

AUSTRIAN ECONOMICS AND CRITICAL REALISM

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Abstract. From the perspective of a realist philosophy of social science, the recent explosion of criticisms of mainstream economics, including reinvigorated Austrian criticism, provides what seems like a rich opportunity to join what are too often disjointed disciplinary interests and inquirers, and also to extend the arguments not only as regards the realist theory of social science, but also as regards the implications of this approach for economics. I begin with a minimum sketch of key features of realist philosophy of science as I understand it. The central difference turns on the role and nature of explanation and of theory, between what is frequently termed ‘deductivism’, and on an alternative in which explanation requires the articulation of a causal mechanism, for example, the mechanism provided by molecular chemistry that gives us an understanding of oxidation. I take the position that in social science, explanation requires social causal mechanisms. I consider the Austrian contribution from this point of view and conclude with some hints regarding how the foregoing bears on our understanding of capitalism and socialism.

Key words: economics, realist philosophy of science, Austrian theory, socialism and capitalism

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Introduction

While neo-classical economic theory has been under intense criticism since its inception, there has been a recent explosion of critical literature from the perspective of a critical realist philosophy of social science.² An important branch of this criticism comes from Austrian theory, initiated by Ludwig von Mises, and Friedrich A. Hayek, early critics of the neo-classical paradigm, but better known, perhaps, as severe critics of any form of socialism. This situation provides what seems like a rich opportunity to join what are too often disjointed disciplinary interests and inquirers, but also to extend the arguments not only as regards the realist theory of social science, but also as regards the implications of this approach for economics. I conclude then with some comments regarding critical realism and our understanding of socialism and democracy.

I begin with a minimal sketch of key features of realist philosophy of science as I understand it. The central difference turns on the role and nature of explanation and of theory, between what is frequently termed ‘deductivism’ and on an alternative in which explanation requires the articulation of a causal mechanism, for example, the mechanism provided by molecular chemistry that gives us an understanding of oxidation.³ I take the position that in social

² For a sample of this, see Tony Lawson, *Economics and Reality* (London: Routledge, 1997) and *Reorienting Economics* (London: Routledge, 2003); Paul Lewis, ed., *Transforming Economics: Perspectives on the Critical Realist Project* (London: Routledge, 2004) and the many citations therein; Steve Fleetwood, *Hayek’s Political Economy: The Socioeconomics of Order* (London: Routledge, 1995); *Critical Realism in Economics* (London: Routledge, 1999), and his various articles, for example, ‘Order without equilibrium: a critical realist interpretation of Hayek’s notion of spontaneous order’, *Cambridge Journal of Economics* 20(6) (1996); Peter Boettke ‘Where did economics go wrong? Modern economics as flight from reality’, *Critical Review* 12 (1997).

³ The two terms, ‘understanding’ and ‘explanation’ are frequently interchangeable, but ‘understanding’ carries the connotation of ‘making intelligible’. ‘Explanation’ is most comfortable as regards the explanation of events. Thus, we have an understanding of the

science, explanation requires social causal mechanisms, a fact of considerable importance. The idea, of course, requires unpacking.

The realist criticism of the uncritically held mainstream commitment to deductivism is a most important contribution of realist theory. But while mainstream economic theory is characteristically deductivist, it also provides a well elaborated social causal mechanism, the mechanism of the market. It is hard to see, however, how one can consistently be deductivist and at the same time provide a causal theory that satisfies the assumptions of realist philosophy of science. But this is not the only problem. When it is recognised that mainstream theory does have a theory of the market that provides a causal account of outcomes, it also becomes clear that the mainstream theory of the market mechanism fails for what are familiar and convincing reasons.⁴ By contrast, Austrian theory rejects deductivism and provides key insights into a proper realist causal theory of the market mechanism. Indeed, once we abandon the theory of the market mechanism of standard theory, and approach markets from the point of view of Austrian theory, it is easy enough to explain the wide variation in the nature and character of market societies, including, accordingly, quite stable orders that are widely inefficient and unjust – a fact too frequently ignored by key Austrian writers. Finally, centralised planned economies assume the key features of mainstream theory, but rejecting these gives the Austrians decisive theoretical arguments against such economies. But this also raises the question of whether, in their own terms, there is a plausible version of a socialist market.

Deductivism and Social Mechanisms

fact that iron tends to rust when we have the mechanism of oxidation. We have an explanation of some event when we show how the pertinent mechanism combined with other actions and mechanisms to produce the outcome – why in some particular instance the iron rusted. For a fuller elaboration, see Peter Manicas, *A Realist Philosophy of Social Science: Explanation and Understanding* (Cambridge: Cambridge University Press, 2006).

⁴ Manicas, *A Realist Philosophy*, Ch. 6.

Deductivism assumes some version of the deductive-nomological (D-N) model of explanation wherein theory is construed as a deductive system in which propositions (the *explanandum*) are deduced from initial conditions and axioms, usually buttressed by taken-for-granted assumptions (the *explanans*). Mainstream economics characteristically adopts this model.⁵ There are, however, by now well established problems with deductivism. I need here to be brief.

In the first place, theories are not logical systems that can be fully expressed mathematically. As Rom Harré writes:

In fact, in actual science, deductive systems are quite rare: fragments of such systems can be found in physics, but mostly scientists come up with descriptions of structures, attributions of powers and laws of change, related by having a common object, not by being then and there deducible from a common set of axioms.⁶

This requires an entirely different understanding of scientific theory, sketched in what follows.

⁵ Thus **Kenneth** Arrow notes that ‘in most mathematical, and generally, in most deductive studies in the social sciences, the starting point is the behaviour of the individual. Each individual is conceived as acting in a way determined partly by his psychology and physical surroundings and partly by the actions of others. If there are n individuals, we may denote the actions of individuals i by A_i and the nonsocial determinants of his behaviour by P_i . Then the actions of the first individual may be described by the symbolic equation, $A_1 = f(P_1, A_2, \dots, A_n)$. There is one such equation for each individual. Together, they constitute n equations in the n variables A_1, \dots, A_n .’ Presumably, then, by solving these equations (along with equations for exogenous factors) we can ‘determine the behaviour of society in the sense that we can determine the behaviour of any individual in society’ (K. Arrow, ‘Mathematical models in the social sciences’ [1951], in *Readings in the Philosophy of the Social Sciences*, ed. May Brodbeck [New York: Macmillan, 1968], 640). It should be noted that this account has no place for agency and is also a Laplacean view of the world. See below.

⁶ Rom Harré, *Principles of Scientific Thinking* (Chicago, IL: University of Chicago Press, 1970), 10.

Secondly, it is easy to show that entailment is the wrong relation for explanation. That is, on the covering law conception, the *explanandum* follows logically from the premises: If P, then necessarily Q. If the *explanans*, P, is true, we have provided sufficient grounds for believing that the *explanandum*, Q, is true. So, presumably, Q is ‘explained’.⁷ But not only is this contrary to our intuitions about explanation, it is easy to construct counter-examples of D-N ‘explanations’ with true premises that are just plain silly. Not only do they not explain, but they do not even provide grounds for believing that the *explanandum* is true.

