econometrics that interested him. I think he pushed Becker to sign off on the dissertation. (I should explain that at that time I was not living in Chicago, having finished my course work I was doing the dissertation from afar.) The third member was Bill Landis (in the law school). He was very nice and I benefited from his work on discrimination as well.

AR: Do you know what he thinks about Austrian economics?

Yes, I think so. Well at least as of 1979. He may have changed his mind. I have not spoken to him about this since that time. Judging by some very brief remarks he made, I gather that he thought Austrian economics was not important or serious. It was not empirical. Becker is (was) very much a believer in the brand of positivism outlined by Friedman. The Austrians had some important and interesting ideas (as is clear from his references to Hayek for example) but, at the end of the day, they do not do real science and cannot be taken too seriously. That is my speculation of how he thinks about it.

AR: Did you have any contact with Milton Friedman?

Yes, I had two courses in price theory from him. He was a great teacher, but less effective than he might have been owing to his intolerance and tendency to intimidate students.

AR: In 1974, when Hayek received the Nobel Prize, you were completing your Masters in Economics at Chicago? What can you remember about it?

Actually, I was right in the middle of my course work. I remember absolutely nothing about it. I am sure I must have heard about it, but I remember nothing. Of course later I realized how important it was. Stigler and Becker used to talk about Hayek, but I could not really figure out what they thought of him from the brief remarks I heard.

AR: Let´s return for a moment to Lachmann. Which lessons can you remember that are important for the reader?

Lachmann did not make a lot of different contributions during his long professional life. I think there were three. The first, his main focus, was to the theory of capital. He was led to this by Hayek's work in the 1930's and 1940's. Perhaps the most important article was Hayek's "Investment that raises the demand for capital"(*The Review of Economics and Statistics*, November, 1937). It got Lachmann thinking about the nature of capital and this ultimately led him to the conviction that current thinking about it was wrong. The key mistake was to ignore the heterogeneous (complementary) nature of capital goods. To think of capital as a homogeneous aggregate was a categorical mistake. It was a categorical mistake with far-reaching theoretical and policy implications. Capital is an intricate structure of functionally different instruments of production. This, of course, makes sense from the viewpoint of the Austrian Business Cycle story. A credit expansion induces a distortion in the structure of capital and produces a cycle.

And, indeed, this is the context in which Hayek was trying to use the Austrian theory of capital to tell the story in terms of longer versus shorter capital investments. Lachmann pretty much changes the level and the dimensions of aggregation. His work is in the tradition of Austrian capital theory from Menger to Hayek. But he sees himself as repairing and extending Böhm-Bawerk's vision. In effect he replaces the notion of roundaboutness with the idea of complexity, an idea whose relevance has grown over time.

His second contribution proceeded from his first (as did his third, which I will tell you about momentarily). It is more philosophical and methodological (epistemological) than his work on capital. It addresses the question of equilibrium. In a world in which expectations of the same future may differ, and in which all action is a response to and itself generates knowledge, it is hard to see that one could predict with confidence a tendency toward equilibrium, that is, toward a situation in which individuals' plans and the expectations upon which they are based are mutually consistent. For Lachmann this then becomes an empirical matter – will the forces making for plan consistency outweigh those forces moving against it? Lachmann saw this as an implication of the subjectivism of expectations and I guess it was because of this that he came to be called a "radical subjectivist."

The third contribution, again directly related to the first two, concerns the relationship between equilibrium and action. Successful action requires prediction at some level. But Lachmann denied the possibility of successful prediction in the kaleidic world of "disparate expectations". How could one reconcile these two ideas? His answer is found in the existence of social institutions which provide the necessary stability for an environment within which individuals can act albeit upon radically uncertain expectations. This was spelled out most fully in his 1971 book *The Legacy of Mac Weber*. (I have tried to build on this contribution of his).

Besides these three areas of contribution, he did write articles on many other things, like money and inflation, trade unions and company law.

AR: Can we say that you have advanced on his own work? Which are your most important contributions?

