

**NEOCLASSICAL THEORY AND SUBJECTIVISM:
EPISTEMOLOGICAL PERSPECTIVES ON DECISION-MAKING
IN ECONOMICS AND LOCATION THEORY**

by

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ABSTRACT

This thesis has a dual focus. It criticises the theory of decision-making inherent in orthodox neoclassical economics, and defines and develops a subjectivist approach to decision-making. Problems of industrial location are used to exemplify the shortcomings of neoclassical economics. A subjectivist approach to industrial location decisions overturns the traditional explanation of a firm's location by showing that economic considerations may be relatively unimportant when people formulate investment plans.

The analysis contrasts the methodologies of neoclassical economics and subjectivism, by identifying and examining the distinct epistemologies associated with each of the two approaches to economics. In examining the epistemologies and their implications for the formulation of economic theory, the thesis draws on the literature of philosophy, sociology, psychology, geography and economics.

The initial premise is that economics, as a social science, involves a double hermeneutic. Formulating economic theory is interpretation, and the economist has to understand how decision-makers themselves understand their 'worlds'. A subjectivist theory reflects this double hermeneutic. Based on *Verstehen*, or interpretative understanding, this subjectivism, identified as the epistemology of the first-person perspective, is an appropriate means of exploring the intersubjective nature of the individuals' social existence and for explaining how and why people make decisions.

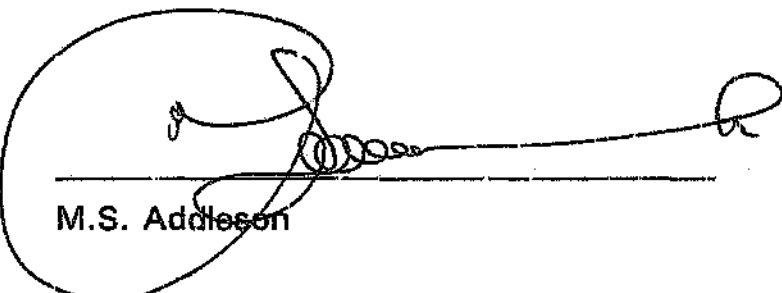
The epistemology of neoclassical economics is that of a positivist methodology, which is termed a third-person perspective. This epistemology is common to all equilibrium theories that conceive of problems in the context of complete systems, and it overlooks the interpretative nature of human activity. The epistemology of the third-person perspective cannot explain how an individual 'sees' the life world and thus orthodox economics is unable to explain decision-making.

At a time when there is considerable dissatisfaction with neoclassical theory, the distinction between first- and third-person perspectives resolves some long-standing problems in economics. It shows that some neoclassical theorists are concerned with hermeneutical questions that cannot be answered with a third-person epistemology, and also that because Austrian economics shares this epistemology, the subjectivism of Austrian theory is not suited to developing a theory of decision-making. Instead, the sorts of categories that an adequate subjectivist theory would involve are derived for the example of industrial location decision-making.

DECLARATION

I declare that this thesis is my own, unaided work. It is being submitted for the degree of Doctor of Philosophy in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other University.

Where the thesis incorporates aspects of my own previously published research, this is explicitly acknowledged in the text.



A handwritten signature in dark ink, consisting of a large, stylized 'A' followed by a long horizontal stroke and a small loop at the end. The signature is written over a horizontal line.

M.S. Addleson

6th day of November, 1992

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I owe much to a long friendship with Professor Ludwig Lachmann. His magnanimous spirit and inspirational scholarship were a major influence on my work.

Once men have been made to realise the crippling mutilations imposed by an objectivist framework - once the veil of ambiguities covering up these mutilations has been definitely dissolved - many fresh minds will turn to the task of reinterpreting the world....'

Michael Polanyi, *Personal Knowledge: Towards a Post-Critical Philosophy*, p.381

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CHAPTER 1

MAIN THEMES

Scientists do not, in general, resort to philosophical work for amusement, nor yet for financial gain. They do so, generally, because the scientific problems they face demand it.

Ted Benton, *Philosophical Foundations of the Three Sociologies*, p.16

Methodology is not the preceptor or the tutor of the scientist. It is always the pupil.... In this role, the methodologist has to ask intelligent questions about the technique of his teacher. And if those questions help others to think over what they really do, and perhaps to eliminate certain intrinsic difficulties hidden in the foundation of the scientific edifice where the scientists never set foot, methodology has performed its task.

Alfred Schütz, 'The Problem of Rationality in the Social World', p.149

I. THE PROPOSITIONS

The language of neoclassical theory is the *lingua franca* of economists. Judged by its almost universal use as the set of conceptual tools for teaching economics, and also by its application to a host of practical problems from education to the location of industry, neoclassical theory is a successful 'paradigm'.¹ Yet, over the past two decades and more, orthodox or 'mainstream' theory has been the subject of sustained and unprecedented critique in what has become known as the 'crisis in economic theory' (see Bell and Kristol (1980)).

Coincidentally there has been a revolution in the philosophy of science, where the precepts of science have come to be questioned and criticised along with the received view of how scientists set about the task of 'doing science'. It is clear that the crisis in economic theory is intimately bound up with a broader

¹ The term, used loosely for a tradition of research involving the application of a common methodology, is borrowed from Kuhn (1962, see pp.10-11), while observing his caution about the existence of paradigms in the social sciences.

philosophical 'conversation' that is taking place.² In this atmosphere the writings of economists reflect an increasing concern with methodological issues, and the criticisms of neoclassical economics point to the methodology of this body of theory. Questions are raised about fundamental philosophical matters, embracing both epistemology and the ontological status of economic phenomena.

This thesis questions whether the neoclassical scheme is fit to serve as a framework for explaining individuals' decisions. The challenge is based on the assertion that the epistemology of neoclassical theory makes it unsuitable for this purpose and, in order to substantiate the argument, it is necessary to examine the epistemology and ontology. As a critique of mainstream methodology, the thesis finds precedence in a long tradition of critical writings. The nature of the critique, however, is modern and takes its cue from current philosophical debates.

In the thesis the aim is to defend two propositions.

- (1) As an application of neoclassical equilibrium theory the economic theory of location does not explain location decisions.
- (2) A subjectivist approach to economics based on hermeneutics, or interpretative understanding, provides an appropriate basis for explaining location and other decisions.

By suggesting that the emphasis of the enquiry falls upon the issue of location, these propositions may be misleading. The matters of concern are methodological ones and relate to the nature of an equilibrium theory, to where its limitations lie, and to how these can be overcome. Issues about the location of manufacturing firms, though important to the thesis, are used to exemplify the limitations of neoclassical theory.

² The term 'conversation' is used by Bernstein (1983) and is preferable to 'debate' for at least two reasons, both of which are conveyed in Bernstein's work. The former term implies that there are a number of different parties, or 'sides', involved in the dialogue. In addition it suggests that the parties are not entirely at cross purposes, but are willing to listen to the arguments put forward by the others.

In their bald form, the propositions also do not intimate the controversial nature of the issues involved in the inquiry. For example, they imply that there is general agreement that a purpose of economic theory is to explain what firms (or at least the people who represent these businesses) do, and that the explanation should be based on an understanding of individuals' decisions.

Although some may find both these assumptions congenial, the issues themselves have been, and remain, the subject of considerable debate in economics. In order to get to the point at which a subjectivist approach can be considered and evaluated (the second proposition), it is necessary to establish that these are indeed legitimate tasks of economic theory. In fact, in developing the arguments that underlie the propositions it is necessary to link together a number of conceptual issues.

Because it consists of interwoven strands, a useful way of clarifying the structure, and presenting an overview of the arguments, is to discuss the central *themes* of the analysis and identify the main issues involved. The four themes deal with issues that economists, and sometimes other social scientists, view as contentious. At this early stage the issues will be boldly asserted. Subsequently, contentious points are justified. Throughout, methodological considerations are emphasised.

II. THEME ONE: THE DOUBLE HERMENEUTIC OF SOCIAL SCIENCE

The first theme, and the main concern of the thesis, involves the relationship between the theorist and his subject-matter. The question of how the economist 'visualises' the world has both epistemological and ontological implications, and it also implies that there are different ways of doing so. If this is so, there is a need to establish how the neoclassical theorist 'sees' things, to determine what shapes his perspective, what the implications are for economic theory, and whether this is a useful way of looking at the world. These are some of the main considerations of Chapters 2 and 3.

The relationship between theorist and subject-matter is a long-standing source of controversy within the scientific community, and is a recurrent and central topic in the philosophy of science. Essentially an epistemological problem, it concerns the scientist's knowledge of his subject-matter: what he knows and how he comes to have this knowledge. The problem receives attention, for example, in the context of the debate about the objectivity, or *Wertfreiheit*, of science, an issue that is examined in Chapters 4 and 5.

The problem also has an ontological dimension that is apparent in asking what are the 'facts' of any science? If there are objective facts, where do the facts, and the world itself, exist? Epistemological and ontological issues are intimately related, and one consequence of developments in the philosophy of science is that the received view of knowledge, and of the 'facts' of science, has changed considerably.

Our chief interest in the relationship between the theorist and his subject-matter concerns the particular problems that arise within the social sciences in general, and in economics in particular. Hayek was probably the first economist to emphasise the epistemological problems concerned, in a justly celebrated article, '*Economics and Knowledge*' ([1937] (1948c)).³

In the opening paragraphs of his book on methodology, Boland (1982a, p.2) highlights similar considerations, indicating that the theorist cannot, or should not, avoid questions about both *what the decision-maker knows* and *how he uses this knowledge* (how he makes decisions).

³ It is important to realise that Hayek's interest lies in articulating the assumptions about knowledge (and foresight), which are implicit in (orthodox) economic theory, in order to make *equilibrium* theory more serviceable. His view is that this body of theory consists of tautologies. If 'the pure logic of choice' - i.e. neoclassical theory - is to serve to explain, or to convey an understanding of, what happens in reality, then economists must clarify how individuals acquire that knowledge which the theory merely takes as 'given'.

Any decision-maker must have some knowledge from which to determine, and by which to assess the options available. What do we presume about the individual decision-maker's knowledge? Or better still, what do we presume about the individual decision-maker's methodology that allows for rational choices? If... economics is supposed to explain, or even to describe, the process of making decisions, surely the methods utilized by the decision-maker must play a central role in the *process* and thereby in the outcome of the process.

The question of what the decision-maker knows or understands - how he interprets the world - is a hermeneutical one. One cannot ignore the epistemological and ontological foundations of any discipline and in this sense there are always hermeneutical questions about the actor's view of the world, questions such as: with what issues is he concerned; or, how he interprets the world that is his subject-matter.

Implicit in this quotation, however, is the idea that in the social sciences there is always a *double hermeneutic*. The idea of a double hermeneutic is attributable to Giddens (1977, p.12). The subject-matter of social science is people and their activities, so the methodologist has two 'levels' of understanding or interpretation to think about. One level pertains to the theorist's understanding - the nature of world that he identifies and describes in his theory. This level of the double hermeneutic is common to all inquiry. Then there is a level that is peculiar to social science. The focus here is on the individuals who inhabit the theory, whose social conduct is the object of analysis. What does the theorist permit them to know? What sort of world do they 'see'?

Recognition of the double hermeneutic raises many different questions. With regard to the theorist's 'world view', what does he know about the way in which individuals - as the object of analysis - construct, or constitute, their world? How does the theorist acquire this knowledge? Is the theorist's knowledge of the world in which he lives somehow different from his knowledge of the world of those individuals who populate his scheme as the objects of analysis? Does the theorist acquire knowledge (of his world) in a way which is different to the way in which he acquires knowledge of those individuals' world?