The alternative argues that scientific explanation is *causal* explanation but rejects causality understood in Humean terms as mere relations of constant conjunction. This is the key point: it argues, instead, that causes are productive powers. ‘Things’ (‘powerful particulars’) have the causal powers they have by virtue of theorised causal mechanisms. To take the simplest case, on the standard view, if one has the ‘law’ ‘If salt is put in water, it dissolves’, you can then predict that in a particular instance, a consequence of putting salt in water will be that it will (probably) dissolve. But similarly, on this view, one (allegedly) explains why some instance of salt dissolved by appeal to the same ‘law’. On this view, explanation and prediction are symmetrical. Of course, it is part of the explanation of its dissolving that the salt was put into water and this explains some of the attractiveness of the covering law model of explanation. And indeed, while science may well begin by identifying patterns and regularities in the world, a scientific explanation does not aim at establishing ‘law-like’ relations of variables, no matter how probable. Rather, explanation comes with identifying the causal mechanisms at work. In this example, there is something about salt *and* water, such that when salt is put in water it tends to dissolve – and not (say) to explode or turn the water to gin! People knew that salt tended to dissolve in water before we had molecular chemistry but they did not know why. Indeed, the idea

⁷ **Carl G.** Hempel acknowledged a weaker form, ‘inductive statistical explanation’. However, in this we lose all hold on the individual case. Sam wants to know why he got lung cancer and does not smoke while Harry, who smokes, is free of cancer!

that the goal of science is to identify and confirm ‘laws’ that explain by subsumption, obscures the critical role of theory and model building in real science.⁸

⁸ The critique of deductivism in the current economic literature has been much influenced by the work of Lawson, who has argued that the absence of system closure is the main problem for the deductivist account. See also **Geoffrey M.** Hodgson, ‘On the problem of formalism in economics’, *Post-autistics Economics Review* 28 (October 2004), who notes, rightly, that Lawson’s conception of deductivism is ‘atypical’. From the present point of view, Lawson’s account is not so much wrong as obscures the main problem: that logical entailment is the wrong relation for explanation. That is, even under conditions of (approximate) closure (for example, our solar system) where outcomes are deducible from fundamental principles, the deduction does not provide an explanation of these outcomes, a point recognised by **Isaac** Newton, who struggled to find a mechanism. This problem led, eventually, to the views of **Ernst** Mach and **Henri** Poincaré that science does not seek explanations. For them, to try to do so is to engage in metaphysics. See my account in *A History and Philosophy of the Social Sciences* (Oxford: Blackwell, 1987), 184–90. As regards ‘deductivism’, there are differences at least in emphasis between **Harré**, **Roy** Bhaskar and Lawson. Lawson emphasises Bhaskar’s ‘principles of invariance’ and ‘instance confirmation’, which depend on closure. These lead to the D-N model of explanation. **Harré**, my primary reference in what follows, is interested in deductivism as a mistaken ‘theory about theories’, boldly but correctly characterising his goal as ‘a Copernican Revolution in the philosophy of science’. See **Harré**, *Principles*, 1, 46 and *Varieties of Realism* (Oxford: Blackwell, 1986); and **R. Harré** and **E. H. Madden**, *Causal Powers* (Oxford: Blackwell, 1977). The relative absence of discussion of causal mechanisms in the literature of the philosophy of science suggests that the ‘revolution’ has not yet occurred. But for some discussion of causal mechanisms, see also **Peter Machamer**, **Lindley Darden**, and **Carl F. Craver**, ‘Thinking about mechanisms’, *Philosophy of Science* 67 (2000), and **Mario Bunge**, ‘How does it work? The search for explanatory mechanisms’, *Philosophy of the Social Sciences* 34(2) (2003).

Social Mechanisms in Mainstream Economics

The idea that explanation proceeds by providing a *social* mechanism has a long history in economics. Sketches of such mechanisms in economic theorising have been available since Adam Smith, who saw, rightly, that the key concepts of economics – wages, rents and so on – presuppose the purposive behaviour of agents. The market was then the pertinent causal mechanism. Smith’s ‘invisible hand’ required that actors had interests and were sufficiently enlightened in pursuit of satisfying them. The outcome was explained in terms of the consequences, intended and unintended, of the actions of actors. The idea thus preceded the ‘formalist’ revolution of the recent past.⁹

One might argue that even if it is true that causal argument is a feature of both classical and neo-classical theory, this became marginal or even disappeared in formalist versions of general equilibrium theory. Presumably, then, the effort in these is ‘to reveal the interconnectedness of economic phenomena without needing to specify the means by which a particular interconnected state is reached’.¹⁰ But this will not do (as Robin Cowan and Mario Rizzo rightly suggest) since unless we accept formalist deductivism as our theory of explanation, one has at most a description but *no* explanation. Indeed, much of the putative explanatory power of formalist accounts depends on the implicit assumption that the market mechanism can be mobilised to fill in the causal blanks. For example, when an economist asserts that some change is endogenous, she means that it is explained in the terms of neo-classical price theory. This is simply assumed in the model.¹¹

⁹ See Peter J. Boettke, ‘Where did economics go wrong?’, 12; David Warsh, *Knowledge and the Wealth of Nations* (New York: W.W. Norton, 2006), Ch. 9; Lawson, *Reorienting Economics*, Part IV.

¹⁰ Robin Cowan and Mario J. Rizzo, ‘The genetic-causal tradition and modern economic theory’, unpublished manuscript (1996), 2.

¹¹ Cowan and Rizzo note that ‘even in more formal theory, the Walrasian tradition found it was necessary to introduce the fiction of the auctioneer to explain the determination of

Some of the confusion, at least, derives from the wide acceptance among economists of Milton Friedman's classic 'instrumentalist' account of theory. He argued that 'theory is to be judged by the predictive power for the class of phenomena which it is intended to "explain"'.¹²

As he says:

the relevant question to ask about the 'assumptions' of a theory is not whether they are descriptively 'realistic', for they never are, but whether they are sufficiently good approximations for the purpose at hand. And this question can be answered only by seeing whether the theory works, which means whether or not it yields sufficiently accurate predictions.¹³

An instrumentalist understanding of theory allows one to have a causal model and still be deductivist. But for the instrumentalist understanding of theory, since the test of theory is 'good predictions' – as consequences of the mathematical model – the theory of the mechanism need not be even a 'sufficiently good approximation' of reality. P can entail Q even if P is false. Theory explains, however, only when the description of the mechanism is true. The problem with the mainstream theory, then, is not merely that it appeals to deductivism *and* to a causal theory of the market, but that the theory of the social mechanism it provides is false: it is not true of the concrete, which it means to explain. We need to say a bit more about *social* causal mechanisms.

Social mechanisms

First and most critically, social mechanisms (unlike the many various mechanisms identified by theory in the physical sciences) require the actions of persons: one of the many meanings of 'methodological individualism'. The theory of social mechanisms requires that

prices; and Edgeworth similarly resorted to the process of re-contract' (*ibid.*, 6). Both assume the neo-classical mechanism.

¹² Milton Friedman, 'The methodology of positive economics', [1953] in *Readings in the Philosophy of the Social Sciences*, ed. May Brodbeck (New York: Macmillan, 1968), 512.

