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General Implications of Subjectivism in Economics

I have often argued that the "Austrians" seem, somehow, to be more successful in conveying the central principle of economics to students than alternative schools, enclaves or approaches. This theme has involved two components. First, I have argued that our most important social role is that of teaching students rather than that of serving as surrogate social engineers. Second, my hypothesis depended, of course, on a definition of just what the most important central principle in economics is. And my position is on record in this respect. *The* principle that exposure to economics *should* convey is that of the spontaneous coordination which the market achieves. The central principle of economics is not the economizing process; it is not the maximization of objective functions subject to constraints. Once we become methodologically trapped in the maximization paradigm, economics becomes applied mathematics or engineering.

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In this connection, let me tell you a story. I recently talked with a prominent economist who mentioned that one of his colleagues had reported having several conversations with the then presidential candidate Jimmy Carter. This colleague passed along his view that Carter was a "good systems analyst," and my friend added, more or less as an afterthought, and "hence, a good economist." I very quickly and very emphatically put him straight, saying that nothing could be further from the "economic point of view," properly interpreted, than that of the systems analyst. Indeed this is precisely my own fear about Carter, that he is, in fact, a good systems analyst without the remotest understanding of the principle of spontaneous order. I should add here that, to my friend's credit, when I pointed this out to him, he immediately took my distinction as relevant. But it is, I think, a mark of how far our whole discipline has deteriorated when we slip so readily and naturally into the simple maximization paradigm.

Or perhaps "economists" should stay in that paradigm. Argument could be made to this effect on etymological grounds. Perhaps what I should be suggesting here is that we need to be studying and promulgating something other than "economics."

But enough of general methodology, although I shall not get very far away from it anywhere. To return to "subjectivist economics" more specifically, my hypothesis is that this sort of economic theory must further a better understanding of the principle of spontaneous coordination. But I need to support this hypothesis by convincing argument. Why does the subjectivist more readily learn and accept the principle of spontaneous order than the objectivist? He does so because that which he seeks to explain and to understand is different. The subjectivist is not trying to explain, positively or normatively, the allocation of scarce resources among uses; nor is his subject matter best described as *price* theory. What he is trying to explain is exchange, conceived in its broadest sense. His is a "theory of exchange," as I have repeatedly argued, but a theory of exchange of whatever it is that persons value. The positive aspects of the theory take form in predictions about the properties of equilibrium positions, potentially observable behaviorally through the cessation of trade among parties. He also predicts, again positively, that interferences with trade or exchange must create trading opportunities that remain unconsummated, and that the existence of such opportunities must necessarily be reflected in enforcement and policing problems. The subjectivist is not likely to accept what is perhaps the most sophisticated fallacy in economic theory, the notion that because certain relationships hold in equilibrium the forced interferences designed to implement these relationships will, in fact, be desirable. In such examples of this fallacy as "equal pay for equal work," even one of the stars in the subjectivist firmament, Professor Hayek, lost his way.

But let me be clear, and fair. I am not setting up some imaginary straw creature, labeled objectivist economics, for the purpose of saying that its subject matter necessarily and certainly leads to ignorance, bewilderment, and confusion, and that the subjectivist possesses the only key to wisdom. (I could expand on this a bit. It seems to me that one of the dangers of the subjectivist approach, and particularly in its pure Austrian variant, is the tendency to form a priesthood, with the converted talking only to those who are converts, and with the deliberate withdrawal from free and open espousal of subjectivist notions to the world around.) An understanding and appreciation of the principle of spontaneous order or coordination may emerge from the very citadels of objectivisim, and often does. After all, Adam Smith was no subjectivist. What I am implying is that to the extent that subjectivism tends to concentrate attention on the interaction among persons and away from the "economic problem," an understanding of the principle of order is facilitated rather than retarded. The post-Robbins maximizer must learn the principle of order in spite of rather than because of his analytical paradigm.

At this point I should restore Professor Hayek to his proper place in my overall league tables by endorsing his criticism of "scientism," a criticism also advanced by my own professor, Frank Knight. Hayek and Knight were sharply critical of any attempts to convert economics into a discipline analogous to a natural science. Economics is, or can be, scientific in a sense that is, I think, unique. The principle of spontaneous order is a scientific principle, in that it can be readily divorced from normative content. Unless we stay within the exchange paradigm, however, we lose the legitimately scientific principle and, instead, launch off into the scientistic implications that emerge directly from the maximization paradigm. Economists find themselves measuring social costs and social benefits, along with a little of everything else.