In addition to these epistemological questions, there are those of an ontological nature. Where does the theorist's world exist? Does it 'surround' him as something out there? Or is it, perhaps, something of his own making, that he 'creates' through his activities? And what of the world of the individuals who he is studying, where does this exist for the theorist? Is it a part of his world, or something separate?

On the other level, we might ask what the individual knows of the world and how he acquires that knowledge. What 'theory' of knowledge does the individual apply in dealing with the world? Is the knowledge of all individuals the same? Or, if in some sense they create or '*constitute*' their worlds, how do they do so?

There are also ontological questions about the 'world' of the individual (as opposed to the theorist). Where does that world exist? Is it a pre-given world out there which exists 'around' the individual, or which he confronts (an objectivist view), or, is it a world of his own making (a subjectivist or relativist view)?

For our purposes it is useful to divide all these questions into two categories. One contains questions about the theorist's (or scientist's) knowledge of his subject-matter, including those raised by the 'debate over methods' in the philosophy of science. For example, does the social scientist employ methods different from those of his counterpart in the natural sciences, and should he do so? The other category of questions is the main concern of the thesis. It overlaps with the previous category, and covers the problems raised by Hayek (1948c) and referred to by Boland (1982a, p.2, as quoted earlier). These are questions related to the premise that economic theory is about individual conduct and that the economist has to explain individual conduct. The main issue here is how does he do so?

The object now is to see how each of the categories signifies in terms of the development of the thesis. Starting with the theorist's knowledge of his subject-matter, how is this related to the double hermeneutic of social science and what are the implications for the arguments in the thesis?

A. Science and understanding

Until quite recently, epistemological problems pertaining to both categories of questions were not much of an issue in methodological discussion. Their topicality is a consequence of developments in analytical philosophy, on which the influence of Ludwig Wittgenstein is clearly discernable.⁴ These developments - including inquiry into the nature of knowledge and the basis of understanding - revived, as matters for debate, issues that seemed to have been settled during the time that the methodology of positivism and empiricism dominated the sciences. Bernstein (1976) refers to the 'image of science', meaning the view of whether a common, unified method of science should be applied, or whether dual methods are warranted for the social and natural sciences. In the light of recent philosophical discussion the image of science has been thrown into confusion.

For nearly a hundred years, some scholars have advocated separate methods for the social and natural sciences. The case for methodological dualism usually rests on methodological arguments associated with Max Weber's *Verstehende Soziologie*. More recently, Peter Winch (1958) revived that case on the grounds that explanation in the social sciences must take cognisance of individuals' ability to *understand* social action and their need to apply this subjective understanding in order to interpret the motives and meanings in activities of others. By contrast, there is no 'meaning' in, or 'behind', the subject matter of the natural sciences, which is accessible to the scientist only through observation.

Developments in the philosophy of science, however, have changed the basis on which a line between social and natural science is drawn. Today there is wider acceptance, though it is by no means universal, of science as a hermeneutical

⁴ A recent, admirable biography of Wittgenstein is that of Monk (1991), which explores the relationship between Wittgenstein's ideas and his life and which helps to explain some of the cornerstones of Wittgenstein's contribution to philosophy.

endeavour⁶. On this view, people bring their interests, biases, and ideologies to bear on their scholarly activities, with the corollary that natural-scientific discourse is anything but neutral. The subject-matter of science does not exist as 'brute facts'.

Individuals endow problems and issues with meaning, in the same way that the literary text is 'brought to life' by the interpretation of the reader when he 'interacts' with it. Without the reader's 'involvement' there would be only words on a page. The emotions, pace, and structure are *constituted* by the *prejudiced* reader who brings his own interests, emotions, and cultural heritage to bear. Different people constitute the text in different ways. So it is with the identification and exploration of natural-scientific problems. All sciences are interpretive.

Such a view has shifted the methodological debate from that of dualism *versus* monism to science as an epistemology *versus* science as hermeneutical discourse. Indeed, some philosophers see the contrast between the epistemological view and the hermeneutical view of science as establishing the foundations of the previous debate. The reasoning is that the origins of methodological dualism lie in the idea of science as epistemology: the notion that the task of science is to provide an objective language in terms of which all phenomena can be explained at all times. Methodological dualism may be supported on the grounds that, as there are two sets of phenomena in the world, the physical and the social, two methodologies

⁶ The term 'hermeneutics', originally associated with textual exegesis, refers to a philosophy which treats knowledge as understanding, while understanding is interpretation. Rorty (1980) represents hermeneutics as opposing the idea of an epistemology, and in the work of modern hermeneuticists, like Gadamer, interpretation is creative or constitutive; 'reality' is what the individual - as consciousness-in-time - *makes* it. From the standpoint of hermeneutics, the problems of science, like all problems, are subjective, constituted by the scientist and reflecting his interests, prejudices, and passions. The notion of 'modern hermeneutics' that is relevant to the thesis is examined in Chapter 4, in analysing subjectivism. It is argued that the hermeneutical turn belongs to the tradition of philosophy that has come down from Max Weber's interpretative sociology through phenomenology.

are needed to deal with them. People understand other people but not other objects, so the social sciences need to reflect this understanding.

The contention that science is hermeneutical establishes different grounds for separating the natural and social sciences and, unlike the older view, the basis for the division is not different types of knowledge. On a hermeneutical reading, scientific problems do not exist *in the world*, but are constituted by the scientist, using the language of his science as a framework, the basis of his interpretation. Any language (of interpretative understanding) is limited in its sphere of application. The object of science cannot be to provide a universal language, but to discover what languages people use, to understand how they use them, and to establish how useful a particular language is in the context of a particular set of scientific problems.

B. Understanding how the individual understands

These considerations identify the task of the scientist as that of understanding and interpretation, and they shift the focus of methodology from the measurement and description of what is observed in the world to the basis of understanding and to epistemological issues. And in the social sciences, we have seen, there is a double hermeneutic. Individuals' activities and the ramifications of these activities are what interest the social scientist. Individuals' activities reflect their understanding and, in order to explain their conduct, the social scientist has to *understand how individuals understand*.

These arguments take us to the second category of questions described above as being the main concern of the thesis: how do individuals understand their worlds; does a particular theory enable the social scientist to explain understanding; does it permit, or facilitate, insight into how people understand; and what sort of theory is required for this purpose?

Coddington (1972, pp.14-15) uses the metaphor of theory as a language in explaining why it is important to examine the nature of one's theory and to determine whether the theory is appropriate.

The language of economic theory, like any language provides a framework for thought: but at the same time it constrains thought to remain within that framework. It focuses our attention; determines the way we conceive of things; and even determines what *sort* of things can be said.... A language, or conceptual framework is, therefore, at one and the same time both an opportunity and a threat. Its positive side is that (one hopes) it facilitates thought within the language or framework. But its negative side arises from the fact that thought must be within the framework.

The thesis contends that the language of neoclassical theory is the wrong one for the purpose of explaining individuals' decisions. The double hermeneutic of the social sciences, while not establishing a case for a separate methodology of social science, will help us to identify what constitutes an appropriate language.

C. Tasks of economic theory

But, it may well be asked, *is* it the task of economic theory to explain individuals' decisions? In the thesis the methodology of neoclassical theory is sharply criticised, and the validity of our argument depends on being able to satisfy the reader that the problems are 'real' ones. Since the argument is that the methodology is inappropriate for the tasks that are required of it, we must ensure that we have identified the task of economic theory correctly. Coddington (1975b, p.540-541, *'emphasis added'*) explains why it is so important to do so.

Before one can effectively set about appraising a theory, it is necessary to be clear about what relationship theories have to their subject matter: what they are theories *about* or what they are theories *of*.... [T]his relationship is not, and cannot be, a straight-forward matter of "correspondence" between theory and subject matter....

[A]ll theories are "unrealistic". But the question can still be asked, whether the conceptual framework is adequate to sustain the intellectual tasks that we set ourselves. Accordingly we cannot provide a context-free appraisal of a theory, but only an appraisal in the light of what we are trying to do, *what question we are trying to answer*.

What questions is neoclassical theory trying to answer? Coddington himself states (see esp. pp.541-542), with reference to neoclassical general equilibrium theory that it is not always clear what neoclassical theorists seek to do with their theory (see also Hausman (1984b)).

Many theorists, starting with Walras ([1874-77] (1954)) and continuing down to Arrow and Hahn (1971) in the present day, probably do not see their task as that of explaining the nature and consequences of individuals' decisions. Alternatively, while some neoclassical theorists may subscribe to this goal, not all do.

The task of explaining individuals' decisions is one which mainstream economists themselves have defined by the questions they seek to answer. For there is a group that includes some of the foremost neoclassical theorists - referred to in Chapter 2 as 'reformers' - who pose hermeneutical questions concerning the nature of decision-making. Their theory, however, does not enable them to answer these questions.

Many neoclassical theorists, including those who formulated location theory, apply the theory in order to explain how particular phenomena result from agents' decisions to maximise or minimise. Their object is to examine the consequences of rational decision-making, on the understanding that the theory is a means for drawing inferences about the locations of firms and about spatial patterns of industry that are observed 'in reality'. The final chapters are devoted to explaining why location theory is not suitable for this purpose.

The point is that some - and probably the large majority of neoclassical economists - do conceive of the task of economic theory in the way in which it has been defined here. Since the thrust of the second theme of the thesis is only that neoclassical theory does not serve this *particular purpose*, if theorists regard the task of economics differently, the methodology of neoclassical theory may indeed be appropriate for their requirements.

III. THEME TWO: THE EPISTEMOLOGY OF NEOCLASSICAL ECONOMICS

The second theme of the thesis addresses the following question: if neoclassical economics does not serve to explain individuals' decisions, why does it not do so? Where do the problems lie, and what is the nature of the problems? The answer, in short, is that the epistemology of mainstream theory is the obstacle, and the epistemology is consistent with the requirements of an equilibrium scheme. So the root of the problem is the desire to construct a determinate scheme to 'explain' market activity.

In order to understand the limitations of the theory, it is necessary to define the 'world view' of the neoclassical theorist, to examine the epistemology, and to explain how the epistemology is linked to the theorist's conception of the scheme of things.

A familiar explanation of the relationship between theorist and subject-matter in economics is that orthodox economic theory explains phenomena such as prices, profits (and even the location of industry), from an *external, or detached observer's* point of view, as opposed to the point of view of a participant in the decision-making process. The theorist's world view is supposedly that of an observer sometimes referred to as an 'omniscient observer', taking cognisance of how people behave, and constructing his theory from the observations.

Neoclassical theory fails as framework for explaining decision-making because the theorist's world view, which we refer to as a *third-person perspective*, is unrelated to the way in which an individual understands. What the theorist and the 'agents' of neoclassical theory know is not what an observer, in the ordinary meaning of that word, knows.

A. The third-person perspective

The postulate that individuals' interactions could, or do, terminate in equilibrium states is an assertion that the interactions are determinate. In making this assertion the theorist adopts a third-person perspective. He conceives of the world in a particular way and adopts a particular epistemology; but the epistemology has no bearing on an individual's knowledge or understanding and therefore cannot serve as the foundation of a theory of decision-making. What is the epistemology and ontology of the third-person perspective?

The notion of equilibrium demands, and the third-person perspective characterises, a world that is absolutely bounded and truly, comprehensively complete. In terms of determining whether the market or the economy will settle at an equilibrium, nothing is unknowable.⁶ Every single bit of the world that is relevant to the equilibrium problem can be defined, enumerated, measured, and compared with every other bit.