¹³ *Ibid.*, 517.

persons be powerful particulars, able to intervene in the world such as to change it. We need to consider whether there are other social causes that should be acknowledged. Secondly, specific typical attributes may be applied to persons and their situation. Their attributes are, to be sure, emergent properties of persons that they have only as social persons interacting socially. Some of these properties are generated by providing answers to the following questions: (a) what do they want; (b) what do they know – including what do they think that they know; and (c) what are their attributes, personal and relational? Thus, do they have special skills, or advantages/ disadvantages as regards the social relations in which they stand? Given (c) we have (d): what can they do? Actors always have choices, but they do not choose who they are or the alternatives that they have.¹⁴

¹⁴ See G. Hernes, 'Real virtuality', in *Social Mechanisms: An Analytical Approach to Social Theory*, eds P. Hedstrom and R. Swedberg (Cambridge: Cambridge University Press, 1998). Many examples are provided in Manicas, *A Realist Philosophy*. I include here a sketch of the mechanism developed in Erving Goffman's *Asylums* (New York: Anchor, 1961). Goffman identifies two antagonistic types of actors standing in a well-defined social relation: 'the managers' and 'the managed' ('professionals' vs. 'clients', staff vs. inmates). By virtue of their place in these social relations, there are resources available that enable the construction of their identities and capacities, including having appropriate credentials and dress along with a number of specific capacities characteristic of the institution. Abstractly, the managed must be constructed as something less than a full person, while the manager is constructed as competent to 'treat' the managed. Thus, 'social distance is typically great and often formally prescribed' (7). Each of the two parties has goals (which 'provide a key to meaning') and each has a system of beliefs (for the managers, an 'interpretative scheme' which includes 'a theory of human nature'). For each group, there are structured capacities for achieving their goals. Typically, 'the managed' undergo 'mortification', the construction of a different self, role dispossession (14–15), 'personal defacement' (20–21), 'contaminative exposure' (23) and a diminishing of their capacity to control action. A mechanism employed in stripping power is 'looping', where a disruptive response from an agent becomes the target of the

While the neo-classical theory of the mechanism assumes, correctly, that the actions of persons, identified by means of the usual economic categories, as consumers, employers and so on, are the critical causal components of the mechanism, it badly *misdcribes* the actors and their situations. For example, they are not rational in the relevant sense, they lack the knowledge which is assumed by the theory, they stand in very different social relations, and thus have very different interests, powers and capacities, not acknowledged by mainstream theory.

The problem, it must be emphasised, is not that the theory of the social mechanism is an abstraction: all scientific theories must abstract from concrete reality. We ‘strip away’ all the properties of concrete (empirical) iron and define it in terms of its atomic structure. Theoretical iron is Fe and, according to theory, it *must* (tend to) rust if exposed to H₂O. And it usually does because most concrete pieces of iron are instances of the abstraction, *theoretical* Fe, even if they are not purely Fe. Moreover, in the real world, all outcomes are the product of complex causes, so there is never closure – the condition in which there are no complicating causal facts. Empirically, the best we have are generalisations: iron usually rusts. But a strong *ceteris paribus* clause cannot save the neo-classical social mechanism since (as has been said many, many times), unlike the mechanisms of molecular chemistry, the neo-classical mechanism makes a host of false assumptions about the elements and processes of the mechanism. Indeed, it would be nearer to the truth to say that while neo-classical theorists claim to abstract from concrete reality, as Steve

next attack (35–6). But the managed also have resources. Resistance by them takes on a number of forms, including contesting the meaning of rules, ‘fraternisation’ and ‘playing it cool’ (61–5). ‘Institutional ceremonies’, including, for example, a newsletter produced by inmates, an annual party and an open house, are regular events in the life of the institution. These are intended to produce a joint commitment to the official goals, even if, to be sure, everyone ‘on the inside’ knows better. Goffman very convincingly shows how the beliefs of actors, true and false, promote behaviours **that** have as their outcome the reproduction of an institution in which there is a manifest disjunction between the ‘official goals’ of the institution and the actual outcomes, and how actors unintentionally act in self-defeating ways that sustain the conditions of their own oppression.

Fleetwood says, they *fictionalise*.¹⁵ Since the actors and their conditions are misdescribed, the process *could not* produce the predicted outcomes, even if the system was closed. For example, persons *cannot* have the information required by the theory. So it is not a matter of saying ‘other things being equal’, markets would reach equilibrium.¹⁶ What is needed here is a radically different theory of the market social mechanism. This is exactly what is provided, at least as an incomplete ‘promissory note’, by the Austrians.¹⁷

¹⁵ Steve Fleetwood, ‘Why neo-classical economics explains nothing at all’, *Post-autistics Economics Review* 17(2) (2002): 1–6.

¹⁶ Nor can we think of the model as a Weberian ideal type, understood as a purely mental construct useful for heuristic purposes. See Boettke ‘Where did economics go wrong?’, 2. Thus, to get a bit ahead of our story, ‘by ignoring the dynamics of disequilibrium, [these] traditions obscure the possibility that real-world market institutions may have coordinative properties even in the presence of dispersed knowledge, pervasive ignorance, the irreversibility of time, and changing conditions’ (ibid., 24). More generally, they sacrifice an understanding of reality for utopianism – with extensive ideological consequences.

¹⁷ In my *Realist Philosophy*, I re-introduce the idea of a ‘promissory note’: the ‘promise’ that a mechanism could be provided, as in pointing to racism or urbanisation, social outcomes which abstractly identify the aggregated actions of interacting agents. In current literature, there is an enormous range of incompleteness, from the mere promise, to nearly fully developed accounts as in Marx (*Capital*, Vol. 1 [London: Lawrence and Wishart], [1865] 1970), Paul Willis (*Learning to Labor: How Working Class Kids Get Working Class Jobs* [New York: Columbia University Press, 1981] or Goffman (*Asylums*) to something in between as in Barrington Moore (*Social Origins of Dictatorship and Democracy* [Boston, MA: Beacon Press, 1966]) or Charles Tilly (‘Coercion, capital and European states’, in *Contemporary Social Theory*, eds Craig Calhoun et al. [Oxford: Basil Blackwell, 1992]). Since explanation is a pragmatic concept, we need to ask **whether** what is offered is sufficient to satisfy the demand for explanation. Moreover, since all outcomes are products of complex causality and there

The Austrian Market Mechanism

Four features stand out: First, as Hayek insists: ‘it is the silliest of the common misunderstandings’ that ‘individualism postulates ... the existence of isolated or self-contained individuals, instead of starting from men whose whole nature and character is determined by their existence in society’.¹⁸ Socialised in society, the individual is situated in concrete social relations, and draws on shared traditions and rules in responding, ‘within limits imposed on him by those abstract rules, to the concrete particular circumstances which he encounters’.¹⁹ The immediate consequence of this conception of individuals and society is that *social mechanisms are historically specific and must be articulated empirically*. In sharp contrast to the mainstream theory, which attempts an ahistorical general theory of the market, social mechanisms in different societies at different times will be different – even if at some level of abstraction there will be similarities. Similarly, because people are social beings, ‘subjectivity’ is actually ‘inter-subjectivity’ in which what is shared allows for communication across potential interpretative differences in meaning.²⁰ This acknowledges that persons can have reasonable expectations about the actions of others but rejects the idea that action is ‘determined’.

will always be missing bits and pieces in a causal history, it is quite impossible for any explanation to be complete.

¹⁸ F. A. Hayek, ‘Economics and knowledge’, in his *Individualism and Economic Order* (Chicago, IL: University of Chicago Press, 1949), 6.

¹⁹ F. A. Hayek, *Studies in Philosophy, Politics and Economics* (London: Routledge and Kegan Paul, 1967), 91–2.

²⁰ F. A. Hayek, *The Sensory Order: An Inquiry Into the Theoretical Foundations of Theoretical Psychology* (London: Routledge and Kegan Paul, 1952). Boettke, Lavoie and Storr, ‘The subjectivist methodology of Austrian economics’, show that on the critical issue of ‘subjectivity’ (in contrast to empiricist ‘objectivity’), Austrian economics would profit greatly by drawing on Dewey’s theory of enquiry. This idea can be extended and enthusiastically endorsed. See my essay, ‘John Dewey and American psychology’, *Journal for the Theory of Social Behaviour* 33(2) (2002).

Secondly, knowledge is widely dispersed, incomplete, mostly tacit, and very often not yet discovered. Critical here is ‘the knowledge of particular circumstances of time and place ... knowledge of people, of local conditions and of special circumstances’.²¹ It is not reducible to ‘information’ as already discursively available ‘data’ that one needs only to access. As realists insist, most of the knowledge employed in acting is not discursive.²² For Hayek, of course, much of the pertinent knowledge employed in economic action is discovered only through competition, a point to which I return.