At one level I have tried to serve as a faithful interpreter of his work. As I have probably read everything he ever wrote in English and knew him in person as a teacher and older colleague I often found myself explaining his ideas and correcting what I took to be misconceptions.

At another level, however, I am most proud of my work on capital theory and its applications to areas that Lachmann may not even have thought of. The most obvious is human capital. Lachmann did not understand the notion of human capital, but all of his ideas, and all of the essential elements of capital theory can be extended to human capital with very interesting implications for labor markets, the family, and the firm.

His work on institutions is incomplete in one important respect. It does not adequately explain how institutions arise and persist. He seems to suggest that they arise as a result of entrepreneurial vision. But the theory of networks provides a very simple and compelling explanation. Institutions are spontaneously evolved outcomes of actions that are subject to network effects, that is they arise from a type of action whose benefits depend positively upon the number of others who act similarly. So customs, norms, common law, language, money, etc. are all the spontaneous unplanned results of human actions. Lachmann was imprecise about the notion of prediction. And I tried to fix this. Plans are multilayered, depend on different *types* of knowledge. Some types of knowledge *do* facilitate very accurate and reliable prediction – it is these types of action that become institutionalized. And it is only because of these institutional constants that we can have the kaleidic world of entrepreneurial action he spoke about without the social world degenerating into violence and chaos. I continue to work on this theme.

Perhaps I will mention just one more. I have applied Lachmann's ideas profitably to the theory of the firm and generated a novel approach to the firm based on it.

AR: Why is the Austrian Theory of Capital is so important and so different to other theories?

I am not sure it is so different. The Austrian Theory of Capital is the most well-known contribution of the Austrian school. Gary Becker refers to it in his work on human capital. The modern production function approach to the firm and economic growth derived from a particular reading of Böhm-Bawerk. What is different is the Mengerian method of analysis.

It is important because capital is an essential, yet not well-understood concept. Capital theory disappeared from the general economics curriculum and the only parts that remained were the formulas relevant in the field of finance.

How can we talk about "capitalism" without an adequate understanding of capital?

AR: Why do you think the mainstream ignores this Austrian Theory of Capital?

They don't know what it means. They don't have the mindset to know. They think they have transcended it. They believe that all the important contributions from the theory are subsumed in the production function, which is more precise and more scientific. There is a small area of mainstream specialization that works only on mathematical extensions of Böhm-Bawerkian models.

AR: What is so important about disequilibrium? What does it mean?

What does it mean? That is a good question and one that I am addressing in an article I am now writing. It is a term used very imprecisely and with variations. Hayek addressed this question as early as 1937 and in his later work he talked more about "order" than about "equilibrium". I think a generally agreed upon definition of equilibrium would be: *a situation in which the plans and actions of individuals are mutually consistent*. So disequilibrium is the absence of this consistency – a situation of inconsistent plans so that not all actions can be carried out. So a supply-demand equilibrium in an isolated market is a situation in which all plans to buy and sell at the market price can be carried out.

Why is it important? Well because all real-world markets are in disequilibrium at some time. And all entrepreneurial profit depends on the existence of disequilibrium. Without disequilibrium there is not much to talk about.

AR: Which is your contribution in your book "Capital in disequilibrium"?

It is basically an evaluative survey of capital theory Austrian-style. Capital theory has often been feared or avoided by economics students, never mind other interested scholars. I hoped and still hope that this book will provide them a comprehensive, sophisticated, yet accessible course in the subject. A second edition is due out any moment. This is good timing. The relevance of capital theory has, all of a sudden, burst upon the field of management and organization studies. Having discovered and digested Schumpeter and Kirzner, management scholars have now, in turn, discovered Lachmann. How delightful it is for me to see Lachmann's insights being applied in this kaleidic, digital world. I know this would have pleased him beyond words. (A real paradox of sorts, because I cannot imagine he would ever have mastered the technology for his own personal use ☺)).