The world consists entirely of *things*, like 'resources', 'tastes', and 'knowledge'⁷

⁶ Paretian welfare economics provides an admirable illustration of the complete world of the third-person perspective. The idea of changes which could make some people better off and none worse off, starts from the premise that, somehow, the options that could be pursued - in experimenting with different states of welfare - exist in some ready-made 'concrete' or real form, out there. The idea of a welfare optimum implies that all possible states of welfare can be known or discovered, and for this to be possible the world must be truly complete. The main problem with Paretian welfare theory does not lie in comparing individuals' levels of welfare or in the difficulties of aggregation (see Cowen (1991)). It is the underlying epistemology that makes this world incomprehensible from a policy-maker's perspective. What does it mean to say that someone is going to be 'worse off'? and *when* will they be worse off?; today or next year? What is a 'course of action'? What are the 'consequences for other people'?

⁷ Throughout the thesis terms employed in neoclassical theory and defined by that epistemology, but unrelated to the same word used in everyday speech, are placed in quotation marks in order to underscore that the meaning is different. Terms like 'choice' and 'decisions' acquire their meanings in the context in which they are used - the social interaction of individuals in the life world. It is unfortunate that economists do not have a separate language to describe the things that agents do. The absence of such a language is a source of considerable confusion. For example, the connotations of 'rivalry' and a 'the desire to attain a goal ahead of someone else', which are integral to the notion
(continued...)

(including technical knowledge), which all have a real, corporeal existence. 'Knowledge' is also something in the world, which has the same qualities as all the other things. Knowledge consists of 'items' or 'pieces' (one imagines like a child's blocks) that can be 'acquired' or 'grasped'. Every piece of knowledge refers to, and has a counterpart in, a piece of the real world out there.

Nothing exists beyond what is 'given' as making up the world. Even if some of what really exists out there is hidden from view in this 'time period', the agent or the theorist knows that it *does, or will, exist* out there to be uncovered, or 'learned', in some 'later time period' (see Hahn (1973a)). This is what determinism implies: the agent or the theorist *knows exactly what, and how much, it is possible to know*.

Even if 'knowledge' has to be 'acquired' in 'the future', a part of the scheme - one of the things that is known - is how 'knowledge' of one 'period' is transformed into knowledge of subsequent 'periods'. Everything that is needed in order to 'explain' how the system 'works' is within one's grasp; and it is possible to conceive of the entire scheme of things as being simultaneously and instantaneously present to the 'mind' of the theorist or agent.

The ontology of the third-person perspective is such that the things that make up the world exist out there, beyond the theorist, or beyond the agent. The world is not the 'my world' of the *participant* who is *part of* events and who is *involved in* social relationships. The agent has no experience of the world, and no insight or understanding. One could say that things have no *meaning*, in that they do not have to be interpreted or understood, but merely exist out there; or one could say that they mean the same to everyone.

⁷{...continued}

of competition, are completely absent from 'perfect competition'. Yet the latter is used - inappropriately - as some sort of benchmark in assessing the former. As a consequence economic theory often does not make sense to businessmen (see Boettinger (1967)), and policies on 'competition' do not promote competition.

Both these statements reinforce the idea that 'knowledge' exists without a knower.⁹ The epistemology of the third-person perspective, in affording the grasp of a scheme of things that is complete, transcends (or passes beyond) the individual's understanding and comprehension. The world is not a world that *any* individual 'sees' and cannot be reconciled with anyone's *point of view*. It is, therefore, not a point of view at all, and that is what the phrase 'third-person' perspective is meant to convey. To speak of 'knowledge' or 'understanding' or 'a point of view' is to refer to someone's (the knower's) view of things - a first-person perspective.

In attempting to articulate a problematic notion, Van Peursen (1977, p.188) has the following to say about 'perspective', as an essential aspect of human cognition.

Human life, its acts, its thoughts unfold in perspectives. To come 'out of perspective' is incompatible with being human....

Perspective expresses the idea that a thing or scene is not looked at from all sides at once. Things show a certain part of themselves, depending on the side from which we approach them. Ideas are likewise grasped in perspectives.

We emphasise later that the hope of a complete scheme of things would eliminate the notion of time experienced as *duration* (Bergson's notion of *durée*), where other moments will follow this, the present moment. Van Peursen comments that eliminating time 'amounts to extracting the world from its horizon. That would make the world unreal; it would no longer be a world for man, or a world related to human consciousness' (p.194). In a view outside of time,

Man would find himself confronted by the most complete and most opaque chaos. It would not be a matter of views, because a view of totality presupposes intentionality - a direction, an orientation, and therefore a point of view in the space-time of a horizon.

Characteristics of the third-person perspective are identified by Spanos (quoted in Leitch (1988, p.199)). Spanos identifies a 'dominant "ontotheological tradition"', which 'transformed, in two parallel ways, the temporality of being-in-the-world into

⁹ I owe this expression to Dr. Karl Mittermaier.

an overall insidious "world picture". Spanos shows how the essential 'temporality of being-in-the-world' is transformed through a process of 'objectification' which, in the thesis, is associated with the methodology of the dominant 'modernist' conception of science that emerged from positivism and empiricism. The transformation produced

(1) a flattened out, static, and homogeneous Euclidean space - a totalized and ontologically depthless system of referents (a map) - if the objectifying consciousness is positivistic or realistic; or (2) a self-bounded or sealed off and inclusive image (icon or myth), if the objectifying consciousness is idealistic or symbolic. In either case, this transformation allows *Dasein* [human being] to see existence from the beginning, i.e., all at once. In so doing it distances him, i.e., it disengages his Care, makes him an objective, or disinterested or careless, *observer* of the ultimately familiar or autonomous picture in which temporality - its threat and its possibilities - has been annulled.

The ideas in this quotation are tailor-made for the thesis. With reference to Spanos's first form of transformation, we explain in Chapter 3 that the map image at the heart of location theory - a series of points in Euclidean space - encapsulates the third-person perspective. The second form of transformation - a self-bounded inclusive image - identifies the equilibrium system of neoclassical theory, in relation to which the theorist has a grasp of the entire scheme of things.

B. The agent's world view

No one has justified giving '*homo oeconomicus*', or the 'rational' agent of economic theory, a world view that differs from that of the theorist. It is difficult to see how, or why, the theorist, and the agents whose activities he is studying, should be subject to different epistemologies. Ironically Talcott Parsons argues that the actors of social theory should be represented in exactly the same way as the theorist, that there should be consistency across both parts of the double hermeneutic - but with the actor being a reflection of the scientist.

Since science is the rational achievement par excellence, the mode of approach here outlined is in terms of the analogy between the scientific investigator and the actor in ordinary practical activities. The starting point is that of conceiving the actor as coming to know the facts of the situation in which he acts and thus the conditions necessary and means available for the realization of his ends.... [T]here is, where the standard is applicable at all, little difficulty in conceiving the actor as thus analogous to the scientist whose knowledge is the principle determinant of his action so far as his actual course conforms to with the expectations of an observer who has, as Pareto says, 'a more extended knowledge of the circumstances'.⁹

These views are quoted by Schütz (1943, pp.130-131) who attacks the methodology advocated in the quotation, arguing that the standpoint of the scientific observer, as reflected in Parsons' archetypal scientist, is not the way in which individuals 'see' the world. In Schütz's terminology, the 'level' of the research is derived from a different meaning of the term 'rationality' to that associated with the individual making decisions in the 'life world'. The theorist cannot understand and explain individuals' conduct from this 'level'. According to Schütz (1943, p.134, emphasis added),

[i]n our daily life it is only very rarely that we act in a rational way if we understand this term in the meaning envisaged in Professor Parsons' previously quoted statement. We do not even interpret the social world surrounding us in a rational way, except under special circumstances which compel us to leave our basic attitude of just living our lives.

⁹ Parsons's views are echoed in the contributions of economists who have tackled the issue of the relationship between theorist and his subject-matter. A list of economists would include Robert Clower, Alan Coddington, F.A. Hayek, F.H. Knight, and G.B. Richardson. These writers hold that the theorist, as observer, has a more *extended* knowledge than that of the actor, but the nature of the knowledge - what it 'consists of' - is the same as that of the individual. Coddington (1972) uses the terms 'first-person' and 'third-person' viewpoints, for the perspectives of the actor and observer, respectively. Though his terms have been appropriated in the thesis, the meaning ascribed to them is completely different. The third-person perspective is not the viewpoint of an observer in the everyday meaning of the word. An observer, as someone who 'sees and notices', or 'carefully watches', or 'pays attention to', particular phenomena always 'sees the world' from a particular perspective, as does any person going about his daily life. There is no difference between the epistemologies of the actor and the observer. The third-person perspective (which is a creation of positive science), however, does embody an entirely different epistemology. It is a view of the world as complete - without perspective. In this sense it is not a viewpoint at all.

This criticism can also be stated along the lines that the epistemology of the scientific observer is not congruent with the way in which the individual ordinarily understands. Schutz is saying that it is absurd to imagine the agent of economic theory as being able to grasp the complete scheme of things out there; and only because his epistemology is mistakenly conceived as the third-person perspective is he supposed to be conceivable as a rational maximiser.

The question might then be asked, what is the correct way of representing the social world of the individual? The answer takes us back to the distinction drawn earlier between science as hermeneutical activity and science as epistemology.

The theorist's, and equally the agent's, world view is a product of positivist methodology associated with the Cartesian notion of science as epistemology. The question, how should the individual's world be represented, is one that stems from a Cartesian desire to show the world as it really is. In adopting the idea of science as hermeneutics, the question becomes how does the individual understand; how does he constitute his 'world'. The object of the *first-person perspective* is to understand how the individual, whether theorist or agent, understands.

C. The first-person perspective

From the time Max Weber brought the notion of *Verstehen* - interpretative, or subjective, understanding - to social theory, the subjectivist approach which he developed has undergone a process of continuous evolution, as explained in Chapter 4. The different 'stages' in the evolutionary process all recognise that understanding what is happening involves interpretation, or attaching meaning to events, though initially subjectivism associated *Verstehen* only with understanding the activities of other individuals.

Contrasted with the third-person perspective of the agent confronting a world that consists of things out there, the more recent subjectivist positions of phenomenology and modern hermeneutics depict understanding as ubiquitous

(because consciousness is interpretative understanding) and creative (the individual contributes to his world rather than passively experiencing it). The individual's 'world' is literally his thoughts, but his thoughts always concern other people who share his social world, so understanding is always intersubjective. As opposed to the friendless and solitary agent of orthodox theory, the first-person perspective takes cognisance of each individual's associations with, and involvement in, the activities of other people. The 'life-world', as the individual knows it, is a social world.

Understanding is time-bound, related always to the present moment, and to the individual's thoughts or perspective at a given moment. Time, here, is not the mathematician's notion of extension that is associated with orthodox theory where events in one period are mechanically transformed into those of another period by some predetermined formula. Rather, 'time' means the time dimension of consciousness. In the *durée* understanding is like a continuous dialogue or conversation in which, with experience, fresh insights are gained and one's standpoint changes.

In the past the individual had certain ideas about things that might happen. At the time 'the future' was conjectural. Now, some time having elapsed, he can assess and interpret the situation. He finds out - to his surprise or disappointment - what other people are doing. He is caught up in a hermeneutic circle of discovery, of finding out, forming new opinions, and consolidating his beliefs. His perspective changes, and perhaps he modifies his views.

