
3 Subjectivism

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Although the Austrian school does share some core methodological concepts with most other economists (for example, methodological individualism broadly understood), the fundamental tenet that distinguishes Austrians from neoclassicism is their belief in subjectivism. It is from subjectivism that so many uniquely Austrian insights flow. As Hayek (1952, p. 52) argued 40 years ago, all of the major advances in economics over the preceding 100 years were steps in the further progression of the subjectivist perspective. He points specifically to the work of Mises as the most consistent of these applications and argues that all of Mises's core theoretical conclusions can be traced back to their subjectivist underpinnings. It is equally true that all of the major new insights and refinements of Austrian economics (though not economics generally) in the 40 years since Hayek wrote are also the result of the consistent pursuit of subjectivism.

For Austrians, subjectivism is more than just an economic methodology, it is an entire approach to the study of human action. The human sciences (including economics) study the interaction between humans and things, or humans and humans. In particular, the theoretical human sciences attempt to explain the unintended and unforeseen patterns of results that evolve from these human interactions. Within economics, this approach leads very naturally into the Austrian emphasis on spontaneous order, where the emergence of institutions and other orderly patterns of behavior are explained as the unintended social resultant of actions driven by the subjective perceptions of individuals (Hayek, 1973, chapter 2).

Consequently, the economist offering a theoretical explanation of human interaction and institutions must start with the subjective meaning that individuals attach to their actions. As Hayek (1952, pp. 44, 53) puts it, 'So far as human actions are concerned the things *are* what the acting people think they are ... [and] unless we can understand what the acting people mean by their actions any attempt to explain them ... is bound to fail.' This is the fundamental subjectivist point: social scientific explanations must start with the subjective mental states of the actors being studied. This requires that social scientists take seriously the roles of context and interpretation and recognize that it is the subjective perceptions of actors that drive their actions, not the objective reality that might underlie the situation. Subjectivism argues that we will be unable to attach meaning to human action if we attempt to

describe it in terms that make no references to human perceptions and plans. Austrians argue that without references to meaning our understanding of the social world is of a meager and unsatisfactory kind.

In many ways it is only natural that Austrians adopt a full-blown subjectivist perspective, in that it was Carl Menger who founded the Austrian school on the basis of the subjective theory of economic value. Rather than adopt the labor theory of value of some of his predecessors, Menger (1981, p. 146, emphasis in original) argued that 'value is entirely subjective in nature. ... Goods always have value *to* certain economizing individuals and this value is also *determined* only by these individuals.' This enabled Menger to reorient economics away from a study of the behavior of businessmen and the creation and division of wealth, to a more comprehensive science of human action. In particular, Menger created a theory of price formation that began with the subjective preferences of participants on both sides of the market. This is in contrast to approaches that recognize subjectivity on the demand side, but see the supply side in terms of objectifiable production or opportunity costs.

Unfortunately, as Mises (1933, pp. 172ff) notes, Menger did not pursue this subjectivism consistently enough. Menger tried to distinguish between 'real' and 'imaginary' wants, based on whether individuals correctly understood a good's objective ability to satisfy a want. The next step forward in the subjectivist paradigm was to recognize that the subjectivity of value depended on a further subjectivity, namely knowledge. An explanation of market phenomena need not make judgements about the accuracy of actors' knowledge. All that was necessary for an explanation of, for example, an actor's willingness to pay a certain price, was the subjective *perception* of the actor. Although one might realize *ex post* that the good purchased was not what one thought it was, this is irrelevant for the explanation of price. The actor's mental state at the moment of choice is where explanations of price formation and market processes begin.

James Buchanan (1969) later argued that subjectivism needs to be thoroughly applied on the cost side of the market as well. For Buchanan, and most Austrians, all costs are seen as subjective opportunity costs. While neoclassicism surely recognizes the notion of opportunity cost, it normally does so by objectivizing it into forgone revenues. Buchanan's point was that opportunity costs are ultimately foregone *expected utility*, from either purchases not made or the cash equivalent of sales not made. Because cost was forgone and never actually experienced, it could never be objectively known. Even the chooser does not know what she forgoes precisely because she forgoes it. What informs choice, argued Buchanan, is our expectation of what each option might bring us. Consistent with the other work of Austrians (see below), we cannot know the expectations of others, especially when they are

not realized. All choices are therefore rooted in balancing subjective opportunity costs.

Many of Buchanan's ideas on cost grew out of the burgeoning subjectivism in London in the 1930s, especially in the work of Hayek. For Hayek and other Austrians of the day, subjectivism, especially referring to knowledge, was at the root of a number of important issues in economic theory and political economy. Subjectivism explains Hayek's position in the two most important intellectual debates among economists of the 1930s – the rise of Keynesianism and the socialist calculation debate. In both cases, Hayek argued that his opponents misunderstood the subjectivist message, especially concerning the role of equilibrium in economic theory. In the debate with Keynes, Hayek argued that macroeconomic aggregates are inappropriate guides for policy as the relationships that comprise them are ultimately grounded in the subjective perceptions of market actors. As a result, macroeconomic theories that attempted to establish causality between aggregates were problematic. This was especially true for Keynes because of the absence of a theory of capital in *The General Theory*. As Hayek (1941) and Lachmann (1956) have argued, the capital structure is fundamental to the market process, and capital is an essentially subjective phenomenon, as what counts as capital is determined by the plans of resource owners. The same objective good may be capital for one person but not for another. Aggregate notions of saving and investment overlook these issues.

