Austrian Economics and the Analysis of Labour Markets

Abstract. Theory and policy relating to labour markets is dominated by the mainstream labour market model, although a less well-known, socioeconomic version can also be identified. The mainstream model is, I argue, methodologically flawed and, therefore, forced to relegate any investigation of labour market institutions or social structures to the margins of its analysis. The socioeconomic account is not so much methodologically flawed, as methodologically confused. Whilst this confusion does not actually prevent the investigation of institutions or social structures, it does promote ambiguity whenever we inquire into the precise nature of the interaction between them and labour markets. Insights from Austrian economics, when used in collaboration with critical realist methodology, can play a part in augmenting the socioeconomic account, generating a totally new approach to the analysis of labour markets.
Introduction

Theory and policy relating to labour markets is dominated by the orthodox, neoclassical or mainstream labour market model, although a less well-known version can be identified, which I refer to as the socioeconomic account of labour markets. The mainstream model is, arguably, methodologically flawed and, because of this, forced to relegate any investigation of labour market institutions or social structures to the margins of its analysis. The socioeconomic account by contrast, is not so much methodologically flawed, as methodologically confused. Whilst this confusion does not actually prevent the investigation of institutions or social structures, it does promote ambiguity whenever we inquire into the precise nature of the interaction between them and labour markets. Insights from Austrian economics, when used in collaboration with critical realist methodology, can play a part in augmenting the socioeconomic account, generating a totally new approach to the analysis of labour markets.

Parts 1 and 2 sketch the mainstream labour market (MLM) model or account, and the socioeconomic alternative before Austrian economics is introduced in part 3. The (now) fairly standard critical realist critique of the deductivist method that underpins the MLM account is deployed in part 4 to prevent Austrian economists (and socio-economists) ‘back-sliding’ into the deductivist method and, hence, importing aspects of the MLM account by default. There is actually no need to do this because, as part 5 shows, some Austrians, especially Hayek and some of his heirs, abandoned deductivism a long time ago and now operate with something approaching a critical realist position. This can be seen via Hayek’s rejection of equilibrium for a (transformational) account of social order. The final part shows how some Austrian insights can play a part in augmenting the socioeconomic account, generating a totally new approach to the analysis of labour markets. This paper draws heavily on, and extends, my (Fleetwood 2005) paper where several issues that are sketched here are elaborated at length – this is available on request.

1. The mainstream account

Part of the attractiveness of the MLM account is that it is theoretically and methodologically systematic. It is theoretically systematic in the sense that the clutch of theorems and sub-theorems that constitute, and support, the basic principle that lies at the heart of the account, are in agreement with one another – e.g. theories of rational agents, marginal cost, marginal productivity and appropriately sloped demand and supply curves. This basic principle can be expressed succinctly: wage rates and the quantities of labour demanded and supplied are functionally related, and labour markets are conceived of as sites where these relations operate, and are theorised as if the ‘economic’ forces of wages, supply and demand for labour over-ride ‘non-economic’ phenomena such as institutions or social structures. The MLM account is also systematic in the sense that its theorems are rooted consistently in the deductivist method. This method
provides the account with unambiguous objectives, namely deduction and/or prediction. It also enables the basic principle to be expressed mathematically via functions. In sum, the basic principle of labour markets, rooted as it is in the deductivist method, constitutes the essence of the MLM account, determines the field of study, shapes the way analysis is carried out, and grounds policy prescriptions.4

Whilst the MLM account suffers from a series of problems, two (connected) problems are pertinent to this paper. First, the deductive method is deeply flawed. I will return to this in part 4, so concentrate for the moment upon the second problem. The very nature of deductivism makes it virtually impossible to investigate labour market institutions or social structures (i.e. mechanisms, rules, resources, conventions, habits, powers, and so on) adequately, so their investigation is relegated to the margins. Mainstream economists are, of course, aware that a range of ‘non-economic’ phenomena and institutions (they do not use the term ‘social structures’) impact upon labour markets, and some do try to investigate phenomena like family, gender, race, trade unions, efficiency wages, insider-outsider distinctions and so on (c.f. Solow 1990; St Paul 2000; Gerhart & Rymes 2003, especially chapter 2). But even when mainstream economists attempt to investigate institutions, the deductive method seriously hampstrings their analysis. Important insights of a sociological or hermeneutic nature are, typically, qualitative in nature, impossible to (meaningfully) quantify, impossible to translate into variables, and therefore, impossible to express as functions.5 Moreover, most mainstream economists would almost certainly consider the kind of methods that can accommodate sociological or hermeneutic insights ‘unscientific’ and hence inappropriate for the analysis of labour markets.6 As a result, any institution that is considered is usually dealt with as a ‘bolt on’ to the basic principle, and analysis takes the form of deducing the effects of that institution on the wage rate, supply, or demand for labour. The possibility that institutions may actually be the over-riding cause of (say) wage rates in a sector, and may even crowd put the ‘economic’ forces of supply and demand, and hence warrant an in-depth analysis in their own right, are never seriously considered. Hyclak, Johnes & Thornton, (2004: 19) probably express the sentiment of most mainstream labour market economists: ‘Adjustment to a demand and supply equilibrium may be complicated by institutional factors, but we would nevertheless expect supply and demand to be major influences on labour market outcomes.’