Knowledge is not grounded in facts out there. What a person knows depends on *his* understanding (literally, what he knows *is* his understanding), and this is always prejudiced in the sense that what one understands reflects one's interest of the moment, and is shaped by relationships with other people, and one's 'history'.

Furthermore, experience is not about revealing more of the world out there, it is just about finding out what has happened, about discovering whether things have

gone according to plan, and about drawing inferences and forming judgements in the light of this. The individual does not accumulate knowledge; that is a characteristic of the epistemology of the third-person perspective, where knowledge is something tangible that exists in the world. Rather, in the hermeneutic circle, in the journey from each here-and-now to the next, the 'being-in-time' understands differently.

The theorist adopting a first-person perspective is interested in how, and why, the individual does certain things. His object is to provide insight into the activities of people by exploring the individual's viewpoint. What factors bear upon the decisions that he makes, and how he takes account of them? Who are the people whose activities have a bearing on his own, and how does he have to take them into account? What is the nature of the relationships between particular people, what factors influence their relationships, and what are the consequences in terms of the things that they do? Answering such questions contributes to understanding the social world.

The idea that there are specific *outcomes* produced by the interaction of different individuals is not reconcilable with the epistemology of a first-person perspective. The question of isolable pieces of the scheme and how they fit together, belongs to a determinate theory which postulates a complete world view. The concepts of optimising and of equilibrium are beyond the purview of the first-person perspective; they belong to a different epistemology.

D. The two perspectives are incommensurable

Central to the thesis, and also to understanding the limitations of neoclassical theory, is the assertion that the epistemologies of the third-person perspective and

the first-person perspective are incongruent, or *incommensurable*.¹⁰ There is no means of translating the concepts which are part of a theoretical framework based on the epistemology of a third-person perspective into concepts which belong to a first-person perspective. The concepts simply belong to two different world views, or two different 'languages'.

Theories constructed from first-person and third-person perspectives appear as disparate and non-overlapping thought-schemes. The epistemology of the third-person perspective precludes understanding, and thus cannot accommodate those notions which acquire their intersubjective meaning in the context of social interaction in the hermeneutic circle of social discourse.

E. On neoclassical economics

In answer to the central question, 'what is it that makes neoclassical theory unsatisfactory, the epistemology of the third-person perspective is found to be inimical to the task of explaining the nature and implications of individuals' decisions. Neoclassical theory is a paradigm, *i.e.* a set of theories with a shared metaphysic and similar assumptions, rather than a precisely delimited school of thought with a well-defined list of professing members. Before dealing with the remaining themes, it is important to identify the contributions that comprise the paradigm that involves applying the third-person perspective to problems of choice. The first major contribution concerns decision-making in relation to neoclassical theory.

¹⁰ Rorty (1980) defines 'commensurable' as 'able to be brought under a set of rules which will tell us how rational agreement can be reached on what would settle the issue on every point where statements seem to conflict' (p.316). Our assertion is that theories which embody a third-person and first-person perspective cannot be brought under a set of rules in order to compare them in terms of, say, their respective abilities to meet some criterion, such as explaining economic phenomena. Each theory has a different task, each operates according to different methodological rules. It is uncertain, at best, whether it is possible to construct a set of meta-rules which would make the theories commensurable.

Decisions or choices became elements of economic theory with the 'marginal' or 'subjectivist' revolution that heralded the arrival of neoclassical economics and signalled a fundamental shift in the interest of economists compared with their classical predecessors.¹¹ Both the terms 'marginal' and 'subjectivist' are apt to be misconstrued (see Blaug (1973, p.10))¹², and the term used by Hicks (1976a, see pp.212-214), 'catallactics'¹³, has the advantage of conveying something about the interests of the protagonists in that revolution.

Hicks juxtaposes catallactics - involving exchange, markets, value, and the formation of prices - with the concept 'plutology' - the study of the 'flow of wealth' (of nations) - which was the object of classical political economy. As the forefathers of the catallactic revolution, W.S. Jevons ([1871] (1957)), Carl Menger ([1871] (1950)), and Leon Walras ([1874-77] (1954)), independently all formulated contributions that revolve around the main catallactic themes.¹⁴ It is now well recognised (see Jaffé (1976)) that there are important methodological differences

¹¹ From the vantage point of modern methodological analysis, the Classical and neoclassical schemes have little in common except the notion of equilibrium, and even that term assumes completely different connotations in neoclassical theory (see Milgate (1979); Petri (1978)). Both are based on the idea of the economy as system and share a third-person epistemology, but apart from this, their lack of affinity casts doubt on whether the term 'neoclassical' was ever apposite.

¹² The papers in Black, *et al.* (1973) provide useful insights into the ideas of the protagonists in the 'marginal revolution' as well as offering an assessment of the revolution both in terms of its niche in the history of economic thought and its impact on economic theory.

¹³ Hicks did not coin the term, which both Schumpeter and Mises use to describe the revolution in economics in the eighteen-seventies.

¹⁴ There is considerable debate about both the methodologies employed by these economists and the nature of the differences in their methodologies, especially between the contributions of Walras and Menger, as founders of neoclassical economics and the Austrian School respectively. Something of the flavour of the debate is contained in, for example, Schumpeter (1967, pp.911-918), Tarascio (1968, Ch.2), Jaffé (1973), various papers in Black, *et al.* (1973) especially that of Blaug, and Hicks (1976a). See also Gram and Walsh (1978). Some of the differences between the methodology of neoclassical theory and Austrian economics are dealt with in subsequent chapters.

among their contributions, but the focus is on markets and prices and individuals and their 'choices' or 'decisions'.

In Menger's *Grundsätze*, individuals' valuations of things in a process of exchange are central to explaining market prices. Menger (1950, pp.120-121) says of value that unlike the classical concept of value as 'cost of production', it is not something 'inherent in goods, no property of them, nor an independent thing existing by itself [but rather]... a *judgement* economizing men make about the importance of goods at their disposal....' (emphasis added).

The idea that individual's valuations are 'behind' market prices might suggest that catallactic theory would be formulated to take cognisance of decisions and motives. But the conceptual scheme of Walras (1954) left the deepest imprint on the new economic theory because the notion of general equilibrium, rather than decisions or valuations themselves, captured the imagination. With equilibrium comes the epistemology of the third-person perspective and it is worth noting that, according to Jaffé (1980), Walras did not intend his general equilibrium scheme to represent the workings of actual economies.¹⁵

The praise for Walras's contribution, in the following quotation (Schumpeter (1967, p.918)), is widely supported by economists.

¹⁵

There has been considerable debate about what purpose Walras, as the father of general equilibrium, intended his scheme to serve. Two papers, one by Jaffé (1980) the translator of the *Eléments*, and the other by Morishima (1980), a modern interpreter of Walras, provide some of the flavour of this debate. Jaffé takes the view that the *Eléments* was not meant to be realistic or to describe the workings of any actual economy. Basing his argument on textual interpretation, Jaffé (1980, p.530) the acknowledged expert on Walras, suggests that

the *Eléments*, instead of aiming to delineate a theory of the working of any real capitalist system, was designed to portray how an imaginary system *might* work in conformity with principles of 'justice' rooted in traditional natural law philosophy.

Morishima, quoting from Walras, contends that the author was applying accepted scientific principles in order to 'obtain a scientific description of the real world' (p.552. See also p.551).

So soon as we realize that it is the general-equilibrium system which is the really important thing, we discover that, in itself the principle of marginal utility is not so important after all.... [M]arginal utility was the ladder by which Walras climbed to the level of his general-equilibrium system.... [Jevons and the Austrians]... , too, found the ladder. Defective technique only prevented them from climbing to the top of it.... [T]hey saw in marginal utility the essence of their innovation instead of seeing in it a heuristically useful methodological device....

Schumpeter's disparagement of the Austrians' technique is revealing. First, it identifies methodological differences between them and Jevons, on the one hand, and Walras, on the other (see also Jaffé (1976)). The Austrians are blamed for focusing too much attention on individuals' valuations and for the failure to realise that the 'correct' approach to economic theory lay in leaving such matters behind in order to reach the concept of general equilibrium.

Though the epistemology of an equilibrium scheme obscures the individual's understanding of the world, the criticism that neoclassical theory is unable to provide insight into the nature of individual conduct and of decision-making is in large measure a consequence of the way in which Pareto (1971) conceptualised the problem of choice.¹⁸

Pareto's object, supposedly (see Pareto (1971, pp.109-118)), is to represent 'rational choice'. In his formulation, however, the individual 'chooser' has a complete and comprehensive world view. All the decisions he could possibly make are simultaneously present to his mind. This is the third-person perspective *par excellence*.

The individual, being equipped to cover every eventuality, has no perspective and no interests. This is evidenced by the fact that it makes no sense to ask questions

¹⁸

Pareto succeeded Walras in the chair at the University of Lausanne and, via the work of Hicks and Allen (1934) and others, in the thirties and forties, had a major impact on the formulation of modern 'axiomatic' neoclassical theory (see below). Tarascio (1968) offers a useful account of Pareto's methodology, including an examination of the influences on Pareto, especially that of August Comte, a staunch advocate of positivism.

such as, for whom is he making the choices, what is the occasion, what is his aim (other than to maximise satisfaction). They are all supremely irrelevant. The world as a whole is laid bare in one instant. Choice is divorced from the flux of time, and thus from experience.

Shackle's (1972a) elegant articulation of why he demurs at calling the Paretian conception of decision-making 'choice', is worth quoting at length.

Economic choice does not consist in comparing the items in a list, known to be complete, of given fully specified rival and certainly attainable results. It consists in first creating, by conjecture and reasoned imagination on the basis of mere suggestions... the things on which hope can be fixed. These things, at the time when they are available for choice, are thoughts and even figments (p.96).

Rational choice, choice which can *demonstrate* its own attainment of maximum objectively possible advantage, must be fully informed choice. But there can be no full information except about what is past¹⁷, or else what is exempt from the world of time altogether.... Rational choice, it seems, must be confined to timeless matters (pp.245-246).

To be free to take some course, rather than to obey some necessity, is to be confronted with a number of rival courses of action.... The same must be true of other men.... But the sequel to the course he takes will be shaped in part by the particular respective courses that they take. To be free to choose one's action implies that its sequel cannot be known (p.365).

Pareto himself accepted that once individuals have left a record of their preference orderings, or 'tastes', they are no longer needed in the scheme (Pareto (1971, p.120)). According to Hahn (1973a, p.33), who is evidently troubled by the matter, the absence of a role for the individual still persists in the more modern Arrow-Debreu general equilibrium theory: '[t]he theory does best', he suggests, 'when the individual is of no importance'.

¹⁷

Shackle is surely incorrect on this point. We can have knowledge of the past, but the individual's experience is personal. Complete knowledge, arising from experience, is inconceivable. Rather, complete knowledge is a defining characteristic of a third-person perspective, an epistemology which does not accommodate experience.

As others have noted, once the preference function is established there is no need to explain how choices are made. Those factors that influence decisions - a whim or passing fancy, ambition, a desire to please - are replaced by 'tastes' and become things that exist *in the world*. It is surely absurd to claim that this is a way of representing, or furthering the understanding of, choice and decision-making.¹⁸ Yet, when it is placed in a 'spatial' setting (see theme three below), that is exactly the claim of the theory of industrial location.