Thirdly, actions are directed not by ‘objective’ circumstances, but by ‘subjective perceptions of those circumstances’. The social mechanism needs to establish both the objective circumstances and the ‘subjective’ perception of them since it may well be that agents act on beliefs that are false. There is, accordingly, an inevitable ethnographic component to enquiry: as Alfred Schütz argued, we need to understand what people are doing in terms that they would understand. But this is only the first step since they are not necessarily aware of either the conditions of action or of the consequences of action. This has critical bearing as regards the assumptions of standard theory, since, in general, there is no reason to believe that people are acting on the *same* ‘facts’, or that their plans are compatible.²³

Finally, the market is a process that is ‘open’ in the sense that because knowledge is dispersed, tacit and incomplete, plans are not compatible and there are interdependencies in action. There are, accordingly, inevitable uncertainties as regards future outcomes.²⁴

²¹ F. A. Hayek, ‘The use of knowledge in society’, in his *Individualism and Economic Order*, 80.

²² That any one person has but a fraction of the total knowledge in society along with the idea that people act on their understanding of the objective circumstances are central themes in the work of Alfred Schütz. Schütz was a member of the Mises seminar in Vienna in the 1930s. See Mie Augier ‘Some notes on Alfred Schütz and the Austrian school of economics’, review of Alfred Schütz’s *Collected Papers*, Vol. IV, eds H. Wagner, G. Psatha and F. Kersten, *Review of Austrian Economics* 11 (1999).

²³ Hayek, ‘Economics and knowledge’, 37–9.

²⁴ For a very useful account of all these themes, see Fleetwood, *Hayek’s Political Economy*.

The Austrian conception of individual action, society and history, just sketched, is a theme familiar in critical realist philosophy of social science, but perhaps two points bear special emphasis. First, for realist theory, the world is not Laplacean. On the realist view, outcomes are the contingent product of complex causality, and what happens has consequences, intended but mostly unintended, on what then happens. There is, accordingly, both stability and contingency in the world. There are patterns and regularities – and also surprises. More generally, while social mechanisms are abstracted from a concrete reality, outcomes that could not have been predicted can, after the fact, be explained. Consider here the simplest case: the dissolving of a particular amount of salt in water (above). It may be, for example, that this particular substance is never put in water! Similarly, we may have an understanding of fundamental social processes, for example, the operation of a market, but as a consequence of the contingent events and actions by key actors, outcomes that could not have been predicted may, after the fact, be explained.

Secondly, for both realist and Austrian theory, ‘economics’ becomes part of the family of social theories in which markets are seen to be embedded in wider institutional arrangements: legal, political and cultural.²⁵ The Austrian point of view is well put by Peter Boettke, Christopher Coyne and Peter Lesson: ‘To put it bluntly, economic behaviour, economic organisations, and economic policy never exist in a vacuum, but are always practiced within a broader social context’.²⁶ This means both that there will be huge differences in the nature and character of markets and that other social mechanisms, but especially political, legal and educational ones will have specific and complex relations to markets and market outcomes.

Again, more generally, Austrian theory, as with other heterodox approaches, encourages a historical comparative social science, what Cowan and Rizzo call ‘genetic-causal’ explanations, what Paul Lewis calls ‘contrastive explanation’ and what Boettke, Coyne and Lesson call

²⁵ One must think here of institutionalists, from Veblen on and other heterodox approaches, e.g. feminist economics. See also note 27, below.

²⁶ Peter J. Boettke, Christopher J. Coyne, and Peter T. Lesson, ‘Comparative historical political economy: an old research program in a modern age’, unpublished manuscript (n.d.).

‘comparative historical political economy’.²⁷ Of immediate interest in this context, Boettke et al.

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Consider also **Max Weber**, who provides nearly all the essentials for a theory of social mechanisms. Guenther Roth and Wolfgang Schlucter (*Max Weber’s Vision of History: Ethics and Methods* [Berkeley, CA: University of California Press, 1979]) ably summarise: ‘Both sociology and historiography proceed from causality inherent in human action. When Weber defined sociology as “a science concerning itself with the interpretative understanding of social action and thereby with the causal explanation of its course and consequences”, he meant to affirm that in history only men act, not social organisms or reified collectivities.’ They continue: ‘The construction of socio-economic models, such as patrimonialism or rule by notables, is possible because, in principle, we can understand the intentions of men and causally explain the course and consequences of their action’ (ibid., 205). Moreover, ‘one model alone cannot adequately describe a given case: a battery of models or hyphenated types, such as a patrimonial bureaucracy, can provide a better approximation. Their utility lies in serving as base lines for identifying the distinctiveness of the case. While secular theories attempt to trace a long line of causation, they too have limited usefulness as regards a given situation. Theories such as those of democratisation and industrialisation diminish in explanatory value when we look at the relatively short span of a few years or even two or three decades, because they are concerned with long-range structural change’ (ibid., 198). Finally, as Weber concluded: ‘Where the individuality of a phenomenon is concerned, the question of causality is not a question of laws but of concrete causal relationships; it is not a question of subsumption of the event under some general rubric as a representative case but of its imputation as a consequence of constellation’ (Max Weber, “‘Objectivity’” in social science’, in his *On the Methodology of the Social Sciences* [New York: Free Press, 1949], 78f.). ‘The conclusion which follows ... is that an “objective” analysis of cultural events, which proceeds according to the thesis that the ideal of science is the reduction of empirical reality to “laws” is meaningless’ (ibid., 80). More generally, Weber rejected the Laplacean metaphysics wherein (following Dilthey’s critique) the ‘ideal goal’ was ‘a sort

provide examples of explanations which contrast sharply with the currently lively mainstream debate regarding ‘endogenous growth theory’.²⁸ For Boettke et al., ‘the search for underlying causal mechanisms explaining differences in the economic performance of countries’ needs to be ‘again located in the realm of comparative institutional arrangements’. Thus, as above, ‘the ends to be pursued must be instantiated in practice by way of institutional forms, and institutional forms in turn structure the incentives that human actors face, and control the flow and quality of information that human actors process in making their choices’.²⁹ Doing this involves recognising historically generated differences in institutions. For example, in the work of Daron Acemoglu, Simon Johnson, and James Robinson, we get an explanation by examining the differences created by colonial institutions in which actors responded differently to different local conditions, natural and historical.³⁰

of “astronomical knowledge” (ibid., 73). Weber’s work, of course, was the starting point for the Mises-Kreis, which convened in Vienna in 1930s.

²⁸ See Paul Romer, ‘The origins of endogenous growth’, *The Journal of Economic Perspectives* 8(1) (1994). The Romer model is mathematical and is well within the framework of standard theory. See my critical discussion, ‘Endogenous growth theory: the most recent “revolution” in economics?’, *Post-Autistics Economic Review* 41 (5 March 2007), pp. 39-53.

²⁹ P. J. Boettke, D. Lavoie and V. H. Storr, ‘The subjectivist methodology of Austrian economics and Dewey’s theory of inquiry’, unpublished manuscript, 2001.