2. The socioeconomic account
A second account of labour markets can be found in the writings of a disparate group of Heterodox economists such as Feminists, Institutionalists,7 Marxists, Post-Keynesians, Regulationists, Economic-Sociologists and Segmented Labour Market theorists, along with many who would not describe themselves as economists (despite the fact that they often write about labour markets) coming from subjects such as organisational theory, sociology of work, labour law, state theory, human resource management, industrial
or employment relations, urban geography and so on. I refer to this body of literature as the
socioeconomics of labour markets. Despite significant diversity, this literature has two key features.

First, most socio-economists are at best deeply sceptical about, and at worst extremely hostile to, deductivism. Being ‘against’ something does not, however, automatically translate into being ‘for’ something else, and the socio-economic account suffers from not having its own coherent methodological alternative. The result is an account of labour markets that is not exactly methodologically flawed, but rather methodologically confused. In spite of this, however, their methodological convictions do not, typically, hamstring their analysis the way it does for mainstream economists, and their methodological ‘instincts,’ or ‘intuitions’ often lead them to take institutions or social structures seriously. This confusion manifests itself the moment we inquire into the precise nature of the interaction between institutions or social structures and labour markets, in the form of ambiguity – of which more in a moment. Second, in the socioeconomic account, labour markets are often conceived of as embedded in institutions or social structures, and the latter form a significant part of the analysis. Henceforth I will refer to simply as ‘social structures.’

The recognition that labour markets are embedded in social structures and that the latter should form an integral part of any labour market account, is a significant advance on the MLM account. It is, however, one thing to recognise that social structures and labour markets interact, it is another thing entirely to explain how they interact. When we inquire into the precise nature of the interaction we run into the ambiguity just noted. Fevre, for example, (1992: 25) suggest that the price of labour is ‘determined (or at least heavily influenced by) the laws of supply and demand. This kind of comment (and Fevre is by no-means alone) leaves the socio-economic in the following highly ambiguous situation:

- Supply, demand and wage rates are recognised as doing something, but no-one is clear about what this ‘something’ is because social structures are also recognised doing ‘something.’
- Social structures are recognised as doing something, but no-one is clear about what this ‘something’ is or how social structures do it because supply, demand and wage rates are also also recognised doing ‘something.’
- Supply, demand and wage rates are recognised as interacting with social structures, but no-one is clear about what this ‘interaction’ means, how it works, or what consequences follow. We might ask:
  - Does the presence of social structures entirely negate the relationship between supply, demand and wage rates? If so, does this mean supply and demand have no effect on the wage rate? If so, are wage rates determined entirely by something other than supply and demand? If so, what? Or does the presence of social structures merely modify the
relationship between supply, demand and the wage rate such that the latter is only roughly determined, or heavily influenced, by supply and demand? If so, how rough is ‘roughly’ and how ‘heavy’ is the influence?

- Do the forces of supply and demand for labour set boundaries to wage rates, and social structures regulate the actual wage rate. Or do social structures set boundaries to wage rates, and the forces of supply and demand for labour regulate the actual wage rate?

If truth be told, the nature of the relations between wages, and supply and demand for labour, and between labour markets and social structures are not well understood. True, the more social structures are allowed into the account, the more powerful the account becomes as an explanation of the operation of labour markets. But the more social structures are allowed into the account, the more difficult it is to maintain the idea that wages, and supply and demand are functionally related and more ambiguous our expressions become. Whilst the socio-economic account is, arguably, an advance on the MLM account, as it stands, the advantage cannot be pressed home. Methodological confusion, coupled with the ‘embedding’ metaphor, encourages the dualistic idea that there are two separate phenomena, one called ‘labour markets’ (i.e. sites where the ‘economic’ forces of wages, supply and demand for labour are functionally related) and the other called ‘social structures.’ This dualism, I will argue, hinders the development of an alternative socio-economic account and should be abandoned. But before getting to this argument, we need to take on board some insights from, amongst others, Austrian economists.

3. Enter Austrian economics

Does Austrian economics, with its much vaunted alternative methodological position, offer any insight into this predicament? At first glance, the answer is: no, for two reasons. First Austrians write very little on labour markets. Second, a perusal of the scant literature reveals that some Austrians (e.g. Ryoo & Rosen 2004; and Vedder & Galaway 2002a) are almost indistinguishable from mainstream labour economists; others (e.g. Yeager 1997) can, with a little finessing, be located in the socioeconomic camp; and others (e.g. Mises 1996) seem to hold views that could place them in either camp. Consider some of their comments:

Ryoo & Rosen (2004: S113) build a generic model of the professional labour market wherein:

\[ w_t = \alpha_1 N_t + \alpha_1 \delta_t \]

The demand for engineering services decreases in the engineering wage and shifts with such things as changing production technology, national defence expenditures, and the expected payoff to R&D:
where \( w_t \) is the wage rate, \( N_t \) is the stock of engineers, represents \( \delta_t \) demand shifters, and \( \alpha_t \) is the inverse of the slope of the demand function.

The supply of new entrants into engineering schools depends on expected career earnings prospects in engineering compared to available alternatives:

\[
s_t = \gamma_1 V_t - \gamma_2 x_t + \gamma_3 s_{t-1}
\]

where \( s \) is the number of people choosing to enter engineering school in period \( t \), \( V_t \) is the discounted present value of future wages expected by entrants, \( x_t \) are supply shifters such as career prospects in alternative professions, and \( \gamma_1 \) is positive, reflecting increasing costs due to crowding and inelastic supplies of teachers and places in schools, as well as heterogeneity in tastes and opportunities forgone in other professions among prospective entrants.