Modern neoclassical theory has two main antecedents. Alongside the Walras-Paretian general equilibrium scheme scholars developed the partial equilibrium approach of Alfred Marshall (1966).¹⁹ The differences between Marshall's approach to economics and those of Walras and Pareto are marked.²⁰ Apart from the obvious methodological difference signified in the former's use of a partial equilibrium framework, modern interpreters highlight Marshall's period analysis and the importance of time in his work (see Boland (1982b); Clower (1975); Gram and Walsh (1983, pp. 520-522); Loasby (1978); Shackle (1972a), Ch.28).

¹⁸ Consider the rather less controversial argument of Hicks (1976b, p.317), that there are many purposes... for which that assumption [of a fully formed scale of preferences] can be justified. But it is itself a very odd assumption; to take it, as many economists do, as being justifiable for all purposes, must, I now believe, be wrong.

The question is, just how 'odd' must the assumption be before it is of no value whatsoever? Our reservations about the methodology of the orthodox theory of choice are not weakened by the more recent models of choice with 'limited information' or with search and information costs (see Lippman and McCall (1976) and Rothschild (1973)). The views of Nelson and Winter (1982, pp.65-71) on the bankruptcy of this theory, including the limited information models, are quite as blunt and uncompromising as those expressed here. For a fuller treatment of the problems raised by the notion of a 'comprehensive preference field' see Lachmann (1977c, pp.9-11) and Rothbard (1956).

¹⁹ Arrow (1968, p.377) cites Cournot and Jenkin as earlier proponents of partial equilibrium.

²⁰ By contrast see Hicks's (1983b) early analysis of the contribution of Walras, in which Hicks indicates an affinity between the ideas of Walras and Marshall.

In the following quotation, Gram and Walsh (pp.520-521) indicate that Marshall was interested in analysing the *choices* of firms, but forcing Marshallian analysis into a (timeless) general equilibrium would lose the essence of what Marshall was trying to achieve.

The interpretation of Marshall as a *partial* equilibrium theorist suggests that a consistent version of his short-period analysis would entail all the properties of a timeless Walrasian *general* equilibrium of supply and demand. But this is to misinterpret Marshall. His analysis is partial in the more interesting sense that firms are managed by entrepreneurs operating in a short slice of *historical* time²¹ - they make decisions under conditions of uncertainty (as distinct from calculable risk). To subject the Marshallian model to a rigorous formulation within a coherent system of general equilibrium would suppress precisely what Marshall wanted short-period analysis for: the study of the choices of a particular entrepreneur... which may turn out to be wrong, but which nevertheless result in the firm being in equilibrium (given the expectations guiding its conduct) for a short period of time.

Putting aside minor complaints, such as problems in the logic of his arguments (e.g., concerning the compatibility of competitive equilibrium and increasing returns: see Hague (1958, p.682)), does Marshall's approach bring us closer than the other strand of theory to being able to explore individual's decisions?

Marshall's is a rich contribution and it avoids many of the pitfalls of modern orthodox theory.²² A partial equilibrium scheme, which focuses on the effects of changes on a particular market or industry rather than on interrelationships in the economy as a whole, is particularly suited to his purpose. In both the *Principles* (1966) and *Industry and Trade* (1919), the author keeps an eye firmly on business

²¹ As opposed to what is sometimes called the 'logical' time of comparative static and dynamic formulations of equilibrium models. In the thesis, this latter concept of time - the mathematician's notion of time as a continuum - is contrasted with Bergson's notion of the *durée* - the 'time' that is experienced.

²² It is important to distinguish between Marshall's ideas and modern 'axiomatic' neoclassical theory. Loasby (1978) lists various ways in which the modern scheme departs from the spirit of Marshallian economics. See also Leijonhufvud (1976, p.107, fn.66) and Moss (1980) on the Marshallian and 'conventional' neoclassical theory of the firm.

practices in late Victorian England. Things are changing around the firm all the time and, without the impediment of having to analyse their effects on all markets at once, it is possible to examine their impact on firms and 'the industry' in a methodical manner. Description and formal analysis can be combined in a way that is precluded by the complexity of the formal structure, interrelationships, and stability conditions, of general equilibrium analysis.

Marshall's equilibrium framework is still an encumbrance when the object is to understand the decisions of individuals or 'firms'. Entities like 'the market' or 'the industry' are taken as given, and appear as things that exist in the world. But explanations of economic issues, such as the nature and scope of competition between firms, depend on understanding individuals' differing *interpretations* of their markets. Similar considerations apply to problems of industrial location, which depend on understanding the nature of investment opportunities.

Economic orthodoxy has been developed over more than a century, and positions on both the subject-matter of economics and methodological conventions have changed in that time. It is therefore hardly surprising that economic orthodoxy is not monolithic nor that there are sometimes fundamental differences of opinion over issues. Some of the principal players have changed their minds and repudiated earlier views (compare Hicks (1976b, pp.137-138) and (1980) with Hicks (1937)).

Different methodologies also contribute to divisions in orthodox theory, not least in the area of macroeconomics, added after the 'Keynesian revolution', particularly through the work of Hicks and Samuelson, to become a branch of the 'neoclassical synthesis'. The contributions of Keynes, Friedman, and Samuelson in the area of macroeconomics are distinguished by what some interpreters (e.g., Shackle (1967), (1972a, Ch.37), (1974); Loasby, (1976); see also Lawson (1985)) see as a strong subjectivist element in the work of Keynes, compared with the instrumentalism of Friedman and the conventionalism of Samuelson (see Boland (1979), (1982a, especially Chs.8 and 9); also Caldwell (1982, Chs.8 and 9)).

Similarly, methodological considerations separate Hicks²³ and Hahn in the area of microeconomics.

Today, the core of neoclassical theory is a widely-used conceptual scheme which Loasby (1978) refers to as 'axiomatic economics'. The substance of this scheme is described by Hausman (1984b, p.345) who identifies eight 'lawlike statements' as the heart of equilibrium theory. The methodology of axiomatic economics is explained by McCloskey (1983). With various fissures in the neoclassical scheme, the unifying element is the notion of equilibrium. Hausman (1984b) is correct in asserting that '[w]hen one has succeeded in saying clearly what *equilibrium* theory is, one has largely succeeded in saying what *neo-classical* economics is' (emphasis added).

The problems with neoclassical theory are a consequence of combining equilibrium with 'choice', and that is what both the Marshallian and Walrasian traditions do. It is not the third-person epistemology of an equilibrium theory, *per se*, that causes concern. It is when the phenomena under discussion depend on interpretations by different individuals of the phenomena themselves (which is the case with the 'things' about which people make decisions), that the epistemology of the third-person perspective will not do.

IV. THEME THREE: INDUSTRIAL LOCATION THEORY ILLUSTRATES THE PROBLEMS OF NEOCLASSICAL ECONOMICS

The third theme of the thesis is that the epistemological problems of the neoclassical scheme are embedded in the economic theory of location. Even if the methodological shortcomings of mainstream economic theory are dismissed as irrelevant for some branches of the theory,²⁴ because it is claimed that their

²³ The 'Preface (and Survey)' of Hicks (1977, pp.v-xviii) affords a good example of his eclecticism and of the broad range of his often seminal contributions to economic theory.

²⁴ Even if this argument is accepted, provided one also accepts that a task of theory is to explain what happens in the world, then those who espouse this view must admit that
(continued...)

purpose is not to explain decisions or how actual economies work (see, for example, Arrow and Hahn (1971, pp.vi-viii)), these arguments do not pass muster in the context of location theory.

A. Two approaches to industrial location

Location theorists, starting with Alfred Weber ([1909] (1929)), treat their models as a basis for explaining both what determines the location of industrial undertakings and the spatial patterns formed by the location of industries. The main requirement of a location theory is to explain how locations come to be identified or chosen. A complementary task is to show why there is a tendency for businesses to cluster together. Location theory does not meet this requirement because its methodology limits its usefulness.

There are in fact two different approaches to industrial location analysis. The older of these is correctly labelled 'neoclassical' location theory, which is also referred to as orthodox location theory, and it suffers from the limitations of neoclassical theory. It originated in the work of Alfred Weber (1929) and is developed in the writings of Lösch (1954), Hoover (1937), Smith (1971), and others. A useful, brief overview and assessment of neoclassical location theory is contained in Carrier and Schriver (1969, Ch.2).

Establishing how the methodology of the orthodox approach limits its usefulness involves an analysis of the way in which the problem of the choice of location is presented, of how far the theory goes in explaining location decisions, and of where the theory is deficient.

²⁴(...continued)

they do not have a wholly adequate theory, and there is at least room for another theory which does explain. In any event, economists who espouse this view do so half-heartedly. In practice, they often draw inferences about the 'real world' from the theory. On the question of whether general equilibrium theories explain, Hausman's views are worth noting (1984b, see especially pp.353-355).

The choice of location is implicitly based on a view of the scheme of things as complete. The third-person epistemology is recognisable in the conception of the location decision-maker's 'spatial knowledge'. With the further assertion that individuals base their location decisions on such spatial knowledge, location theory misrepresents the decision-maker's understanding of the location problem.²⁵

Location theory also provides a misleading explanation of the nature of location decisions. These decision-makers are ordinary Paretian optimisers, except that the variables relevant to them have a 'spatial dimension'.²⁶ Given a complete spatial picture of the world out there, in terms of prices at different points in Euclidean space, the answer to the location problem is implicit in the formulation of the problem itself.

The evolution of the neoclassical line probably ended in the late sixties, possibly with the work of D.M. Smith (1979), which is still based on a conventional framework). At that time, geographers dissatisfied with neoclassical location theory, began to develop new models of location decision-making under the umbrella of 'industrial geography'. The theory of decision-making adopted for this purpose was developed in the field of behavioural psychology, so the term 'behavioural' location theory, or the location theory of industrial geography, is used to identify this approach.

According to Downs (1970, p.68), the behavioural approach of industrial geography

²⁵ An interesting anomaly is that, in defining the location problem within the context of the epistemology of mainstream theory, the firm exists independently of, and prior to, the location that it is going to choose.

²⁶ It is argued in Chapter 3 that, like the notion of time in neoclassical theory, the notion of space is a purely formal construct associated with a third-person perspective. It has no bearing on the individual's experience.

replaces the black box concept of man by a 'white box'. Thus more realistic assumptions about the nature of man, drawn largely from other social sciences, are employed, and mean that the basic schema for analysis is no longer environment/spatial behaviour, but environment/man/spatial behaviour. Man therefore becomes an intervening variable, and in this behavioural formulation is a significant, if not crucial variable.

The promise that industrial geography would provide a theory of location *decision-making* that neoclassical economics lacks, has not materialised. This is because industrial geography has a deterministic conception of the scheme of things, and the notion of 'procedural' rationality associated with the behavioural approach is not far removed from that associated with 'decision-making' in neoclassical theory. The third-person perspective is still at the root of the 'explanation' of locational choice and this is what makes the models unsatisfactory, though in the behavioural models the theorist's world view is not the same as that of decision-makers.

In a survey of the field and an assessment of the achievements of the geography of enterprise, Hayter and Watts (1983) express an accepted view when they argue that most of the contributions lack an explicit theoretical underpinning. Many of the studies of location decisions are empirical, and insufficient attention has been paid to conceptual issues so 'common threads linking this literature... remain at best implicit and the [field]... faces problems which arise from the lack of unifying methodology' (p.157).

The limited success of the behavioural approach is also attributable to its exponents not having agreed on what is wrong with neoclassical theory. Industrial geographers have not identified the sort of methodological shortcomings of neoclassical theory which form the substance of this thesis. They remain committed to explaining location decisions through the medium of a determinate theory.