Regarding the book, those wishing to understand concepts like radical subjectivism, capital heterogeneity, capital complementarity and substitutability, etc. would probably find it useful. Chapters 2 and 3 seem to me particularly important for an understanding of the concepts of *equilibrium* and *disequilibrium* that we just discussed and about which there is so much confusion. Chapter 9, and less so Chapter 10, address specifically the question of capital combinations in business organizations. The final part of the book is about human capital and creates a bridge between the work of Lachmann and Becker.

AR: Last year you wrote an article on "The Capital Based View of the Firm". Can you summarize this connection between the Austrian Theory of Capital and the Austrian Theory of the Firm?

I believe that an understanding of the nature of capital is indispensable to an understanding of production and business activity. I am continually struck by the mistakes that eminent scholars make for lack of this understanding. A somewhat pedantic but fairly well-cited article that addresses this is an article I wrote with Steve Phelan (in the book *Entrepreneurship and the Firm: Austrian Perspectives on Economic Organization* edited by Nicolai Foss and Peter Klein).

This and some other work has led up to the publication of the article you are asking about, "The Capital-Based View of the Firm" (*Review of Austrian Economics)*. It is co-authored with Howard Baetjer. At the time I wrote my book I knew of Howie's work (subsequently published in his book *Software as Capital*) and there is a brief mention of the basic idea, but, clearly, this is the most glaring omission from my book. This article hopefully rectifies that. I believe it is very important.

Here is a quick take: One cannot understand the nature of capital without understanding its connection to *knowledge*. Howie brilliantly showed that capital goods are basically *embodied* productive knowledge – knowledge of how to get certain things done. It is this *knowledge-aspect of capital goods* that makes them valuable, in combination with other capital goods and with human capital. Fundamentally there is no categorical difference between physical capital and human capital in this regard. To be useful they must both embody potentially useful knowledge. And we all know (from Hayek and Polanyi, and from Lachmann) the problems associated with the management and creation of useful knowledge. The only relevant difference between human and physical capital as instruments of production to be organized and managed, is that the former is alienable (ownership of it can be transferred) and the latter is not. Managing human capital involves relationships. This leads to insights about the firm management, boundaries, organization, etc.

AR: And what do you mean with an Austrian Theory of the Firm?

I wish I had not used that title. The article by that title is essentially the same article as the chapter I referred to a moment ago – written with Steve Phelan. In the received literature there is no Austrian theory of the firm per se. There is a lot of discussion about organizations (in Hayek) and bureaucracy (Mises) and diverse contributions by Rothbard, Lachmann and others – lots of stuff that bear upon an understanding of those business organizations that we call firms; but not a specific theory of the firm. So in that article, and in my work subsequently, I have tried to pull it together to see what such a theory would look like. I think the latest article – the CBV of the firm – is the best attempt.

AR: Is there any insight that we can take from the neoclassical theories of the firm?

Actually there is no neoclassical theory of the firm, not really. What goes by that name is really a theory of the industry. It is about industry structure and not about firms as organizations. No, there is nothing in that theory that tells us anything useful about firms as real-world institutions. It is a black-box theory.

Now, of course, Ronald Coase's seminal article on "The Nature of the Firm" in 1937 has, belatedly, given rise to an enormous literature (including the work of Oliver Williamson and notable others). If you want to put this within the neoclassical camp then, yes, there are very valuable insights to be gained. This work has sailed very close to the Austrian camp and I would be hard put now to tell the difference.

AR: What is the State of this field? Am I right if I say that Austrian economists are making big improvements on the Theories of the Firm, better than the Mainstream?

This is a dynamic and very exciting field. I believe most of the valuable work is being done by non-mainstream scholars or, moreso, those working in the adjacent disciplines of management studies, namely, organization studies, strategic management and entrepreneurial studies – the last mentioned in particular. The synergies are palpable. Many of the ideas I might think of as Austrian have actually developed independently in some of these other fields. So we benefit from different perspectives. It’s not a one-way street by any means. The Austrians like myself learn as much, or more, than we teach.

AR: Let´s return to Macroeconomics. What about expectations? Do you know of any book or article that improves Shackle´s and Lachmann´s work on “subjectivist expectations”?

Improves? That is hard to say. It’s not really my area. I would refer you to the work of Roger Koppl and Bill Butos.