Vedder & Galaway write:

In the broadest sense, labor markets tend to conform to the economist's perception of institutions that tend to move towards equilibrium outcomes. In an unconstrained labor market, the price of labour (the wage rate) will move towards a level at which the number of workers interested in working at that wage will match the number of workers that employers are interested in hiring (Vedder & Galaway 2002a: 106.)

Theory expects the wage-enhancing goals of unions will reduce employment in the private market economy where firms try to maximize profits by producing where marginal costs exceed marginal revenues (ibid: 124).

They also employ concepts such as the 'equilibrium or natural rate of unemployment;' an 'unhampered competitive labour market;' and demand and supply functions (106-8). Comments like these from Austrian labour economists reveal a commitment not only to the basic principle found in the MLM account, but also to the deductive method that facilitates the basic principle.

Whilst Mises does write on labour markets, he does not do so systematically and, moreover, his work is extremely ambiguous. Passages that place him in the MLM camp sit alongside passages that place him with the socio-economists. The following are examples of this.

Descent, language, education, religion, mentality, family bonds, and social environment tie the worker in such a way that he does not choose the place and the branch of his work merely with regard to the height of wage rates (Mises 1996: 627)

If we assume that there are no institutional barriers preventing or penalizing the transfer of capital goods, workers, and commodities from one place or area to another and that the workers are indifferent with regard to their dwelling and working places, there prevails a tendency toward a distribution of population over the earth's surface....It is hardly necessary to observe that the migrations which these theorems describe come to pass only in so far as
there are no institutional barriers to the mobility of capital, labor, and commodities...[T]he tendencies they describe are fully operative only within each nation's boundaries (627-8).

Within certain limits labor can be substituted for material factors of production and vice versa. The extent that such substitutions are resorted to depends on the height of wage rates and the prices of material factors (594).

[A]n employer who tried to reduce wage rates below the height consonant with the marginal productivity of labor would not recruit the type of men that the most efficient utilization of his equipment requires. There prevails a tendency for wage rates to reach the point at which they are equal to the price of the marginal product of the kind of labor in question. If wage rates drop below this point, the gain derived from the employment of every additional worker will increase the demand for labor and thus make wage rates rise again. If wage rates rise above this point, the loss incurred from the employment of every worker will force the employers to discharge workers. The competition of the unemployed for jobs will create a tendency for wage rates to drop (598-9).

Yeager’s comments could be found in most socioeconomic work:

Austrians treat institutions not as givens that can be captured by a parameter or two in an economic model but rather as a complex social arrangement whose evolution requires serious thought ... Austrians recognise the time dimension of economic life. They take change, uncertainty, and unpredictability seriously... Austrians are not obsessed with contemplating and comparing equilibrium states...Equilibrium is not automatic and is never in fact reached... They pay attention to disequilibrium processes. They do not suppose that demand curves and cost curves...are given to decision makers...Austrians stress the subjective element in value: economics is primarily about people and their purposes, not about things and their quantities.

Austrians...do not suppose that demand curves and cost curves...are given to decision makers....The Austrian conception [of competition] is closer to the everyday understanding of competition: rivalry to gain customers by better service, and not necessarily in price alone but in other dimensions as well...[M]ost prices and wages are not determined impersonally but are consciously set (although with an eye on supply and demand) and that these other circumstances can cause or reveal price stickiness (Yeager 1997: 154-157).

Yeager accepts the existence of demand and supply curves (and hence functions), accepts the existence of institutions (or social structures) within which supply and demand operate and, thereby, runs straight into the same ambiguity as socioeconomists. His comment that 'wages are...consciously set (although with an eye on supply and demand)' expresses the same sentiment as Fevre (above) who thinks wages are ‘determined (or at least heavily influenced by) the laws of supply and demand.10

Before we write Austrian economics off, however, as having little to offer a socioeconomic account of labour markets, perhaps we should look a little closer. If Austrians have written little specifically on labour markets, but much more on markets in general, why restrict our remit to their work on labour markets? Moreover,
there are Austrians who take social structures seriously, even if they do not comment on labour market structures per se. Furthermore, there are Austrians whose methodological commitments are not only clear, but are also sufficiently close to critical realism, to make help us over the methodological confusion that afflicts many socioeconomists. The work I have in mind here is that of Hayek (1946, 1960, 1968, 1976 passim), Boettke (1997); Boettke & Storr (2002); Beaulier & Boettke (2005); Lewis (2004b & 2005); Runde (2001) and Vaughn (1999). I return to this in part 5 after a methodological note.

4. Critical realist methodology critique of positivism and deductivism

This section deploys critical realist methodology, applied specifically to the theories of labour demand and supply in order to locate the flaws in the deductivist method that bedevil the MLM account. Whilst my interest is not in this account per se, this section is necessary to prevent Austrian economists (and socioeconomists) ‘back-sliding’ into the deductivist method and, hence, importing aspects of the MLM account by default – as, arguably, Ryoo & Rosen, Vedder & Galaway do, and in places Mises does.

Because the critical realist critique of the method underpinning positivism and deductivism is nowadays relatively well documented (see footnote 2) and is specifically set out with respect to labour markets in Fleetwood (2005), this section offers only a truncated account.

According to critical realists, the MLM account is systematically rooted in the deductivist method or deductivism, wherein to 'explain' something is to deduce/predict a statement about that something from a set of initial conditions, assumptions, axioms and a covering law or some form of constant conjunction of events or event regularity.