B. Location from a subjectivist standpoint

Armed with an alternative subjectivist approach to decision-making (see theme four), and having used location theory to illustrate the problems of neoclassical theory, our object is to re-examine the location of industry from a first-person perspective. First, it is necessary to explore the meaning of decision-making and planning from a subjectivist standpoint, and this is the purpose of Chapter 6. After establishing that the location decisions are likely to be taken in planning an investment in plant and equipment, we then ask what the location decision means to the investment planners and what factors are likely to influence their decision and the firm's location. These questions are addressed in Chapter 7.

The epistemology of the third-person perspective absolutely subverts our understanding of what it is to make a location decision. So, in re-examining the location of industry, it is necessary to question the entire narrative of the economics of location, starting with the idea of that individuals possess and use a map image when they make location decisions.

Schütz (1943, pp.131-132) describes how different individuals, including an 'expert' brought up in the city, a stranger to it, and a cartographer understand a city. He paints a stark contrast between a first-person perspective and the ontology associated with the map image of *spatial* knowledge. Referring to the expert, Schutz says that he

will find his way in its streets by following the habits he has acquired in his daily occupations. He may not have a consistent conception of the organisation of the city, and, if he uses the underground railway to his office, a large part of the city may remain unknown to him.... [The]... centre will usually be his home, and it may be sufficient for him to know that he will find nearby an underground line or a bus leading to certain other points.... He can, therefore, say that he knows his town, and, though this knowledge is of a very incoherent kind, it is sufficient for all his practical needs. (p.131)

Schütz makes no reference to spatial relations, but emphasises the subjective nature of understanding. The centre is merely the area from which (in the expert's

experience) everything happens. The city is 'defined' by his own interests and lifestyle, and his understanding of institutions is important in his daily life. Knowing where to catch a bus is more important than having a map (or specific information) of the route from one place to another.

Placing these ideas in a hermeneutical context, the individual's city does not exist out there. What he knows, and how he knows, it is what *he makes* of it. The 'structure', or the way he thinks about it (which need not have spatial connotations), reflects his interests, habits, work and family relationships, and many other things. Schütz also highlights the incoherent and inconsistent nature of knowledge compared with the comprehensive and well-structured world-view associated with the epistemology of the third-person perspective (compare Aangeenbrug (1968), Barr, *et al.* (1980), Gould and White (1974), Huff (1960)).

The arguments in Chapters 6 and 7 reveal that, from a different epistemological perspective, decision-making looks completely different. Decisions are judgements and reflect the essential uncertainty of the individual in the *durée*. Uncertainty means that the decision-maker cannot estimate the potential benefits, or value, of different possible courses of action. Decisions always involve his social relationships, because other peoples' interests or requirements matter to the decision-maker.

A theory of location (or any other) decisions must explain how social relationships matter, *i.e.*, the importance to the decision-maker of the people with whom he mixes. The thesis offers a framework for identifying the decision-maker's associates and for taking account of their influence in the planning of an investment. The approach is based on a distinction between small and large firms because the nature of social relationships is different in the two business 'environments'.

Besides the question of whether spatial considerations are relevant to location decisions, the critique of traditional location theory reveals a need to reassess the

most fundamental elements of a theory of decision-making, and the subjectivist approach adopted in the thesis provides a means of doing so. The questions that are posed include: what is a decision and what is a location decision?; who makes these decisions and what are their motives?; and, are locations chosen?

The answers are more than a little surprising in that they contradict the 'conventional wisdom' of mainstream economics. We argue that locations are not selected, the decision-makers do not usually have occasion to think about alternative locations, and the idea of finding an optimal location is irrelevant from a first-person perspective. In fact, when it comes to planning an investment, economic considerations may hardly enter the picture.

V. THEME FOUR: SUBJECTIVISM AND DECISION-MAKING

Economics needs a conceptual scheme that permits the theorist to examine the individual's understanding of his social world, and to ask questions about how the individual makes decisions. The approach that is appropriate for the task we call 'subjectivist', and the nature of a subjectivist approach is the subject of Chapter 4 where the meaning of subjectivism is defined, the suitability of the label is considered, and the epistemology is discussed.

Having identified why the quest for an alternative approach to economic theory is an important part of the thesis, it is useful to indicate what that approach entails and how it is used. The second proposition of the thesis refers to a subjectivist approach to economics, based on hermeneutics, or interpretative understanding. This form of subjectivism may be unfamiliar, and as one aspect of the thesis is concerned with whether the subjectivism of the Austrian school²⁷ is a basis for

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The Austrian School is defined in Chapter 5 and an effort is made to identify an 'orthodox' Austrian position. But the exercise is complicated by the fact that the history of Austrian economics is short and intermittent. There are not many 'classic' Austrian works, and those that do exist, such as the contributions of Menger, Mises, Hayek, and Lachmann, were produced at different times in different milieus.

explaining decision-making, it is desirable to outline differences between Austrian subjectivism and hermeneutics.

A. Austrian subjectivism *versus* hermeneutics

The reader who is familiar with Austrian economics may have detected an Austrian 'tone' in the first two themes of the thesis, which contain motifs that are present in the work of Austrian writers. He may assume that the subjectivism of the thesis follows an Austrian line. That assumption would be incorrect. For, in spite of rejecting the formalism of neoclassical economics and espousing subjectivism, Austrian theory embraces a third-person perspective (see Chapter 5). The epistemology of the third-person perspective is inimical to understanding decision-making, which precludes using Austrian theory for this purpose.

The purpose of a subjectivist theory is to provide concepts which are appropriate for explaining conduct and those phenomena associated with individuals' conduct. Subjectivist methodologies assert that these theories afford knowledge, insights, or an understanding of 'how things happen' which is general in form and which is intersubjectively valid.

A hermeneutical approach adds the important rider that the intersubjectivity of understanding cannot be taken for granted and the nature of understanding has itself to be understood. Understanding, though intersubjective, is not universal, and depends on who the understanders are, and to what extent they share a common basis of understanding and interpretation.

A feature of some subjectivist methodologies is the (often tacit) acceptance of a particular ontology - that *the world exists out there*, independently of the individuals themselves. Here something more is claimed. The theory is objective and is able to explicate what the world 'out there', beyond the experiences of individuals, is really like. There is one real world, though individuals' experiences of it may differ.

Because, apparently, the theory is formulated from the standpoint of individuals' 'experiences' of the world, it can lay claim to being subjectivist. This conception of the scheme of things, however, is part of the foundation of the third-person perspective. Completing the foundation requires that this *weak subjectivism* is combined with determinism, which means that the world out there can be grasped and represented in its entirety. Weak subjectivism characterises Austrian economics and, in most Austrian contributions, is combined with an *emphasis* on equilibrium outcomes to produce a theory that is not subjectivist.

As we have already seen, hermeneutical approach to theorising, which comes from the tradition of interpretive sociology and of phenomenology, eschews an ontology associated with the idea of a world that exists. In contrast to a conception of an individual as *something* oriented towards a (given) world out there, the focus of hermeneutics is on the individual's world, which he '*constitutes*' through being conscious of things and doing things. The individual breathes meaning into his 'world' which is coextensive with his thoughts, changing as his interest, or perspective, changes. Meaning is temporal, tied to experience in the *durée*, and re-constituted with experience.

This approach still claims generality as a theory - *i.e.*, that the categories with which it deals are general ones and provide the scholar with an insight into, and understanding of, a scheme of things which can be understood by different people. But its subjectivity is complete in the sense that everyone knows, and understands, differently.²⁸

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The previous sentence attempts to head off the concern that this approach necessarily is, or must lead to, solipsism. The matter is dealt with more fully in Chapter 4. The term 'complete' subjectivism is used instead of 'radical', because the latter is associated with the contributions of Ludwig Lachmann (see various contributions in Kirzner (1986)), who argues that the future of Austrian economics lies in 'radical subjectivism'. The meaning that Lachmann attaches to the term is discussed in Chapter 5.

B. How Austrian theory and hermeneutics diverge

There are a number of ways in which the subjectivism of the thesis deviates from modern Austrian thinking.²⁹ The three most important are identified below.

The first way concerns the scope of economics. In an unflattering assessment of the revival of (Austrian) subjectivism in economics, Coats (1983, p.97) comments on the capacity of subjectivists to borrow from other disciplines. He states that

subjectivists do not feel constrained by the conventional boundaries of economics. They readily incorporate into their analysis elements from any source - e.g. psychology, anthropology, sociology, organisation and decision-theory, political science - which help to shed light on economic problems.

A feature of an approach based on interpretative understanding is that the conventional barriers between disciplines - as much a part of Austrian economics as of other theories - disappear. Organisation theory and sociology, for example, become an integral part of economic theory, when the latter is understood as a theory dealing with the way in which people make decisions that are related to the management of resources.

Austrian theory extends into areas that neoclassical economics does not cover and new directions for Austrian economics are being identified (see Lachmann (1991, pp.139-142) on the desirability of providing a leading role for institutions). Yet, even though Mises (1949) treats economics as a part of the broader science of

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Lavoie (1991b, pp.7-8), draws attention to the influence of hermeneutical thinkers on Austrian economists. In Chapter 4, it is argued that hermeneutics forms part of the subjectivist tradition that gained momentum with the work of Max Weber. While in Chapter 5, reference is made to the bonds between Austrian economics and the subjectivist tradition. It is submitted that Austrian theory, nevertheless, has retained an objectivist epistemology. Lavoie also notes that there is, today, a small group championing hermeneutics as a basis of economic theory who 'advocate bold revisions to traditional Austrian economics' (p.9). In the light of the distinction between the first-person and third-person perspectives, as set out in the thesis, hermeneuticists (whose epistemology is consistent with a first-person perspective) have little option but to 'advocate bold revisions' to Austrian subjectivism.

human action ('praxeology'), the scope of Austrian economics remains fairly narrowly circumscribed.

It is not easy to establish why this is the case, but it appears to be a consequence of an objectivism, associated with Mises's neo-Kantian leanings, that identifies the actor's economic interests, on the one hand, and economic variables and other variables in the world, on the other. Reason dictates that the actor takes his orientation from the *economic* variables in order to satisfy his *economic* interests.

At any rate, in adopting a hermeneutical approach, which recognises that people do things for different reasons even when they take 'business decisions', the subject-matter of economics is no longer insulated from considerations that, according to convention, are the domain of other social sciences.

The second respect in which subjectivism deviates from modern Austrian thinking is that the consistent application of a first-person perspective entails the eschewal of the notion of equilibrium. The analysis of decision-making does not refer to 'tendencies towards equilibrium'. It also avoids attempts to describe any 'state of the world' as inconsistent with a first-person epistemology. To paraphrase Leitch (1988, p.200), man is thrown into an endless interpretative existence. There is never closure. Equilibrium demands closure, in the form of a complete scheme.

Once the epistemological perspective of the third-person is dispensed with, and the conviction that individuals do attempt to maximise is rejected, there is no need for an all-embracing world view. Austrians remain ambivalent toward to role of equilibrium in economic theory: some readily embrace the notion, others feel that equilibrium is not without its problems.

One of the products of recent debate on the implications for economics of time and uncertainty is the view that the state of the world is one of *disequilibrium*, where tendencies towards equilibrium exist, but are continually thwarted by unexpected changes (see Rizzo, 1979b). This reasoning is the product of a third-person

perspective and has no relevance to a scheme which aims to explain how an individual constitutes his world.³⁰ The standpoint of the thesis is, bluntly, that there is no role for a notion of equilibrium in a subjectivist theory.