³⁰ Daron Acemoglu, Simon Johnson and James Robinson, ‘The colonial origins of comparative development: an empirical investigation’, *American Economic Review* 91 (2001); ‘Reversal of fortune: geography and institutions in the making of the modern world income distribution’, *Quarterly Journal of Economics* 117 (2002). See also Thomas Palley, ‘Breaking the neo-classical monopoly in economics’, review of Dani Rodrik, *One Economics, Many Recipes: Globalisation, Institutions and Economic Growth*, www.thomaspalley.com/?p=97 (2008). Palley makes the important point that Thomas Rodnik fails to see that heterodox economic theory provides powerful alternatives to the mainstream economics of both the Chicago school and those who, like

Indeed, once we abandon the theory of the mechanism of neo-classical theory, and approach markets from an empirical point of view, it is easy enough to explain the wide variation in the nature and character of market societies. That is, the market mechanism that produces outcomes at a particular time and place will vary as a function of the history of the economy in question. Thus, it is clear enough that mechanisms operating in the former Soviet Union are very different from those functioning in the US and these are different from the markets functioning in France, Peru, Uganda, Korea or Japan. Of course, there will be important similarities. These will derive from the fact that markets are social institutions in which people voluntarily exchange commodities (goods, services, resources) with price being a critical factor of the coordinating mechanisms. As regards the voluntary character of choices, even given very limited choices, short of the threat of violence, actions are voluntary even if they are not free. One is free to the extent that one can be, do and have what one wants to be, do and have. Thus, from a realist perspective, it is an analytic consequence of the concept of action that an agent ‘could have done otherwise’, but freedom is a function of the enabling and constraining conditions of action.³¹

Insisting on the role of social institutions as providing immense materials for ‘coordination’ in market arrangements does not entail denying the critical role of prices. But entirely open is the question of *how* markets are constituted and *how* prices get fixed. Thus, as regards the former, what is the role of the state? This begins with the specific norms and rules that are the legacy of a particular history, with the particular set of property rights, tax policy, labour, health and environmental policies, and what can be called socialism for the rich: subsidies, bail-outs, no-bid contracts, and so on.³² As regards the question of how prices get fixed, mainstream theory

Paul Krugman and Joseph Stiglitz, are still committed to the defining features of neo-classical theory.

³¹ See Gerald Feinberg, *Social Philosophy* (Englewood Cliffs, NJ: Prentice Hall, 1973) and Roy Bhaskar, *The Possibility of Naturalism* (Atlantic Highlands, NJ: Humanities Press, 1979), 146.

³² Dean Baker, *The Conservative Nanny State: How the Wealthy Use the Government to Stay Rich and Get Richer* (Washington, DC: Center for Economic and Policy Research, 2006); available as an e-book, www.conservativenannystate.org/cns.html.

recognises, of course, monopoly and oligopoly, and stripped of assumptions regarding equilibrium, many of its insights can be preserved, for example, the distinction between price-making and price-taking, ‘fix-price’ and ‘flex-price’, the administered pricing theories of post-Keynesians, and the immense role played by the marketing effort in shaping wants. But as would probably be acknowledged, too little work has been done in establishing how prices in various markets actually get determined.³³

Problems in Austrian Theory

In what follows, I concentrate on two issues. First, there is the question, raised prominently by Lewis and Jochen Runde, whether there are deficiencies in the Austrian philosophy of social science which are remedied by critical realism. The second problem regards the problem of ‘plan coordination’. As Hayek insisted, the problem is explaining ‘how socio-economic order is possible in decentralised market economies’.³⁴ But, as I will subsequently argue, it is quite one thing to provide a social mechanism that shows how socio-economic order is achieved in the real world of markets, and quite another to show that ‘the social rules and institutions of a liberal polity provide the information required by private citizens to coordinate their plans and so achieve their individual goals in peace and harmony’.³⁵ That is, once one accepts that people are social beings ‘whose beliefs, expectations and plans are profoundly shaped by the institutional environment that they inhabit’ and that their actions are directed by ‘their subjective perceptions of circumstances’, there could be all sorts of ‘stable orders’ in which the plans and goals of people are profoundly shaped and restricted by the institutional environment that they inhabit. Indeed, a very unjust and inefficient existing order may require that the existing institutional order shape these plans and goals in particular ways. Put in other terms, there is the lingering suspicion that while the Austrians undermined both general equilibrium theory *and, therefore*, planned economies, they are mistaken

³³ A good beginning has been made by Fleetwood’s work on Hayek. See note 1, above.

³⁴ Paul Lewis, ‘Hayek: from economics as equilibrium analysis to economics as social theory’, in *The Elgar Companion to Hayek*, ed. N. P. Barry (Cheltenham: Edward Elgar, 2006), 2.

³⁵ *Ibid.*, 2.

if they argue that capitalist competitive markets are the sole sustainable alternatives, that in the absence of the conditions of general equilibrium, the institutions of private-property market-capitalism give us the *only* hope for attaining both freedom and efficiency. I turn first to the question of critical realism and the Austrian theory of society.

Austrian social theory and problems of agency/structure

Within current critical realist theoretical debate, there are two fundamentally different solutions to the question of the relation of agency and structure. In what follows, I try to identify what seems to me to be the heart of the matter. No effort is made to consider the subtleties and differences between the many writers who have engaged this topic.³⁶ One view, held by Roy Bhaskar, Margaret Archer, Douglas Porpora, Paul Lewis, J. H. Runde and Dave Elder-Vass, asserts that while it is true that agents are causes, social structures (as variously analysed) are also causally efficacious. The other view argues that agents are the sole causal agents in society. This stance was suggested by Anthony Giddens, argued by Harré and following him, Charles Varela, and reframed in the present author's *Realist Philosophy*. This seems to be the posture of the Austrians.³⁷ But Lewis and Runde argue that if the Austrians are to sustain their case, they must side with Bhaskar et al.

³⁶ Two recent issues of the *Journal for the Theory of Social Behaviour* (37[2] and [4] [2007]) provide an excellent overview of the current state of the debate. Nearly all the key writers and key texts are referenced therein. For Harré, see R. Harré, C. Carter, T. May, M. Williams and P. Strydom, 'Symposium on Rom Harré and social structure', *European Journal of Social Theory* 5(1) (2002), 107–48.

³⁷ Lewis points out that 'Austrians describe themselves as being committed to a variant of methodological individualism according to which socio-economic phenomena of interest are to be (causally) explained as the (often unintended) consequences of the subjectively meaningful, purposive action of individual economic actors' ('Structure and agency in economic analysis: the case of Austrian economics and the material embeddedness of socio-economic life' in *The Elgar Companion to Economics and Philosophy*, eds J. B. Davis, A. Marciano and J. H. Runde [Cheltenham: Edward Elgar, 2004], 365).

Like the Austrians, both sides in this debate reject that form of methodological individualism that conceives of individuals atomistically and both sides insist that individuals are persons only in so far that they encounter, from birth on, historically constituted social institutions. And, as already noted, their powers and attributes as persons are emergent, and not reducible to psychology or biology. Thus, their beliefs and decisions are constrained *and* enabled by the particular biography and social situation they find themselves in. In neither case is action ‘determined’, if that means that actors could not have acted other than the way they did. The difference is that for Giddens, Harré, Varela and Manicas, as concept- and activity- dependent, social structure is not causal. As concept- and activity-dependent, social structures (and the social mechanisms that explain them) are incarnate in action and do not exist independently of action. Put in other terms, the putative causal efficacy of institutions results from the fact that in acting, persons are aware of their position in institutions and employ their understanding of the rules of the institution that practice reproduces (and transforms). We need first to be clearer about the ontology of the social world.

There is a fundamental ontological distinction between ‘brute facts’, or facts about features of the world that exist independently of us, and ‘institutional facts’, or facts about features of the world that require special human institutions for their existence.³⁸ We share the belief that a piece of paper is a dollar bill, which allows me to purchase an ice cream cone from you. Similarly, that an ice cream cone costs one dollar is an institutional fact. By contrast, that iron tends to rust is a brute fact. Institutional facts and brute facts are both facts; both are ‘objective’. But institutional facts depend on a range of widely shared beliefs and practices, involving, for example, money and markets. These in turn depend on a large ensemble of other beliefs and practices, for example, private property and the system of law. Unlike iron, which would still exist and tend to rust, none of these institutions would exist if humans were eliminated from the face of the earth. That is, the paper that is a US dollar bill would still exist, but it would not be a US dollar bill. Its existence as US dollar bill is, as Bhaskar et al. acknowledge, ‘concept- and activity-dependent’.