And, of course, to the extent that quantities may be measured, independently of choice behavior and hence objectively, there must exist an objectively determinate "solution" to any problem that is posed. There is some "optimal" allocation of economic resources, defined by the physical units of resource located in time and space. And let us recall here that Professor Tjallings Koopmans won a Nobel Prize in economics, not in engineering. He did so for his efforts that commenced from working out the optimal allocation of a set of tankers plying oil across the Atlantic during World War II, where the variables were ships, distances, port locations, barrels of oil, and, of course, a set of shadow prices. (To claim a bit of credit for myself here, I think I was a confirmed subjectivist long before I realized what I was because I recall thinking in 1946, when Koopmans was lecturing on this at the University of Chicago, that there seemed to be absolutely no economic content in what he was doing, at least as I then, and now, conceived our proper subject matter to be.) There must also exist an equilibrium set of prices that are objectively computable, at least conceptually, and indeed, we have observed Professor Herbert Scarf of Yale now trying to work out ways of computing equilibrium prices, which effort seems, to the subjectivist, an absurd exercise.

To the extent that there exist objectively determinate and physically describable allocations or imputations that may be evaluated by some efficiency or optimization criterion, the market is necessarily reduced to one among several institutional devices whose operations may be compared one with another. The market becomes an "analogue computing device," a "mechanism," which may or may not rank better than its alternatives in terms of the objectifiable performance criteria. At this level, the distinction between the market and the centrally planned economy is purely in comparative performance. And, at this point, there is a subtle but vitally important principle or insight that the objectivist tends to neglect. Economic performance can only be conceived in values; but how are values determined? By prices, but prices emerge only in markets. They have no meaning in a nonmarket context. Hence, the market can hardly be compared in terms of performance against a nonmarket institution. In this sense, the whole efficiency criterion as traditionally applied to socialist economies, even as idealized, is devoid of meaning.

The 1930s debate between Mises on the one hand and Lange, Lerner and Dickinson on the other was never properly grounded. As this debate has been widely interpreted, the conceptual possibility of market socialism was made dependent on the informational potential of the central planning authority, a problem that an iterative procedure was alleged to resolve. But this is not the central issue. As I tried to discuss in my little book *Cost and Choice,*[1] the issue is not simply one of information. The central issue is the critical interdependence between market choice itself and the informational content of this process which can only be revealed as the process is allowed to occur. Let me try to explain by an example. This seems to me to be a vitally important point, but it is one that I am not at all sure how to present here. Suppose that we consider an allocation of apples and oranges between two persons, A and B, persons who are located externally to us, say, in Timbuktu. If we know their utility functions, along with the initial endowments of the two commodities, we can define the "efficient allocation" of apples and oranges, an allocation that would, of course, be equivalent to that which

[1] *Cost and Choice: An Inquiry in Economic Theory* (Chicago: Markham Publishing Co., 1969).

would be attained as a result of voluntary exchange or trade between A and B. But we cannot, as external observers, possibly know the utility functions because such functions do not, and cannot, exist independently of the choice action of A and B in the exchange process itself. That is to say, even if we could establish perfect verbal communication with A and B, they could not "write down" their utility functions in any meaningful operational sense. We may, if we desire, postulate utility functions for the two persons, as given to us or as imagined for them, and we may then define efficiency by these postulated functions. But this would amount to empty exercise since there would be little or no relationship to the efficiency, so defined, and that which an actual exchange process might generate. (Although I cannot go into it here, there is an affinity between my criticism of orthodox procedures in economic theory and the radical Marxist-oriented criticism, by Gintis and others, centered on the assumption of invariant preferences.)

Considerations such as those outlined in the example here have led my colleague Robert Staaf to despair of even using indifference-curve analytics. I do not go quite so far, but I can recognize the pedagogical problem. Utility-function, indifference-curve constructions may be useful in depicting or illustrating the underlying rationality of the voluntary exchange process, provided that these constructions are understood in strictly subjective terms, as constructions that cannot, in their nature, be communicated to observers independently of the exchange process within which they emerge.

In one sense, it becomes misleading at the outset to say that persons "act as if they were maximizing a utility function subject to constraints," since this terminology itself tends to suggest that the utility functions exist independently of the acting-choosing process. It is better, at this level of discussion, to say simply that persons choose among alternatives as they arise, and that there is, hopefully, enough consistency in their behavior to allow us to make some predictions about changes in outcomes as a result of changes in the choice alternatives. At this point, the strict Austrians may enter into a debate with me and, more important, with those who insist on the empirical corroboration of the elementary principles of human behavior in voluntary exchange processes. Such debate has always seemed to me to be of only indirect significance. As Frank Knight used to say, most of the empirical work in economics is "proving water runs downhill," a proposition that the Austrians would scarcely question.