AR: What is the problem with “adaptive expectations” or “rational expectations”?

Lachmann liked to say that expectations were autonomous, uncaused. Theories of expectation formation have no room for novelty. “Rational expectations” as a tautology is ok, but not very helpful. As an empirical tool for actually attempting to measure expectations of key variables it is false. I don’t think you can have a universal theory of expectations that would allow you to measure and predict them.

AR: What do you think about Roger W. Garrison´s contribution in “Time and Money”?

Roger’s work provides very important theoretical and historical insight. It is a masterful pedagogy. Anyone who takes the trouble to follow it comes away with a much richer understanding of the issues involved.

AR: Ludwig van Der Hauwe wrote that Garrison´s Capital Based Macroeconomics approach “represents a rather radical rupture from traditional and established modes of thought within Austrian economics”. What do you think?

Yes and no. It is true, and this is probably what Ludwig means, that one does not find other examples of diagrammatic analysis using aggregate variables. Austrians have frowned upon their use for fear of succumbing to the fallacies of composition that lurk within. But with Roger’s work I think this danger is absent. He has brilliantly illustrated the fallacies of Keynesian economics using the expositional tools of the Keynesians themselves. And he has chosen his aggregates in such a way that the reader is in no doubt about what distinctions cannot be abstracted away – for example the difference between consumption and capital goods and even different kinds of labor. So it think it was a risk worth taking and has paid dividends. And I see that some of your own recent work has extended Garrison's analysis in an interesting way.

AR: Is there any connection between the crisis of the mainstream and the financial crisis?

Very interesting question. Yes of course. Ideas have consequences. History does not speak to us in one voice. Therefore we recycle old ideas and repeat the mistakes of history. The current crisis is a reprise of many similar precedents that are the consequences of government hubris fueled by Keynesian reassurances.

AR: In which field and topic are you working now?

I am busy on a paper (at least one) provoked by the interesting work of Todd Chiles and co-authors in a half dozen or so recent articles, specifically addressing Lachmann's (and sometimes Shackle's) concept of *radical subjectivism.* I am reexamining this concept and this work in the hope of providing greater clarity as to what it implies, and more importantly, what it does *not* imply. In doing so I have had to use Lachmann's work on social institutions, in *The Legacy of Max Weber* — rereading it with great interest and seeing how amazingly relevant it still is or has become.

As I mentioned, this work is connected to and arises out of the growing field of study into the nature of entrepreneurship. Indeed the connection between capital and entrepreneurship is clearly addressed by Lachmann. I have a recent paper, in need of revision, entitled "Entrepreneurial Paradoxes".

I have done a bit of work on economics and ethics, one paper on the economics and ethics of intellectual property. With sufficient time and energy I would like to do a few of these in the form of "the economics and ethics of …". The subjects I have in mind are illegal immigration, illegal drugs and maybe some others.

AR: Would you define yourself as optimistic or pessimistic with respect to the future of Austrian economics? Do you think that Austrians can ever win this "battle of ideas"?

I am very optimistic in the sense that believe that the Austrian paradigm will continue to gain adherents and produce works of value at an accelerating rate. I have seen its beginnings in the 1974 revival and I now see around me a growing multiple of the original effort. (The crucial influence of Peter Boettke should be mentioned in this regard.) I think that Austrian ideas will gain influence in policy and in academic circles, but not necessarily or likely in the mainstream. I think the mainstream is firmly insulated. It is a fortified impregnable autarky and will become more and more technically obscure and irrelevant. In that sense the Austrians will never win the battle of ideas. But it will win on other battlefields that may matter more.

AR: Are there any suggestions that you want to offer for young students who are interested in Austrian Economics?

It depends where they are and what they want to do in life. I guess as a general comment I would say, whatever your circumstances you can probably find a way to make Austrian economics fit into your life. I was able to master the ideas and tools of the mainstream, and to benefit from them, without giving up my interest in Austrian economics. Often it's not easy, but it is worth it in the long run.

AR: Thank you so much for your time!

My pleasure. Thank you for the opportunity.