- Central to the way deductivism is operationalised is a mathematical device, the functional relation, generalised as \( y = f(x) \). Functions are often treated in terms of laws such as the ‘law' of labour demand, which can be expressed as \( l_d = f(w) \) and generalised as ‘whenever event x then event y’.
- Functional relations and laws presuppose constant conjunctions of events. The ‘law' of labour demand, for example, states that whenever the quantity of labour demanded changes (event x), then the wage rate changes also (event y).
- Constant conjunctions of events, then, drive the nomological machinery of the deductive method: without them, it is impossible to deduce or predict an event(s) from antecedents.
- A system characterised by constant conjunctions of events is referred to as a closed system: an open system is one characterized by a lack of such constancy. Events are constantly conjoined in
the sense that for every event y, there exists a set of events \( x_1, x_2, \ldots, x_n \) such that y and \( x_1, x_2, \ldots, x_n \) are regularly conjoined.\(^\text{11}\) Deductivism necessarily presupposes closed systems.

Despite its widespread use, the deductive method is inappropriate in cases where events do not manifest themselves as constant conjunctions, that is, in \textit{open systems}. Let us explore this inappropriateness via the theory of labour demand and supply.

\textit{Theory of labour demand}

No one suggests that the event regularities that constitute the law of labour demand are ubiquitous. Even advocates agree that sometimes the law does and sometimes it does not hold, depending upon various (usually) unmentioned circumstances that are buried within the \textit{ceteris paribus} clause or in other stated assumptions. Putting matters like this, however, is tantamount to denying the existence of closed systems and constant conjunctions of events, in which case the nomological machinery of the deductive method fails and deductions or predictions cannot be made. Mainstream economists avoid this situation by engineering (in theory only) constant conjunctions of events by means of a set of closure conditions. They do not call them closure conditions of course, they call them the Marshall-Hicks (M-H) conditions of derived demand – but this is a semantic difference only.

The very possibility of stating that a change in the wage rate will cause a deducible or predictable change in the quantity of labour demanded, depends on the existence of a event regularities functional relation between labour demand and the wage rate. This in turn depends upon the M-H conditions. The M-H conditions are usually used to demonstrate how \textit{elastic} (i.e. responsive) the demand for labour will be to changes in wage rates. It is, however, not quite correct to say that these conditions merely effect the elasticity of demand for labour. Without them the very law of labour demand becomes meaningless. Take a case where there is not just \textit{low}, but \textit{zero}, elasticity of substitution between labour and capital. One cannot substitute an extra wing for a pilot following an increase in pilots’ wages, so the wage increase might have no effect at all on labour demand. Whilst this is an extreme example, the point is not: production usually involves a fixed crew of workers who operate a specific configuration of machinery. In many cases, even if it is technically possible, it is not socio-politically possible, to substitute a worker for a piece of machinery. But if substitutability is not assumed,\(^\text{12}\) the idea that an increase in wage rates causes the substitution of labour by capital is undermined, and with it the law of labour demand.\(^\text{13}\) In short, the M-H conditions are not just about establishing the elasticity of labour demand: \textit{they are assumptions needed to ensure a constant conjunction of events and systemic closure}.


Theory of labour supply

The critical realist critique of the theory of labour supply is similar to that made against the theory of labour supply (although without the M-H conditions). There is, therefore, no utility in going through it again, so I shift the focus slightly towards the consequences that arise from closure. The requisite constant conjunction of events constituting the ‘law’ of labour supply, is engineered (again in theory) via a set of closure conditions. I will not run through all the assumptions that create the closure conditions but will merely mention one.

The MLM account of labour supply assumes the individual worker is free to choose the number of hours s/he works in accordance with his/her preferences and subject only to an income constraint. The length of the working day, (week or year) is assumed to be the aggregate outcome of free choices by individual workers who have expressed their preference for it to be this length. This is, not only a false assumption (which should not be confused with a legitimate abstraction), even economists who use it know it is false. The working period is the length it is because workers and their employers have used the resources at their disposal such as: national or supranational government directives and legislation; and political, industrial and ideological power. Putting matters like this, however, is tantamount to denying the existence of constant conjunctions of events, in which case the nomological machinery of the deductive method fails. Once phenomena like legislation and power enter the account, the very idea of a simple choice between working an hour more or an hour less because of a change in taste, non-wage income, or the wage rate evaporates and uncertainty, indeterminism and unpredictability arise. In this case, the constant conjunction of events that form the basis of the claim that the quantity of labour functionally related to the wage rate will no longer hold.

In short, the (plethora of) knowingly false assumptions surrounding the activities involved with supplying labour are not made because economists have studied these activities and decided they are realistic, they are made for the sole purpose of ensuring systemic closure.

The problems with closed systems

Commitment to the deductive method, encourages the theories of labour demand and supply to be set up in terms of closed systems. And this brings us to a fundamental problem. Whilst closed systems are fundamental to deductivism, they are exceptionally rare phenomena. There appear to be very few spontaneously occurring closed systems in the natural world, and virtually none in the social world. This is not to deny the possibility that constant conjunctions may occur accidentally, or over some restricted spatio-temporal region, or be trivial – e.g.
all aeroplanes have a pilot. But virtually all of the constant conjunctions of interest to science, including economics, only occur in artificially closed systems.