Indirectly, however, and in opportunity-cost terms, the empirical-nonempirical debate is of importance. The young and aspiring economist who becomes the expert empiricist has necessarily sacrificed training time in learning more about the process to which his highly polished technical tools are to be applied. These gaps in the training of modern economists are beginning to show up in many forms, not the least of which is the deadly dullness that dominates whole departments in many universities and colleges.

I should like to say something about the relationship between subjectivist economics and mathematical economics. The important and central principle that the subjectivist paradigm advances is that of spontaneous order, as I have already suggested several times. The theoretical foundations here can be readily mathematized. But the mathematics called for is not the maximization of objective functions subject to constraints. The mathematically inclined economist who seeks to put all analysis into this form is already on the wrong track, and he is likely to confuse both himself and his students. The mathematics dictated here is that of general equilibrium, properly understood, the search for the solutions of systems of simultaneous equations, solutions that emerge from the interdependence among the variables described in the whole system of equations. For this reason, I find no difficulty at all in allowing the general equilibrium theorist to do his work alongside his subjectivist, nonmathematical counterpart, provided that he does not slip into error by somehow imputing, even at some conceptual level, objective meaning into his wholly imaginary constructs.

I am perhaps even more favorable toward the sort of thinking that game theory fosters, and especially in its development of solution concepts applicable to many-person games. Almost by necessity, the game theorist is led to think about an interaction process that produces an outcome through the behavior of many participants, each one of whom acts independently of the others. Game theory takes the wrong turn, however, to the extent that the emphasis shifts to the normative problem of defining optimal strategies for particular players or coalitions of players, even for games against nature and even for the all-inclusive coalition.

I have suggested that the principle of spontaneous order is "scientific" in the sense that it embodies a logically coherent argument. But does the economist who considers his main role to be that of teaching this principle to his students necessarily plead guilty to the charge that he is imposing an ideology? In one sense the answer is yes. Adam Smith was offering an alternative vision of how an economy might work. It was necessary to provide this alternative vision before the mercantilist blinders could be removed. Smith's effort was, in this quite literal sense, subversive of the existing order and of the set of attitudes that supported this order. I see no reason why our task in 1976 is any different from that in 1776. We must offer a vision of economic process that is not natural to man's ordinary ways of thinking. And faith in the efficacy of the process of spontaneous coordination arises only from a thorough understanding which only economists are equipped to transmit.

Milton Friedman, a friend whose work I admire greatly, objects to the Austrian-subjectivist approach largely on the grounds that it implies conversion rather than gradual conviction by the weight of logical argument and empirical tests. In part, this objection is based on the observable priesthood tendencies, which I noted above. More important, however, Friedman's objection seems to be based on what I regard as a naive notion of how persons shift paradigms. Admittedly, a connection between accumulated empirical evidence and paradigm shifts must exist, but this is not nearly so direct as Friedman seems to think. But I think we all must admit that the patterns are mysterious here, and these may well vary considerably from one person to another. For my own part, I do not object to the "preaching" implications of subjectivist economics, although I can appreciate both the dangers of this and the advantages of something like the Friedman position.

Unfortunately, most modern economists have no idea of what they are doing or even of what they are ideally supposed to be doing. I challenge any of you to take any issue of any economics journal and convince yourself, and me, that a randomly chosen paper will have a social productivity greater than zero. Most modern economists are simply doing what other economists are doing while living off a form of dole that will simply not stand critical scrutiny. Beware the day for educators generally when the taxpaying public finds out that the king really has no clothes.

I think I know what I am doing, and I think that most of those who espouse a variant of Austrian subjectivist economics know what they are doing. And I think that our efforts are socially productive, highly so. I suppose that all of this finally reduces to an admonition to keep the faith, whether we want to call this doing economics, subjectivist economics, Austrian economics, or something else. The set of ideas and attitudes that emerges from an understanding of the principle of spontaneous order can be transmitted. We can have a part to play in developing a meaningful "public philosophy," even if this amounts to little more now than playing the role of subversives of the dominating mindset that conceives the economy as chaos independent of collective controls. But recall two things. Adam Smith had no idea that he would, in fact, work a revolution in economic thinking and in economic policy in the half-century after 1776. And the same Adam Smith memorably observed: "There's a deal of ruin in a nation." Keep the faith.