In the calculation debate, Hayek's neoclassical opponents argued that a socialist planning board is theoretically just as able to discover equilibrium prices as is a market and is thus equally able to allocate resources rationally. This argument hinged on the view that the board would have the data of the market 'given' to it, in much the way that one takes knowledge as given in the theory of perfect competition. Hayek saw this as a confusion over the nature of knowledge and the notion of it being 'given'. The 'givenness' of knowledge, for Hayek, was just a restatement of subjectivism, in that it meant that the observing economist had to start any explanation of economic processes with the perceptions of market actors. It did not mean that the economist knew everything that the actors knew, as has become the norm in neoclassical theory.

This latter view of 'givenness' enabled planners to assume they could acquire the knowledge needed to find equilibrium prices. Hayek's subjectivist view suggested that such knowledge not only *was* not known by observers, but *could* not be so known. When one recognizes that much of the knowledge relevant to economic coordination is subjective 'knowledge of the particular circumstances of time and place' (Hayek, 1948, p. 80), then it becomes impossible to imagine it marshalled in one mind or group of minds. The whole *raison d'être* of the market, for Hayek, was that it enabled the use of

subjective knowledge through intersubjective signals such as prices and profits. These phenomena are the unintended outcomes of the interplay between the subjective perceptions of suppliers and demanders. Precisely because they rejected these subjectivist underpinnings, the neoclassical defenders of planning misunderstood the nature of market processes. Markets are better seen as process for the creation, discovery and use of knowledge that originates in the subjective mental states of individuals.

These Hayekian arguments provided the platform for the recent revival of Austrian subjectivism as well as other subjectivist-influenced schools of thought such as the Post Keynesians and followers of the late G.L.S. Shackle. Since the Austrian revival in the mid-1970s, the major development in subjectivist thinking. The first has been Ludwig Lachmann's work on the relationship between expectations and equilibrium. Lachmann has argued that, once the creative and imaginative nature of choice and its implied variety of reactions to market changes is recognized, how can Austrians feel assured that market processes tend toward equilibrium? The 'kaleidic' view of markets in Lachmann's work, called 'radical subjectivism' because of its rejection of any tendency towards equilibrium, is the next logical step in the subjectivist paradigm. Whereas Hayek moved Austrians from subjective value to subjective knowledge, Lachmann has taken the next step to subjective expectations.

The subjectivism of Austrian economics can be compared to the objectivism of more neoclassical approaches. At a general level, Austrians have not been guilty of what Mirowski (1989) calls 'physics envy'. Much of neoclassical economics has been patterned on the way physics approaches its subject matter. The problem, from a subjectivist perspective, is that human beings are not atoms or billiard balls. The deterministic utility maximization equations of general equilibrium theory deny any scope for the 'subject'. Agents do not make real choices, they exercise no imagination and their maxima are simply functional implications of objective data. Although this might accurately describe the path a billiard ball takes over a frictionless surface, to a subjectivist it does not describe real, historical human action.

This general equilibrium approach to economics has found its most logical extension in rational expectations models. In such models the fundamental mental phenomena that interest subjectivists are ignored. By assuming that agents will make use of all relevant available information in forming their expectations, the theorist once again eliminates any real 'subject'. Expectations are defined independent of the context, ability or individuality of market actors. For Austrian subjectivism, the main fact to be explained in economics is how actors with *different* expectations and knowledge are able to coordinate their behavior despite such differences and despite the anonymity inherent in markets. The notion of a movement from the individualized

knowledge of actors to the coordination of the market-place is ruled out *ex hypothesi* when one uses rational expectations models. The progressive objectivization of neoclassicism all the way to expectations drives an even deeper wedge between it and Austrian economics, which has progressively *subjectivized* the same path.

Similar subjectivist insights fuel Austrian criticisms of other macroeconomic approaches. Even without the assumption of rational expectations, Keynesian and monetarist macroeconomic models that attempt to derive functional relationships between statistical aggregates also fail to account for the importance of the subject on two levels. First, the aggregates themselves are likely to be meaningless to the subjective decision-making patterns of individuals. Individual decisions to buy and sell are not made according to the consumer price index (CPI) or aggregate investment (although some financial decisions might be). Thus the relationships between such aggregates are merely statistical and are difficult to explain in terms of specific human choices. Second, viewing the macroeconomy as a set of aggregate relationships obscures the underlying individual actions that comprise the economy. For example, monetarist models that hypothesize a direct relationship between an increase in the money supply and the price level rightly point out that inflation is always a monetary phenomenon. However, stopping there ignores the transmission process and its effects on individual prices. From a subjectivist perspective, the interesting question is how changes in the supply of money affect the decisions of individuals. Given that money supply increases occur at specific times and places, how the individuals who receive them react will be crucial to explaining the macroeconomic patterns that result. Subjectivists are interested in these individual reactions and are thus able to note the relative price effects of inflation that result and see how these price changes lead to recognizable patterns of behavior (as in the Austrian theory of the trade cycle). By focusing only on aggregates and not taking the role of the subject seriously enough, mainstream approaches miss the full story.

It can be briefly noted that Austrians argue that some non-mainstream approaches also suffer from insufficient subjectivism. Neo-Ricardian approaches (such as Sraffa's) which are concerned with the distribution of wealth between various factors of production or which focus on input coefficient matrices are attempting to objectivize what are essentially subjectively driven phenomena. Some forms of institutionalism, to the extent that they divorce the emergence and power of institutions from their bases in the subjective perceptions of individual actors, can also be seen as lacking important subjectivist insights.

For Austrian economics, subjectivism virtually defines the way it views economics and in so doing demarcates its approach from most others in economics. Many of the uniquely Austrian perspectives on economic phe-

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nomena, as well as the path by which they have developed, are simply the consistent application of subjectivism and its emphasis on the individual's active, perceiving, interpreting mind as the beginning, but not the end, of economic understanding.

See also:

Chapter 22: The Austrian theory of price; Chapter 2: Methodological individualism; Chapter 11: Praxeology

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