Thus, the present level of unemployment is an objective fact. But while that fact is of huge importance to someone seeking a job, it is not a brute fact but an institutional fact. It is the product of the social mechanisms that persons reproduce and transform in their actions. Forgetting this, if

³⁸ John R. Searle, *The Construction of Social Reality* (New York: Free Press, 1995), 27.

you cannot find a job that pays a living wage, it is easy to believe that it is nobody's fault but your own: not the fault of the practices of the economic system being reproduced by the actions of capitalists, governments – and workers.³⁹

Similarly, social structures can be 'material causes' only if, like magnetic fields and the materials employed by a sculptor, they are what they are quite independently of what we may believe.⁴⁰ Perhaps here one collapses the fact that institutions exist prior to the birth of any particular person with the idea that they exist independently of the actions of all persons. An account of 'institutional facts' as the 'background' of all human action, along with a firm acknowledgement of the material ('natural') and historical constraints of 'virtually existing' social

³⁹ As W. M. Dugger writes: 'According to market mythology, our fate is due to natural law – supply and demand in the market – and cannot be changed. In this way, the market myth weakens the credibility of those who would reform the market, dashes the hopes of those dispossessed by the market, and hides those who benefit from the particular way the market has been instituted' (*Underground Economics: A Decade of Institutionalist Dissent* [Armonk, NY: M. E. Sharpe, 1992], 237).

⁴⁰ The question might be raised here regarding the importance for the present discussion of Bhaskar's distinction between transitive and intransitive objects of scientific enquiry, or those that 'exist and act ... independently of their identification' (*The Possibility of Naturalism*, 13). The question here, however, is not whether social structure exists and acts independently of its identification but *how* it exists, whether independently or incarnate in practice. For Bhaskar, the key point as regards social structure is the question of the possibility of critique. As he says, the hermeneutic tradition recognizes the concept-dependence of social reality (in contrast to the independently existing 'objects' of nature), but fails to 'sustain the "intransitivity of both beliefs and meanings"' (ibid., 28). By failing to situate 'the possibility of reference to aspects of reality at once social and inadequately conceptualized' it cannot sustain critique: the possibility that beliefs and meanings that are essential to a social process are false or distorted (ibid., 27, 66). But, as far as I can tell, nothing is lost by insisting that beliefs and meanings exist incarnate in activity.

structure is quite sufficient to provide all the benefits of structuralist insights without any of the manifest disadvantages of attributing causality to a concept- and activity-dependent social structure. Indeed, much would seem to be lost. In addition to the incoherence of a theory of causality that allows that something that is not a powerful particular can have causal efficacy, we risk the reification of social structure and the tempting slide into determinism and the loss of agency. Finally, it is hard to see how ‘dialectical’ solutions are not vulnerable to the criticism Bhaskar made of the older view of Peter L. Berger and Thomas Luckmann.⁴¹

Agents must work with ‘materials’ at hand. As organic (‘natural’) beings, these include material causes *and*, as conscious (‘human’) beings, historically generated and intersubjectively sustained beliefs and meanings. But the view of causality insisted on here allows that something is a material *cause* only if it is a powerful particular. Thus, agents are powerful particulars and, for example, an agent’s natural powers are complexes of material causes. But social relations are no more material causes than are the beliefs and meanings that are constitutive of them.⁴² Indeed, the point of distinguishing brute facts from institutional facts is exactly to insist that magnetic fields are *not* like prices, and that the ontological difference makes for differences in the possibility of attributing causal powers. Thus, Porpora insists that in speaking of the choices of the poor, we need to consider ‘objective circumstances’ that relate to the distribution of jobs or social positions in society. This cannot be denied. But these facts are ‘intersubjectively sustained’ and are not ‘material’: surely they are what they are only because of our *shared* beliefs and practices. But if so,

⁴¹ That is, it would seem that if social structure is causal, then the model needs to be dialectical, as in Berger and Luckmann, not, as in Bhaskar and Giddens, transformational. There would seem to be a usually unnoticed tension in Bhaskar, **although** not in Giddens, who insists that social structure has but ‘virtual reality’. See **my** ‘The absent ontology of society: response to Jukes and Barresi’, *Journal for the Theory of Social Behavior* 33(2) (1993), 217–28; Roy Bhaskar, ‘On the possibility of social scientific knowledge and the limits of naturalism’, *Journal for the Theory of Social Behaviour* 8(1) (1978), 1–28.

⁴² The independently existing natural world and our incarnate existence in bodies, of course, are a continuing critical material cause of all human activity, but social structure is not reducible to it.

it is quite sufficient to say that these beliefs and practices have consequences, to be sure, among them the absence of sufficient numbers of decent paying jobs. Similarly, our beliefs and practices give us intellectual and cultural resources that, given the ‘objective’ facts about employment, we can seek use to transform belief and practice. But the incentives and, more important, the capacities that different groups have to support or resist entreaties to change their minds and acts in particular ways, are all the product of actions in the past currently incarnate in everyday practices.⁴³

In conclusion, then, while some of the terms of Austrian theory are misleading, ‘subjectivism’ being an outstanding example, their version of methodological individualism seems adequate, and properly understood, a version of at least one variant of realist social theory.

Consequences of Accepting the Austrian Point View

Stable but unjust and inefficient orders

Consider, for example, an Austrian-type account of the labour market in the present USA.⁴⁴ Both employers and employees face an objective situation which they need to interpret and both have beliefs in terms of which they act. But as Hayek argued, the parties share in having a mostly tacit grasp of the ‘social rules’ that are ‘repositories of practical social knowledge’. This solves the problem of a ‘kaleidic world’ in which ‘individual plans, each consistent in itself, never have time to become consistent with each other before new change supervenes’.⁴⁵ Employing in interaction intersubjectively shared social rules ‘makes it possible for them to form reliable expectations of

⁴³ For me, **Charles** Varela’s criticism of the most recent sophisticated attempt to rescue Bhaskar and Archer by Elder-Vass is decisive; see ‘Elder-Vass’s move and Giddens’s call’, *Journal for the Theory of Social Behavior* 37(2) (2007), 208. In sum, ‘relational emergence theory’ violates the fundamental principle of causal powers theory. There is ‘no person in social structure that connects with the person in social relations’ (ibid.).

⁴⁴ Also see S. Fleetwood, ‘Austrian economics and the analysis of labour markets’, *Review of Austrian Economics* 20(4) (2007).

⁴⁵ Paul Lewis and Jochen Runde, ‘Subjectivism, social structure and the possibility of socio-economic order: the case of Ludwig Lachman’, *Journal of Economic Behavior and Organization* 62(2) (2007): 167–86, quoting Lachman.

each other's future conduct, enables them to foresee with some confidence the outcome of their own actions ... thereby facilitating (without, of course, guaranteeing) the formation of mutually compatible plans'.⁴⁶

Suppose we find few females in the labour pool for engineers but that they are not only not able to demand somewhat higher salaries by virtue of being few in number, but their average starting salaries are less than those of males. How is this to be explained? Broadly, the institutions that produce the level of skills and motivations of workers are distorted by patriarchy. Thus, at birth, the social mechanism that explains family practices tends not merely to teach that there are differences between the sexes, but that some of these differences have a bearing on the future roles of women in society. From early on, females are discouraged from pursuing careers in engineering. This is reinforced by the social mechanisms of schools. Finally, because most employers of engineers are males, they tend to hire people like themselves. But given the small size of the pool, everyone who wants a job in engineering gets one, albeit poorly paid relative to the wages of males.