The individualism of neoclassical theory is a conception of the individual-as-mechanism. Hayek (1948b) refers to this individualism, associated with Cartesian rationalism, as a 'false' individualism, and Hodgson (1986, p.219, fn.1) notes that it deprives the individual of any sense of 'agency'. In keeping with a general rejection of attempts to apply a methodology of the natural sciences to economics, Austrians try to avoid a mechanistic conception of the individual but methodological individualism is a cornerstone of Austrian theory. This is the third deviation of Austrian theory from true subjectivism. There appear to be two reasons for this.

One is an affinity for the eighteenth-century liberal social and political philosophy found, for example, in the work of Hayek (see Hayek (1948c) and Barry (1979, Ch.1)). The other, the more strictly methodological reason, is seen in Mises' praxeology (see Mises (1978) and (1949, Part 1) on the praxeological method), which has been influential in shaping modern Austrian economics. Praxeology is the method of social science. Its function is to provide a formal framework in which human action is rendered intelligible. The essence of the method of praxeology, according to Mises, is that individuals have an *a priori* understanding of the categories of action.

We have two principal objections to the Austrian conception of individualism, both of which can be identified as consequences of the conception of the praxeological method.

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Similar considerations apply to the concept of 'market process', which according to Lachmann (see (1986)) should replace equilibrium, and the 'kaleidic society' of G.L.S. Shackle (see (1972a, pp.76-79)). Both represent a world view, or cosmology.

Praxeological reasoning is only applicable to, and can only explain, action which has meaning in that it reflects individuals' purposes - their attempts to use means to attain particular ends. Economics, therefore, is concerned only with '*rational*' - i.e., conscious, deliberative - action. Other forms of behaviour based on habit or a response to stimulus, are not intelligible to the praxeologist. What is more, 'collective' entities - like the firm or the government - exist as intersubjectively constituted 'meaning structures', and what they do can be explained only in terms of the activities of individuals who work for, or belong to, them.³¹

The first problem with the Austrian conception of individualism is raised by Hodgson (1986, p.215). His concern is that 'there is no adequate differentiation between actions which are carefully planned and others, such as habits....' The tenet that the limits of praxeology lie in the area of rational action means that economists can, or should, have nothing to say about peoples' **habits, customs, conventions, or routines**, and how and why these forms of conduct are important.

Because there is no distinction between planned and habitual conduct (the latter is not part of economics), the misleading impression is gained that the individual plans meticulously all his activities. The resulting view of conduct suggests that individuals do try to maximise and are guided by careful plans. Epistemologically, this is not unlike Pareto's approach.

The second problem with Austrian individualism is that it is excessively 'atomistic' and fails to take cognisance of the **social nature of action**, including the importance of social institutions. The problem seems lie in a combination of methodological

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See Hayek ('955c, pp.53-59) for his discussion of 'methodological collectivism'. Hayek argues that the collectivist approach 'mistakes for facts what are no more than provisional theories... to explain the connection between some of the individual phenomena which we observe' (p.54.). He states that 'wholes as such are never given to our observation but are without exceptions constructions of our mind. They are not 'given facts' ... we spontaneously recognise as similar by their common physical attributes' (*loc. cit.*). The difficulty with this type of critique, from the standpoint of hermeneutics, is that it presumes that there *is* a world 'out there' of *individual facts*, one which can be grasped spontaneously and, unlike the 'wholes', is independent of 'constructions of the mind'.

precepts. One is the idea that institutions only exist as the individuals (and their actions) who comprise them. The other is that both according to praxeology - where the explanation of economic phenomena is achieved by spinning out the implications of a few self-evident theorems - and in terms of what Hayek (1955c, pp.38-40) calls the 'compositional method' of the social sciences, nothing much matters beyond individuals' choices.

According to Hodgson, (1986, p.222), 'the socio-economic and institutional environment has a significant effect on the kind of information we receive, our cognition of it, our preferences, and thereby much of our behaviour'.³² Hodgson's critique of methodological individualism still contains the idea of the individual as a passive recipient of information about the institutional environment. Hermeneutics goes considerably beyond this critique.

Following a hermeneutical reading, understanding is always in terms of our relationships with other people - our colleagues, associates, friends, or immediate family - the people whose interests we have in mind because they have a bearing on the things we are doing at the time. Although the individual is rightly the

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Compare Hayek's (1967c) explanation of individuals' purchasing decisions in his response to Galbraith's argument that wants are dependent upon the process of production. This article highlights a phenomenon common amongst economists. They understand perfectly well how the economy 'works' but will not reflect this understanding in their modernist theories. In the article cited, Hayek offers useful insights into the social nature of market activity. Yet none of these insights, which are certainly useful for making a case for advertising, 'spill over' into the theory of advertising or of competitive conduct.

It seems to be essential to keep separate one's *understanding* of market activity and the *theory* of market activity. Yet by doing so, one is rejecting the very insights that Hayek himself deems important for the social theorist - his understanding of human conduct which forms the basis for the compositional method of 'building up' an explanation of economic phenomena. In fact, this apparent paradox is easily explained. When the Austrians, following Mises, say that the nature of human conduct is known to the theorist and therefore forms the starting point of social scientific theory, they do not mean the practical aspects of human conduct, as in going shopping. Instead, what is referred to is the *category* of action itself. Individuals consciously choose ends and the means to achieve them, people are rational, and economic phenomena can be 'explained' in terms of these '*a priori*' categories. Whether this is the appropriate way to proceed - giving up the practical insights for the sake of 'theory' - is debated in the next chapter.

protagonist of a subjectivist theory, the individual's 'world' - the life world as he understands it - is always constituted *intersubjectively*.

VI. OTHER DIRECTIONS

In Austrian theory the individual is isolated from his social relationships and the nature of interpersonal relationships and their role in decision-making have been overlooked. Add to this the absence of social relations and institutions in axiomatic neoclassical theory, and the result is that economists do not have a particularly penetrating or perspicacious theory to apply to social problems.

In this context, Hodgson's argument (1986, pp.219-220) deserves consideration.

[W]e are justified in giving [social institutions] some analytical prominence combined with the notion of agency of the individual. The aim should be to avoid the pitfalls of voluntaristic individualism on the one hand, and structural determinism on the other. There is no single or clearly marked route to success, but it is a direction worth taking nevertheless....

The thesis shows that a subjectivist scheme, based on interpretative understanding, and borrowing from Schütz (1972) and others, can take us along such a route. Making that journey is not only challenging because it opens new vistas to economists, but also because it means giving up much of the legacy of economic theory.

Whether the journey is worth taking depends on how wedded economists are to a narrowly-conceived notion of rational action and to equilibrium. If it is deemed to be neither desirable nor necessary to champion the notion of equilibrium and if - as is argued - there is adequate support for the view of that science neither does, nor can, provide us with a set of universal truths, then there seems to be little need to remain wedded to a narrow notion of human conduct. On the basis that such a notion precludes economists from asking questions about pertinent and important issues, and leaves economics somewhat barren, there is every reason why we should seek a broader perspective on individual conduct.

This discussion of the main themes of the thesis highlights the nature of the methodological considerations around which the structure of the argument is developed. No doubt the nature of the arguments upon which the thesis is based is controversial. What the arguments in this chapter should show, together with the survey of methodological issues in the next, is that the basis of the thesis is not idiosyncratic. The thesis is an attempt to place a particular perspective on, and so to clarify, problems of neoclassical theory which have long been felt and have been articulated in other ways. It is also an attempt to address some of these problems.

The critical perspective of the research is a sign of the times. For a changing outlook (though not yet a new consensus) on what theory is about, and what theory can or should do, has accompanied a widespread disquiet, and even a disgruntlement, with orthodox theory. These changes lend support to the arguments that underpin the thesis. Our object at the start of the next chapter is to survey them, to show their implications for the formulation of economic theory and how they lend support to the basic premises of the research.

In developing the themes identified in this chapter, the thesis is structured as follows. The next two chapters are about neoclassical theory and why it is unsuited to explaining decision-making. Chapter 2 covers the methodology of modernism and the epistemology of the third-person perspective. The hermeneutical questions posed by neoclassical economists about decision-making are examined. Chapter 3 is an analysis and critique of the orthodox theory of industrial location which concludes with a critical assessment of the story that the theory tells about how location decisions are made.

Chapters 4 and 5 are devoted to examining and clarifying the meaning of subjectivism. In Chapter 4 the tradition of *Verstehen* and the contributions of Weber, Schütz, and modern hermeneuticists are studied in defining the epistemology of the first-person perspective. Then in Chapter 5 the epistemology of Austrian economics is investigated in order to ascertain whether Austrian

subjectivism provides the foundation for a first-person approach to decision-making.

The last two chapters are concerned with the application of a first-person perspective to decision-making. Chapter 6 addresses the question what are plans and decisions, contrasting the conventional account of the decision-maker as optimiser with a hermeneutical view. Chapter 7 reassesses location decisions, examining the way in which investment opportunities are identified by managers of small and large enterprises. This analysis is used to draw inferences about firms' locations and about the considerations that bear upon the decision to invest.

CHAPTER 2

NEOCLASSICAL ECONOMICS AS EPISTEMOLOGY

The notion that there is a permanent neutral framework whose 'structure' philosophy can display is the notion that the objects to be confronted by the mind, or the rules which constrain inquiry, are common to all discourse, or at least to every discourse on a given topic. Thus epistemology proceeds on the assumption that all contributions to a given discourse are commensurable. Hermeneutics is largely a struggle against this assumption.

Richard Rorty, *Philosophy and the Mirror of Nature*, pp.315-316

Determinism is history without humanity. Men and their roles appear in the still and complete (though perhaps infinite) picture as mere details on the same footing as all else.

G.L.S. Shackle, *Time and Choice*, p.4

I. VIEWS ON THE NATURE OF SCIENCE

This chapter is about the methodology of neoclassical theory. Its object, first, is to identify what methodology neoclassical economists espouse, and what they aim to do with it. Then, by examining the sorts of questions that neoclassical theorists are posing, it aims to establish that what they are trying to do cannot be accomplished using the espoused methodology. Finally, the task is to reveal the 'world view', or conception of the scheme of things, that the methodology supports, and to explain why the methodology is not suited to its purpose, even as defined by the questions of neoclassicists.

Shaping the direction of the inquiry is the argument of Coddington (1975b, pp.540-541), quoted in Chapter 1, that the basis for judging a theory is not its 'realism', but whether it is suited to its purpose. To evaluate a theory it is necessary to ascertain its purpose and, in the case of neoclassical theory, this is not easy, because the same theorists have assigned it two different, and contradictory, purposes. The first arises from the conventional role of theory associated with the 'modernist' methodology that neoclassicists espouse. In this case, the task of

theory is to codify, classify, categorise, and predict. The second purpose is established by the types of questions which neoclassical theorists are *now* asking about the nature of decision-making, and these imply a 'hermeneutical' conception of science, the purpose of which is understanding and insight.

The two different tasks of theory are associated with different conceptions of science identified in the first quotation used as an epigraph to this chapter. According to Natanson (1962, p.196), the first task is associated with the received (epistemological) notion of science. It traces its origins to Francis Bacon and Descartes and emphasises

what theory does, what it produces, what its applications are....
[A]ccording to its fruits the theory is judged valid, weak, or impotent.
The acid test... is performance, and performance is itself judged in
accordance with the canons of standard scientific method....
Knowledge is validated by its capacity to transform the world....