In natural science, the point of experiment is to close the system by creating a particular set of conditions that will isolate the one interesting mechanism. This mechanism is then allowed to operate unimpeded and the results, the constant conjunctions, recorded. In social science, however, constant conjunctions of events appear to be found only in the conceptual experiments’ (Pencavel 1994: 14), that constitute theoretically closed systems. Unfortunately, (natural or) social scientists who adopt the deductivist method face the following problematic and counterintuitive implications:

a) Outside closed systems, where constant conjunctions of events are not usually found, one would have to conclude that there are no laws. This would be tantamount to saying that nothing governs the (non-constant) flux of events in open systems; science would, then, become a fruitless endeavor.

b) It is often the case that conclusions derived from experimental situations (i.e. in closed systems) are successfully applied outside experimental situations (i.e. in open systems). Because of (a) above, this state of affairs would have no valid explanation.

c) The obvious problem of how one may, justifiably, claim anything about a reality that constitutes an open system from an analysis of a closed system has never been seriously addressed by mainstream ‘economists’. In fact, deducing statements about the action of agents operating in a closed system, and transferring them to the action of agents in the open system, commits the fallacy called *ignoratio elenchi*. This entails ‘assuming that one has demonstrated something to be true of X when the argument or evidence really applies to Y which is not the same as X in some respect’ (Gordon 1991: 108). What is ‘not the same’ is the existence and ubiquity of constant conjunctions of events.

d) Systemic closure, typically, requires the use of *knowingly* false assumptions. The use of known falsehoods (not to be confused with legitimate abstractions) in an account immediately divests it of all explanatory power (Fleetwood 2002).

The problematic and counterintuitive implications that derive from closed system theorizing, render the deductive method singularly inappropriate for the analysis of open systems such as labour markets. This has not, of course, prevented deductivism from dominating labour economic theory: but might does not necessarily make right.

5. Hayek’s critical realism: from equilibrium to a transformational account of social order
Fleetwood (1995) and Lawson (1994, 1995) have argued that Hayek started to abandon mainstream approaches to theory and methodology in the 1930s, and by the 1960s had adopted ways of doing
economics that are incompatible with mainstream ideas, but compatible with critical realism – although, clearly, Hayek did not use this terminology.

The kind of theory Hayek eventually uses does not involve rational agents maximising a set of objectives under a constraint, does not involve functional relations so basic devices like supply and demand functions have no place, and does not use any notion of equilibrium. The kind of theory he does use, by contrast, involves non-rational agents following tacit social rules of conduct, operating in a world of radical uncertainty and even ignorance with this process generating an order. The kind of method Hayek eventually uses does not involve mathematics or statistics, does not employ the deductive method (or any of its variants), does not involve regressions and hypothesis testing, and does not make use of unrealistic or (knowingly) false axioms and assumptions. The kind of method he does use, by contrast, is close to what I call causal-explanatory, and is close to critical realism. Furthermore, Hayek’s eventual method recognises a realist social ontology where the world is structured and transformational. Let us weave together a Hayekian/critical realist understanding of markets.

Unlike mainstream economists who are preoccupied with empirical events and the alleged event regularities they manifest in (i.e. regularities between changes in wage rates and quantity of labour demanded) critical realists focus their attention on the social structures that govern this (usually) irregular flux of events. Unlike mainstream economists (indeed any deductivists) who presuppose an ontology restricted to the fused domains of the actual and empirical, so that what we see is what is and, furthermore, is all that is acceptable to ‘science’ the critical realist considers a domain referred to (metaphorically) as the ‘deep’. Figure (1) illustrates this stratified ontology.

<table>
<thead>
<tr>
<th>Domain</th>
<th>Entity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Empirical</td>
<td>Experiences &amp; perceptions</td>
</tr>
<tr>
<td>Actual</td>
<td>Events &amp; actions</td>
</tr>
<tr>
<td>‘Deep’</td>
<td>Structures, mechanisms, resources, rules, powers, relations</td>
</tr>
</tbody>
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Figure 1.

Not only is the ontology stratified, it is also transformational. Whilst traditionally most commentators recognise that society consists (in some sense) of agents and structures, the debate centres upon the way they interact. Agents do not create or produce structures ab initio, rather they recreate, reproduce and/or transform a set of pre-existing structures. Society continues to exist only because agents reproduce and/or transform those
structures that they encounter in their social actions. Every action performed requires the pre-existence of some social structures which agents draw upon in order to initiate that action, and in doing so reproduce and/or transform them. For example, communicating requires a medium (e.g.) language, and the operation of the market requires the rules of private property. This ensemble of social structures simply is society. The transformational principle, then, centres upon the social structures that are the ever-present condition, and the continually reproduced and/or transformed outcome, of human agency. Agents, acting purposefully or consciously, unconsciously draw upon, and thereby reproduce, modify and/or transform the structures that facilitate their actions in daily life. In this way, via active human involvement, and only via human involvement, structures continue to endure, although perhaps in modified or transformed forms. Some agents may well deviate from the rules, and engage in new forms of conduct which others might subsequently follow, reproduce, or once again modify and/or transform. This transformational account grasps the never ending process of continuity and change that seems to characterise socioeconomic life. This is what Bhaskar (1989) refers to as the Transformational Model of Social Action (TMSA) although Archer has elaborated upon this in her Morphogenetic Approach (1995).

With the recognition that events do not manifest as constant conjunctions, and socioeconomic systems are not closed, combined with the further recognition that something must govern these (irregular) events, then the method, if it is to bear fruit, must switch. The emphasis of investigation necessarily switches (ontologically speaking) from the domains of the empirical and actual, to the domain of the deep and hence to the social structures that govern these events. Investigation switches from the outcomes or results (in the form of event regularities and statistical associations between variables) of some particular human action, to the conditions that make that human action possible. Because of the openness of socioeconomic systems, outcomes cannot be induced, deduced or predicted from premises. This is not lost on many Austrians: Yeager, for example writes:

> As for predictions, Austrians take another fact seriously: the economic world is an open rather than a closed system and as such has an unknowable future. Except perhaps for short run extrapolations or in identifying wide ranges of possible outcomes, numerical forecasts cannot be reliable. A pretence of satisfying unsatisfiable demands for forecasts is intellectually disreputable. The best that can be supplied are qualitative predictions, recognitions of patterns, and explanations of the likely consequences of contemplated actions (Yeager 1997: 157).