But equally important, if the majority of females do not challenge patriarchy in their everyday lives, *a stable unconflicted order will emerge*. Indeed, as per Parsonian 'equilibrium', role expectations will conform to objective employment possibilities. Everyone *has* achieved their goals and plans, even if, of course, these have all been radically shaped by existing institutions. This raises the question of how might institutions be structured so that market outcomes are more nearly just.

Is socialism impossible?

Socialists believe that justice requires some form of socialism. And it is often supposed that, having rejected general equilibrium theory, the economic and political arguments of Mises and Hayek undermine prospects for *any* sort of socialism. For Mises and Hayek, there is no such thing as a market socialism. But it can be shown that while their arguments undermine *centrally*

⁴⁶ Paul Lewis, 'Hayek: from economics as equilibrium analysis to economics as social theory', in *The Elgar Companion to Hayek*, ed. N. P. Barry (Cheltenham: Edward Elgar, 2006), 13.

planned socialist economies – an important achievement – the question of a market socialism is not resolved.⁴⁷ The Austrian argument is briefly summarised by Mises: ‘Economic calculation [to determine allocation of means of production] can only take place by means of money prices established in a market for production goods in society resting on private property in the means of production.’⁴⁸ It is a bit more developed in Boettke:

1. Without private property in the means of production, there will be no market for the means of production;
2. Without a market for a means of production, there will be no monetary prices established for the means of production;
3. Without monetary prices, reflecting relative scarcity of capital goods, economic decision makers will be unable to rationally calculate the alternative use of capital goods.⁴⁹

For standard versions of market socialism, (2) and (3) are ‘solved’ by appeal to general equilibrium theory. But as the Austrians insist, this assumes what needs to be established in the ongoing process of competition.⁵⁰ As Hayek observed, equilibrium theory ‘starts from the

⁴⁷ Diane Elson, ‘Market socialism or socialism of the market’, *New Left Review* 172 (1988).

⁴⁸ Ludwig Von Mises, *Socialism* (New York: Macmillan, 1936), 142.

⁴⁹ Peter Boettke, ‘Economic calculation: the Austrian contribution to political economy’, in his *Advances in Austrian Economics*, vol. 5 (Greenwich, CT: Jai Press, 1998), 134.

⁵⁰ Since competition does not serve the role that it was supposed to serve in neo-classical theory, we can be fairly sure that the Austrians do not assume ‘perfect competition’ as that is defined in the theory. But there is surprising inattention to what competition means. Hayek notes that in sports or examinations, competition serves to determine who is best, and that he wants to consider competition as the procedure **that**, analogously, generates facts not available in the absence of competition (F. A. Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas* [Chicago, IL: University of Chicago Press, 1978], 179). Of course, the analogy is not entirely sound. But we can perhaps assume that competition for the Austrians satisfies at least part of the ordinary sense of the term:

assumption of a “given” supply of scarce goods. But which goods are scarce goods, or which things are goods, and how scarce or valuable they are – these are precisely the things which competition has to discover’.⁵¹ So we are driven to (1). Why is private property in the means of production necessary? The answer would seem to be straightforward: without capitalists, there can be no capital markets. In capitalism, there are many owners of the means of production, each is interested in profit and they relate only in terms of markets. As buyers and sellers of capital, they make judgments about the use to which capital is put. These transactions establish exchange rates expressed as monetary prices (2). Similarly, producers of consumer goods then use this price information along with information regarding demand to make production decisions. Here is one version of the argument from Mises:

Now if it is to remain socialistic, the socialist State cannot leave in other hands that disposition over capital which permits the enlargement of existing undertakings, the contraction of others and the bringing into being of undertakings that are complete new. And it is scarcely to be assumed that socialists of whatever persuasion would seriously propose that this function should be made over to some group of people who would ‘simply’ have the business of doing what capitalists and speculators do under capitalist conditions, the only difference being that the product of their foresight should not belong to them but to the community. Proposals of this sort may well be made concerning the managers of joint stock companies ... The function which capitalists and speculators serve under capitalism ... is only performed because they are under the incentive to preserve their property and to make profits which increase it or at least allow them to live without diminishing their capital.⁵²

Mises then concludes: ‘Thus, the alternative is still *either* Socialism or a market economy.’ Hayek ultimately agrees, but notes that ‘it is not evident why ... a socialist system with

competition is understood to mean ‘seeking to gain what another is seeking to gain at the same time and use’ (OED).

⁵¹ F. A. Hayek, ‘Competition as a discovery procedure’, in his *New Studies in Philosophy*, 181.

⁵² Mises, *Socialism*, 141.

competition within industries as well as between them should not work as well or badly as competitive capitalism'.⁵³ In response, one might here offer that we need to see whether and how competition in capitalist markets structures the incentives to seek the kind of knowledge that the Austrians insist is required,⁵⁴ and whether, if it does, there are other institutional arrangements that might do the same.

Hayek rightly sees that for competitive socialism, there are prior questions that need answers. If the system is not planned, then 'the crucial questions ... are "What is to be the independent business unit? Who is to be manager? What resources are to be entrusted to him and how his success or failure to be tested?"'⁵⁵ These are very good questions, addressed by 'fifth generation' socialist writers.⁵⁶ But they do not, it seems, meet the fundamental objection.⁵⁷

⁵³ Hayek, *Collectivist Economic Planning*, 232.

⁵⁴ It is not self-evident that it does, especially if we notice that managers may have many goals other than profitable investment, including what **John Maynard** Keynes called 'casino capitalism'. Thus, as Krugman writes, we have rising productivity, stagnant wages and a 'gusher of profits'. This is easily explained: 'Instead of investing in physical capital, many companies are using profits to buy back their own stock. And cynics suggest that the purpose of these buybacks is to produce a temporary rise in stock prices that increases the value of executives' stock options, even if it's against the long-term interests of investors.' He concludes: 'In any case, next time someone tells you that any action that might reduce corporate profits a bit – like actually enforcing health and safety regulations or making it easier for workers to organise – will reduce business investment, bear in mind that today's record profits aren't being invested. Instead, they're being used to enrich executives and a few lucky stock owners' (Paul Krugman, 'Another economic disconnect', *New York Times* [30 April 2007]).

⁵⁵ Hayek, 'Competition as a discovery procedure', 181.

⁵⁶ P. Bardham and J. E. Roemer, 'On the workability of market socialism', *Journal of Economic Perspectives* 8(2) (1994), 178.