Although prediction might not be possible in the social world (at least prediction based on the alleged past constant conjunctions of events), the social structures that govern this human action, and the meanings and intentions of human agents themselves, can be uncovered and explained. Explanation supplants
prediction/deduction as the objective of theorising and what I call the causal-explanatory method supplants deductivism. The method is ‘causal-explanatory’ because its objective is to explain, and it explains in terms of providing a causal account that is fully cognizant of both structures and agents.

This stratified and transformational ontology, coupled with the causal-explanatory method, discourages the search for equilibrium conditions at the level of empirical (or hypothesised) events and encourages the search for the social structures that, in conjunction with human action, generate socioeconomic order. I refer to this as a transformational account of socioeconomic order. Moreover, I argue that this interpretation sits well with Hayek’s own ideas. Let us consider them.

In 1968, Hayek explicitly abandons the notion of equilibrium, writing:

Economists usually ascribe the order to which competition produces an equilibrium – a somewhat unfortunate term, because such an equilibrium presupposes that the factors which have already been discovered and competition has therefore ceased. The concept of an ‘order’ which…I prefer to that of equilibrium, has the advantages that we can speak about an order being approached to varying degrees, and that the order can be preserved throughout a process of change (1968: 184).

He defines order as:

a state of affairs in which the multiplicity of elements of various kinds are so related to each other that we may learn from the acquaintance with some spatial or temporal part of the whole to form correct expectations concerning the rest (1973: 36).

Explaining socioeconomic order, then, requires an explanation of how the socioeconomic activity of millions of unconnected individuals is co-ordinated when this requires the prior co-ordination of their plans, which in turn requires the discovery, communication, and storage of an enormous amount of knowledge that exists only as a decentralised and fragmented totality. His explanation runs as follows.

Agents (individuals and/or groups) make plans and initiate future courses of action with no guarantee that they will be able to see their plans through to completion because they are ignorant of the plans of others whose subsequent actions will affect them. Even if an individual or group had knowledge of the initial plans of others, these plans may, and often do, change in ways that are unknown even to those whose plans they were. The sum total of knowledge cannot be gathered together in one place and known by one agent because it is fragmented, dispersed and, in many cases, tacitly known (and therefore in-articulable), so this state of ignorance is ubiquitous.
Whilst the price mechanism acts like a telecommunications system, with prices acting as signals alerting individuals to things like scarcity of a particular input (e.g. labour) into production, prices do not inform individuals of everything and they remain ignorant of many other things. It is, he notes, ‘mainly changes in price that bring about the necessary adjustments (1960: 350, emphasis added) which means, of course, that something other than prices (or wages, the price of labour) are also at work. In another place he recognises that agents ‘knowledge of the alternatives before them is the result of what happens on the market, of such activities as advertising etc. and the whole organisation of the market serves mainly the need of spreading the information on which the buyer is to act’ (Hayek 1946: 21 emphasis added). Reference to the ‘whole organisation of the market’ indicates Hayek’s awareness that, once again, something other than the price mechanism must also be at work.

What assists agents in making plans that have a fair chance of coming to fruition is that they are able to draw upon a dense web of social structures in the form of social rules of conduct – which include, as a sub-set, traditions and customs. Rules guide actions in situations of ignorance. By ‘guiding the actions of individuals by rules…it is possible to make use of knowledge which nobody possesses as a whole’ (1973: 49). By drawing upon these rules, individuals avail themselves of a part of the collected wisdom of an evolving society and this facilitates the discovery, communication and storage of knowledge and have grounds for action.

What reconciles these individuals and knits them into a common and enduring pattern of a society is that...they respond in accordance with the same abstract rules...What...enables men to live and work together in peace is that in the pursuit of their individual ends the particular monetary impulses which impel their efforts...are guided and restrained by the same abstract rules. If emotion and impulse tells them what they want, the conventional rules tell them how they will be able to and allowed to achieve it (1976: 12)

The following comments, suggest that at least some contemporary Austrians are happy interpreting Hayek as a critical realist.

Hayek regards his social structures as enduring, as defining relations between individuals, and as having an existence over and above the subjective beliefs and attitudes of the particular individuals who form the foci in the network of relations defined (Runde 2001: 11)

Austrians do indeed view the individual as the primary agent of change in the social nexus. Yet, Austrians are fully aware of the role non-economic institutions and culture can play when individuals are acting and interacting in the social world...[I]ndividuals acting in the social world are deeply affected by the non-economic institutions of power, culture and history
surrounding them. We believe this position is identical to the critical realist position (Beaulier & Boettke (2005))

There is, however, a twist to this. Hayek is not the only economist to have recognised the role of social structures: Veblen and Keynes famously recognised the role of institutions and conventions respectively. Furthermore, it is relatively easy, given what Hayek wrote in his early years, to assume that he simply sees prices as sufficient sources of information. But what Hayek grasps, and is one of his greatest insights, is that social structures, are also sources of information and are also necessary for socioeconomic order. A few commentators have spotted this in Hayek’s work:

The price mechanism is not, however, the only knowledge–dispersion system in a market economy…the rules of conduct and the social institutions which have evolved through centuries…themselves constitute a knowledge disseminating system. Through them, the knowledge of the legal, political and moral framework of any social activity is conveyed to all market participants (Ioannides 1992: 38)

[I]t is worth noting that there are good reasons for attending to the role played by institutions, as well as that of relative prices, in the generation of plan coordination (Lewis, 2005:??)

Whilst rules can reduce uncertainty, they are only guides to action. Because the ability of these rules to handle knowledge is far from perfect, then co-ordination of plans and actions is far from perfect, efficient, optimal or some such, and never generates an equilibrium: in fact, the very concept of equilibrium is quite literally inconceivable in a Hayekian analysis. At every point in time, some agents are in a state of disorder. Because they are affected by other people’s new, or changed plans and actions, and because other parts of the system evolve and change, their initial plans often fail to result in the expected outcome. They learn from their mistakes, re-think their plans and initiate courses of action once again. Some of these revised plans will eventually yield the anticipated consequences, and others will not: there is no guarantee of success. In fact, to the extent that many plans do result in anticipated outcomes, the socioeconomic system is orderly: order comes from disorder via a continual stream of overlapping disappointments.

To say, then, Hayek subscribes to a transformational account of socioeconomic order means that the inherited rules, traditions and customs, the social structures, that constitute markets, are the ever-present condition, and the continually reproduced and/or transformed outcome, of human agency. Agents, acting purposefully or consciously, unconsciously draw upon, and thereby reproduce, modify and/or transform the structures that constitute markets and in this way, markets continue to endure, although perhaps in modified or transformed forms. Some agents may well deviate from the rules, and engage in new forms of conduct which others might subsequently follow, reproduce, or once again modify and/or transform. This transformational
account grasps the never ending process of continuity and change, whilst resisting the temptation to either
collapse into hand-wringing, or to fall back on imaginary functional relations and notions of equilibrium. This,
according to Hayek, is how markets, real markets, work. And I see no reason why labour markets should
differ from this general analysis.

6. Augmenting the socioeconomic account with Austrian insights

Generations of economists have been misled by an unholy alliance of mainstream theory and deductive
method. The deductive method has generated a particular style of thinking and shaped the mainstream’s
basic principle that has determined the field of study, shaped the way analysis is carried out, and grounded
policy prescriptions. So dominant has this unholy alliance been, that it has even tainted the analysis of its
critics, resulting in some Austrians (and some socioeconomists) ‘back-sliding’ into deductivism and into
importing aspects of the MLM account by default. But not any longer. If Austrians accept the critical realist
critique deployed here, and think labour markets are open systems that should be analysed as such, then
they should reject mainstream’s deductivism, along with its basic principle. Without deductivism, constant
conjunctions of events and closed systems, functional relations lose their rationale and labour markets
simply cannot be conceived of as sites where the ‘economic’ forces of wages, supply and demand for labour
are functionally related.

This does not, of course, mean that wage rates exert no influence upon quantities of labour demanded and
supplied or vice versa. It does mean that the presence of social structures makes such influence impossible
to express solely in terms of, functional relations, and impossible to predict. It means, for example, that an
increase in the wage rate sets in motion a chain of tendential reactions between sets of agents acting within
a complex web of social structures. At the end of this chain, the quantity of labour demanded may increase,
(significantly or insignificantly); may decrease (significantly or insignificantly); or may even remain constant.
Predicting the outcome a priori is impossible.15 Neither does it mean there are no such things as labour
markets. It does mean that labour markets are far more than sites where the ‘economic’ forces of wages, supply and demand for labour are functionally related in the absence of social structures - as if there existed
little supply and demand systems, expressed via little supply and demand diagrams!

Abandoning deductivism, constant conjunctions of events, closed systems and functional relations is not
something to mourn: indeed, it is liberating because it encourages us to steer a completely new course. And
the new course I suggest, lies in the direction of taking social structures far more seriously than hitherto, and
radically extending their scope. This means breaking with the dominant ‘embedding’ metaphor, and the
dualistic idea of two separate phenomena: labour markets and social structures. Search as we might, we
will be unable to find these things called ‘labour markets’ as sites where the ‘economic’ forces of wages, supply and demand for labour are functionally related and will, therefore, be unable to find how exactly they are embedded in social structures. Labour markets are not embedded in social structures because labour markets just are, or are exhausted by, the social structures that constitute them, along with the human agents that engage with them.¹⁶

Whilst this is an extremely contentious and radical claim, it must be said that a few socioeconomists, and at least two Austrians, have come very close to saying the same thing. According to Rubery & Grimshaw:

Institutions and social forces are taken to be central determinants of the structure and organisation of employment. There is no division between the economic and the institutional as ‘markets’ are formed and shaped through institutions (Rubery 1992; 246-7).

[Many socioeconomists] would argue that markets cannot be regarded as working in opposition to institutions. Instead, markets are themselves institutions…It is, for this group of theorists impossible to consider the labour market and the price of labour as determined by some abstract universal forces of supply and demand (Rubery & Grimshaw 2003: 37; see also Grimshaw & Rubery 2004).

Now consider two Austrians: Boettke & Storr. In their analysis of contemporary economic sociology, and especially the work of Granovetter (1992), Boettke & Storr (2002) refer to what they call ‘single embeddedness.’ By this they mean Granovetter’s idea that the economy is embedded within the social and the political. They explicate this with a diagram consisting of concentric rings, with the economic at the centre, the political in middle ring, and social on the outside. The problem, as they see it, is that this conception rigidly separates these realms and prevents the social, political, and the economic from mutually determining one another. Their solution is to conceive of the social, the political and the economics as overlapping rings, as in a Venn diagram. They refer to this as ‘multiple levels of embeddedness’ (Boettke & Storr 2002: 166).