⁵⁷ **Bruce** Caldwell seems to have it right. He writes: 'Within the general equilibrium model there was no way on theoretical grounds to distinguish a competitive free market system

After identifying the important questions – ‘What is to be the independent business unit’, and so on – Hayek notes that ‘to begin with, it must be clear that the need for some central authority will not greatly diminish. It is clear, too, this authority will have to be almost as powerful as a planned system.’⁵⁸ But ‘if the community is the owner of all the material resources of production, somebody will have to exercise this right for it, at least in so far as the distribution and control of the use of these resources is concerned’. The central authority could not be a kind of ‘superbank’ that lends the available funds to the highest bidder. If it lent to ‘persons with no property’, it would bear all the risk and ‘would have no claim for a definite amount of money as a bank has’. Nor can its decision be ‘confined to redistribution of free capital’. Finally, it would have to decide whether a particular plant or piece of machinery should be left further to the entrepreneur who has used it in the past, or whether it should be transferred to another who promises a higher return from it.⁵⁹

This explains, of course, the constant tendency of the Austrians to regard market socialism as ultimately reducible to central planning. And it explains what seems to be frequent talking past one another among parties in the debate. But the very powerful arguments against central planning do not show that there could not be some socialist alternative to capital markets. Indeed, Hayek is sensitive to this possibility: He writes:

There is no reason to assume that the historically given legal institutions are necessarily the most ‘natural’ in any sense. The recognition of the principle of private property does not by

from a market socialist state. In like manner, there is no way within the model provided by the economics of information to distinguish between a free market system and a market socialist one in which all agency problems have been identified, and to the extent possible, corrected’ (‘Hayek and socialism’, *Journal of Economic Literature* 35 [December 1997], 1882). So the question is not incentives of managers who in a socialist economy may well have motivations to do what they should. The problem is elsewhere. In sum: since socialism lacks ‘legally secured property rights’ constituting capital markets, there is no way, on the Austrian understanding of market process, to provide the requisite knowledge. But see below.

⁵⁸ Hayek, *Collectivist Economic Planning*, 232.

⁵⁹ *Ibid.*, 233.

any means necessarily imply that the particular delimitation of the contents of this right is determined by the existing laws are the most appropriate. The question as to which is the most appropriate permanent framework which will secure the smoothest and most efficient working of competition is of the greatest importance and one which it must be admitted has been badly neglected by economists.⁶⁰

I want to strongly endorse these observations, and add that neither Austrians nor mainstream economists have done all their homework on the critical issues. It is not the aim here to settle issues but merely to help clarify the terms of the debate and to notice there are possibilities that have not been carefully considered.

Thus, Mises suggests an answer to Hayek's question: Why would not some version of socialism accept that the function of capitalist markets 'should be made over to some group of people who would "simply" have the business of doing what capitalists and speculators do under capitalist conditions, the only difference being that the product of their foresight should not belong to them but to the community?'⁶¹ Mises would seem to hold that such an arrangement could not be socialist since this effectively abandons ownership. But it need not. As he sees, shareholders are owners who do not manage. Why could not all citizens be shareholders in the wealth of the community, under the control of decentralised managers with sharply circumscribed rights.⁶² Thus, 'shareholders' would be 'under the incentive to preserve their

⁶⁰ Ibid., 22.

⁶¹ Mises, *Socialism*, 141.

⁶² For example, the legal system may give rights to possess, use, manage and receive income, a duty not to use harmfully, but not the liberty to abandon, consume or destroy. It may impose additional duties, for example, as regards a large corporation, to provide insurance or health care for employees. Similarly, 'shareholders' may own, receive income, have voting rights, dispose or transfer shares, and have rights to the net book value, but not manage. A very good place to begin is the work of **S. R. Munzer** (*A Theory of Property* [Cambridge: Cambridge University Press, 1990]), who, as far as I can tell, provides the most thorough theory of property. He considers all the conceptual, legal, economic and moral issues. Also see **John Roemer** who suggests that 'socialists should be eclectic in

property and to make profits that increase it', and given, that investment decisions would be transparent in profound contrast to capitalism, shareholders as citizens would be in far better position than shareholders under capitalism.⁶³ Finally, if managers in capitalist institutions do function as entrepreneurs, then in socialism, even with important constraints put on them, the incentive issue raised by Mises is not a problem.

Conclusion

The Austrians have a philosophy of science that is an adequate version of realist philosophy of social science. They seek causal explanations and, in the spirit of Max Weber, offer a version of methodological individualism in which the account of markets requires an appreciation of situated action, of inter-subjectivity, the importance of correlative institutions and of history. They also have a theory of markets that is a powerful alternative to the mainstream theory. Taken together these are important ideas, suggesting several additional conclusions.

1. Actually existing markets vary considerably in all sorts of ways. But too little attention has been paid to examining them empirically. As the foregoing suggests, there are many questions that demand answers, for example, whether capitalism has unsolved, and perhaps unsolvable, 'agency' problems.
2. In rejecting mainstream theory, neither equilibrium nor efficiency (as defined by neo-classical theory) are relevant goals, but insufficient attention is paid to actual outcomes in terms of both efficiency and justice.⁶⁴ This is not a matter of what Hayek called 'interventionist chaos', but

their attitude toward property relations: there may be many forms of ownership more amenable to socialism's goals than traditional state ownership in the means of production' (John Roemer, *A Future for Socialism* [Cambridge, MA: Harvard University Press, 1997], 6–7).

⁶³ Elson, 'Market socialism'. While the issue opens a can of worms, Elson seeks to show that in a proper socialist market, there would be no fetishism of commodities, a critical departure from the capitalist value-form.

⁶⁴ Freedom has, of course, been a primary value of Austrian theory, and planning has important political consequences not evident as regards competitive markets. Still, there

of seeing that on their own premises, there are plausible institutional reforms that take us well beyond the utopian vision of mainstream theory.⁶⁵ Thus, while capitalist markets provide a method of discovery, it is also true that there are powerful incentives not to share information. Innovations, in products, technologies, and management and organisation, are jealously guarded to provide the innovating firm an advantage – even if it is temporary.

Secondly, capitalist markets build in entrepreneurial initiative and sensitivity to the ‘hard budget’ constraints, making, as Marx also saw, a powerful dynamic for development.⁶⁶ But it is also true that they build in a tendency toward monopoly, speculation and rent-seeking behaviour – what John Maynard Keynes dubbed ‘casino capitalism’, just as they motivate predatory competition and wholly unjustified immense inequalities. These cut in exactly the opposite direction.⁶⁷

is a difference between the voluntary action requisite for markets, and freedom understood as a bundle of capacities to act as one wishes. Market capitalism generates immense *inequalities* of freedom, inequalities **that** are neither just nor conducive to continued stability.

⁶⁵ Caldwell, ‘Hayek and socialism’, Section C.

⁶⁶ Indeed, it is not self-evident that ‘development’ as it is generally understood is any longer a justifiable goal for a production system.

⁶⁷ One may wonder about an economy in which Ford Motors lost \$12.7 billion last year and Chrysler lost \$1.48 billion, while at the same time the income of CEOs of these ‘firms’ (like most American ‘firms’) was several times the income of the managers of Toyota, which reported record profits and sales. Similarly, some 200,000 autoworkers lost jobs in 2006 **owing** less to global competition than to bad management. See L. Uchitelle, *The Disposable American: Layoffs and Their Consequences* (New York: Knopf, 2006). Similarly, Krugman notes that the \$77 billion needed to provide full medical care for all the uninsured is gained by ‘either eliminating costs of private insurers, or paying what the rest of the world pays for drugs and medical services’ (Paul Krugman, ‘The health care racket’, *New York Times* [16 February 2006]).

Thirdly, in capitalist markets, consumers do get to express preferences over available products and services. But it is also true that in such markets, 'information' is largely replaced by manipulation – without which the system could not be reproduced. Moreover, since actors are atomised, there is no mechanism for overcoming micro-rational choices that are macro-irrational. Finally, in capitalist market societies, private power has remarkable influence over public policy. Subsidies, lobbying efforts and no-bid contracts are only the most visible part of this. And much of this requires no conspiracy: politicians need to do what is required to reproduce the system. So a convention centre gets built with tax dollars, but affordable housing does not.

3. There are institutional responses to many of these problems consistent with a radically reformed capitalism. Socialists, of course, believe that the vices of capitalist markets may be eliminated in a plausible version of socialism. Of course, it may well be that socialism is not today on the historical agenda. Still, as Hayek seems to have acknowledged, it would seem premature to conclude that there is *no* possible version of a market socialism.

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