Discussing the economy becomes nearly impossible without discussing social mores and political and legal institutions. Similarly, discussing the social becomes nearly impossible without discussing the economy and the polity and discussing the polity is nearly impossible without discussing the other two (ibid: 170)

Now, transposing this to an analysis of labour markets, and into my analytical framework, gives us the following.

• **Single embedding** is consistent the dualistic idea of two separate phenomena – labour markets and social structures. Indeed this is precisely Granovetter’s position which myself, and Boettke and Storr conceive as inadequate.
- **Multiple embedding**, despite the quasi-dualist terminology (which shows just how hard it is to wrestle free of discursive constraints) can be interpreted as actually breaking with the dualism. Indeed, a recognition of the complete inter-penetration of the social (which for ease I take here as subsuming the political) and the economy, or in this context, of social structures and labour markets, is perfectly consistent with my idea that labour markets just are, or are exhausted by, the social structures that constitute them.

If I have interpreted Boettke & Storr correctly, their Austrian insights, when used in collaboration with critical realist methodology, can play a significant part in augmenting the socioeconomic account, generating a totally new transformational, socioeconomic account of labour markets. The foundations are now in place to begin the task of elaborating precisely upon those social structures that, along with human actions, constitute labour markets.

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1 Critical realist ideas in economics can be found in Downward (2003); Lawson (1995 & 2003); Lewis (2004a) and Fleetwood (1999).
2 I prefer the term ‘account’ to ‘model’ or ‘theory’ because the latter come with so much unwanted baggage. On my understanding an ‘account’ is a coherent and consistent set of statements designed to systematically explain some aspect of the phenomena under investigation.
3 Gerhart and Rynes (2003: 15) clearly have something like this ‘systematicity’ in mind when referring to the ‘highly interconnected logic of the neoclassical model’.
4 The fact that this model can be made more sophisticated does not actually mean the basic principle is, or can be, abandoned. I have never come across a mainstream economist (even one ready to concede that a socioeconomic approach has some validity) who is ready to abandon the idea that wages, supply and demand for labour are functionally related.
5 Saint-Paul (2000) is a good example of this. Misleadingly entitled *The Political Economy of Labour Market Institutions*, it contains virtually no insights into the nature of institutions or social structures: in fact they are not even defined.
6 Whilst Gerhart and Rynes (2003: 40-44) recognise there is a gap between mainstream theory and reality, in the final analysis they cite both Samuelson and Coase to make the point that mainstream theory may not be perfect, but it is probably the best available.
7 Note well that (Old) Institutionalists have little or nothing in common with New Institutionalists or Neo-institutionalists who, essentially, attempt to ‘modify or broaden the mainstream toolkit’ (Rogers 1994: 6).
8 The precise relationship between institutions and social structures has, to my knowledge, never been fully elaborated. I will stick with the term ‘social structures’ (with apologies to Institutionalist fellow travellers) as a generic term to cover both phenomena because (a) institutions are generally understood to be special kinds of social structures; and (b) the main arguments in this paper are damaged by it (c.f. Auer 2001; Hodgson 1988; 1999: 537; 2001: 295; Rogers 1994).
9 In a review of economic sociology, Ingham (1996) comes very close in a couple of places to actually stating this sentiment.
10 If another socioeconomic example is needed, then consider the following: ‘Whereas in standard theory it is assumed that in markets the exchange between supply and demand occurs in abstraction of any power relation or regulation, the term ‘institutions’ implies a socioeconomic regulation of the unbridled working of the markets’ Auer (2001: 3).
11 A deterministically closed system can be expressed probabilistically and can, thereby, be transposed to a stochastically closed system. Here y and x₁,x₂,…,xₙ are regularly conjoined under some well behaved probabilistic function. In effect, the claim ‘whenever event x then event y’ is transposed into the claim ‘whenever events x₁, x₂,…,xₙ on average, then event y on average’, or ‘whenever the average value of events measured by variables x₁, x₂,…,xₙ are what they are, then the average value of event y measured by variable y is what it is’. Stochastically closed systems, are still closed systems.
Mainstream theorists do, of course, recognise that substitution between labour and capital is not ubiquitous and attempt to deal with it through non-convex isoquants. ‘L’ shaped isoquants associate one production technique with one capital-labour combination and allow no substitution. Isoquants with n ‘flat’ sections imply n-1 production techniques and allow limited substitution. But, where tangency between the isocost curve and the isoquants is at a corner, factor prices could change without ‘causing’ substitution. Where tangency occurs along the face of one of the ‘flat’ sections of the isoquant, then the choice of technique becomes indeterminate.

Incidentally, this argument works despite the fact that in many cases workers can be substituted for machinery because the MLM assumes that this substitution is always possible. It is forced to treat non-substitutability as a special case.

See Fleetwood (1996) footnote 1 for a comment on the way mainstream economists try to deal with processes.

In any case, the account most socio-economists seek is, almost certainly, not one preoccupied solely with deducing/predicting wage rates and quantities of labour, perhaps in the presence of ‘imperfections’ like social structures. Wages and employment levels are important, but they should not exhaust the scope of a socioeconomic account.

I wish to thank Nick Wilson, for constantly reminding me not to lose sight of the role of agent when attempting to emphasise the role of social structures. He also expresses a similar anti-dualist position in Wilson (2004).
References