The other way of looking at theory has a very different lineage.
From Plato through St. Thomas Aquinas... comes the fundamental
idea that knowledge is understanding and that understanding is self-
validating. The task of theory is comprehension; and not
comprehension for the sake of something else, but comprehension for
the sake of comprehension. The criteria for a good theory are its
internal coherence, its capacity to illuminate the structure of reality,
its power to transform not the world but the theorist, to make him a
wise man.

As an objective of science, the 'legitimacy' of the latter task is still somewhat suspect. The hermeneutical notion of science as social discourse and inquiry finds support among certain philosophers today and is part of a post-empiricist philosophy of science (see Bernstein, 1983; Rorty, 1980). With hindsight, the hermeneutical interpretation of science has been evolving for some time, as Ebeling (1986, p.46) indicates with a concise explication of the meaning of the hermeneutical turn:

for the last hundred years the hermeneutical aspect to all human
understanding has slowly become apparent.... Once 'the facts' are
seen as theory laden, i.e. bound by context,... the interpretive element
in both evidence and argumentation becomes an essential quality in
all understanding. *All sciences become... human sciences*, for it is
minds and not matter that serve as the tentative arbitrators
concerning the world and its working.

As the hermeneutical view gains support, the second task of science comes into its own in that, if all human activity including science is interpretative and exploratory, science has no claim to certitude or to universal knowledge. Until now, however, the Cartesian legacy has maintained a hegemony over scientific method in the twentieth century and has shaped the method of neoclassical economics.

The significance of the two tasks assigned to orthodox economic theory is that they belong to the Cartesian and hermeneutical notions of science which are incongruent not only in terms of the objectives they endorse, but also in terms of their epistemologies. The epistemology of the Cartesian view, manifested in the methodology of orthodox theory, precludes the theorist from answering his questions about decision-making because these involve insight into how the individual understands. They pertain to the double hermeneutic of social science and the answers require an understanding of individuals' understanding.

It is this that makes the methodology and, specifically, the epistemology of neoclassical theory unsuited to its purpose, and forces economists to choose which task they will pursue, because the same methodology cannot serve both purposes.

So far, the 'choice' has been to force hermeneutical problems into an orthodox methodological mould, but the results are unsatisfactory. Questions about the meaning of conduct are intrinsically relevant and the social scientist should be able to handle them. Our object in this chapter is to show why the epistemology of neoclassical theory is an obstacle to answering these questions. In order to do so, it is necessary to explain the implications of that epistemology in terms of the sort of world view that it entails. The epistemology, and the limitations of orthodox theory, are associated with a determinate scheme, identified by the concepts of equilibrium and optimising behaviour.

II. THE RECEIVED VIEW OF SCIENCE: MODERNISM

The present objective is to examine the philosophical tradition on which neoclassical theory is based, highlighting the 'epistemological' conception of science, in order to establish the role of theory within this tradition and the attitude towards explanation associated with this conception of the role of theory.

One is aware that orthodox economics is an amalgam of methodologies. There is the danger that by describing one 'neoclassical methodology', differences among scholars working within the paradigm are underestimated. Even so, there are grounds for defining the neoclassical approach as having a coherent methodology.

While the contributions assembled under this heading are all rooted in the positivist-empiricist methodological tradition, there are at least three other unifying elements: the acceptance of methodological individualism (what Boland (1982a) refers to as 'psychologistic' individualism (see pp.33-35, the particular notion of rationality related to maximising utility or profits (see Hausman (1984b), p.344 for a succinct statement of the conditions associated with this notion of maximising); and the central role ascribed to an equilibrium outcome (either market or general) based on individuals' and firms' 'choices'. Taken together, the latter two signify that individual 'choice', or behaviour, is determinate.

McCloskey (1983) refers to the dominant methodological tradition as 'modernism' in order to 'emphasise its pervasiveness in modern thinking well beyond scholarship' (p.484). Modernism is an 'amalgam of logical positivism, behaviourism, operationalism, and the hypothetico-deductive model of science'. Its intellectual origins are mixed and the lineage of some strands in this heritage of modern science stretch back at least to the Middle Ages when, according to Benton (1977),

[t]he new movement in philosophy was intimately connected with innovations in scientific knowledge and constituted a challenge to the intellectual authority of tradition, divine revelation and faith, at least in those spheres being opened up to scientific knowledge. And this challenge was not, of course, a purely intellectual one. It had social and political implications of the most profound kind.

Modernism is particularly associated with the philosophy of Descartes which, through the tradition of empiricism, made its way into the social sciences. It did so *via* scholars such as John Locke, supplemented by the Kantian conception of an ultimate objective basis for grounding knowledge, and came to social science through August Comte and positive philosophy (see Benton (1977); Losee (1972)).

Perhaps the purest expression of this empiricist philosophy of science is to be found in the writings of members of the Vienna Circle, such as Carnap and Schlick, in the twenties and thirties, which are identified with logical positivism (see Caldwell, 1982, Ch.2). An important variant, logical empiricism, was defined by Popper at this time. Separating Popper's contribution from that of the logical positivists, Magee (1975, p.49) states that 'Popper was never a positivist of any kind; quite the reverse, he was the decisive anti-positivist,... who put forward from the beginning the arguments that led... to logical positivism's dissolution.'¹ Since that time, the enchantment with the Cartesian-Lockean-Kantian view of method has waned in philosophy, and even successive generations of positivists like Nagel and Hempel did not make the same claims for their philosophy as the key to knowledge.

¹ In making his compelling case against the inductivism of logical positivism, Popper argues that evidence accumulated through observation is never sufficient to prove the validity of a theory. Instead, the scientist's task is to attempt to *falsify* hypotheses. Discovery of a single counter-instance is the basis for rejecting one hypothesis and for attempting to discover others which cannot be refuted. Science progresses by first conjecturing about new relationships and then attempting to refute these. Popper (1963, Ch.1) explains his philosophical position, contrasting it with positivism. There he makes clear that science is a social activity, that observation 'presupposes interests, points of view' (p.46) and that it proceeds by conjecture, verbal argument, and trial and error.

Today, in the light of epistemological challenges to the Cartesian legacy, and the debate over method in the philosophy of science that began in the nineteen sixties, there is an extensive literature defining the modernist paradigm of science and exploring its history, with the result that there is fundamental agreement over the main tenets or precepts.²

Benton (1977, p.19) suggests that a 'central pre-occupation in epistemology ... (though it is by no means always explicit), is the search for criteria by which to distinguish scientific knowledge from the non-scientific.' It is in this sense that the positivist-empiricist paradigm is referred to by Rorty (1980) as an 'epistemology'³. In Rorty's view (see esp. pp.317-318), the term carries a connotation which is unflattering because it reflects a narrow and rigid conception of the nature of intellectual endeavour and of the problematic of philosophy: philosophy's role is to serve as referee in respect of claims to knowledge and, since culture is the sum total of knowledge, philosophy is the foundation of all enlightenment.

The Cartesian dream or hope was that with sufficient ingenuity we could discover, and state clearly and distinctly, what is the quintessence of scientific method and that we could specify once and for all what is the meta-framework or the permanent criteria for evaluating, justifying, or criticizing scientific hypotheses and theories.

In this quotation Bernstein (1983, p.71) conveys the essence of a modernist philosophy of science. He adds that

[t]he spirit of Cartesianism is evidenced not only by rationalists but by all those who subscribe to strong transcendental arguments that presumably show us what is required for scientific knowledge, as well as by empiricists who have sought for a touchstone of what is to count as genuine empirical knowledge.

² Useful overviews of the history and main precepts of the logical positivist and empiricist, hypothetico-deductive conceptions of science are contained in the following works. On the tenets see Benton (1977, Chs. 3 and 4); Celúwell (1982, Chs. 2 and 3); Hollis and Nell (1975, Ch.1); also McCloskey (1983, pp.484-485). On the history see Losee (1972).

³ In referring to this paradigm as *an* epistemology, the implication is that there are others. One of these is Transcendental Phenomenology, as conceived by Husserl, who saw in the method of phenomenological reduction a route to apodeictic knowledge. See Chapter 4.

In the idea of a meta-framework, associated with modernism, all thought is subject to the same criteria for evaluating the correctness of knowledge.⁴ As a consequence, the oft-cited dichotomy between natural and social science is without substance.

A. The nature of scientific endeavour

What is the modernist conception of science? The description of tenets of modernism that follows serves as a background for answering various questions that are then posed about the nature of theory and its role in science.

The purpose of science is, to borrow Rorty's felicitous expression, to provide a mirror on nature. This metaphor identifies the subject-matter of science as something that exists 'out there', separate from, and independent of, the individual. Discovering nature, out there, involves observation, and observation must be neutral and objective. To justify its claim as such, knowledge must be a true representation of what happens out there.

The problem is that observation, being partial and subjective, cannot be counted upon to yield a true representation, and even language and terminology gets in the

⁴ Polanyi (1973, p.139) argues that the 'paradigm of a conception of science pursuing the ideal of absolute detachment by representing the world in terms of its exactly determined particulars was formulated by Laplace.' He quotes Laplace as follows (p.140):

all forces by which nature is animated and the respective positions of the entities which compose it, ... would embrace in the same formula the movements of the largest bodies in the universe and those of the lightest atom: nothing would be uncertain for it, and the future, like the past, would be present to its eyes.

Polanyi comments that '[t]his ideal of universal knowledge is mistaken, since it substitutes for the subjects in which we are interested a set of data which tells us nothing that we want to know'. He continues (p.141) that the 'tremendous intellectual feat' of Laplace 'has diverted attention (in a manner commonly practised by conjurers) from the decisive sleight of hand by which he substitutes a knowledge of all *experience* for a knowledge of all atomic *data*. Once you refuse this deceptive substitution, you immediately see that the Laplacean mind understands precisely nothing and that whatever it knows means precisely nothing'. (Emphasis added). Lavoie (1991b, p.2, fn.2) credits Polanyi with a hermeneutical approach to the natural sciences.

way of describing the world as it really is. How can one tell whether a proposition actually conveys knowledge? Only by subjecting it to an empirical test and confirming its status as knowledge if it passes the test. Science, then, consists of testing hypotheses. A theory is a hypothetico-deductive system for generating propositions about observable phenomena - hypotheses - which can be tested.

This is the one view of the purpose of theory, which is judged according to its results, its applications, and its performance in yielding knowledge about what happens 'out there'.

Although this account of the Cartesian legacy of science glosses over complex problems with which successive generations of philosophers grappled, for a long time there was substantial consensus about the task of science. The philosophical issues revolved around the problems of *how* to construct the neutral, objective 'language' or conceptual scheme for expressing the relationships that it was the task of an empirically-based science to discover.⁵ This is the conception of science that neoclassical theory adopted.

B. The tenets of modernism

The main principles of modernism are captured by McCloskey (1983, pp.484-485) and Hollis and Nell (1975). Between the eleven statements of McCloskey and the ten tenets identified by Hollis and Nell there are appreciable overlaps.

For example, both agree that the task of science is prediction and control. Both agree that claims to knowledge are based solely on observation. Likewise they overlap in the claims that it is necessary to devise objective, reproducible

⁵ Various aspects of the problems which confront theorists in pursuing an inductively-based science, and of asserting proof on the basis of induction, are examined by Losee (1972, Ch.10); and also by Boland (see 1982a, Ch.1), Caldwell (1982, Ch.4), and Hollis and Nell (1975, Introduction and Ch.1), who all place considerable emphasis on the particular form of these problems in economics and the social sciences.

experiments and that things cannot be known *a priori*⁶. There is a need - implicit in the notion of modernism as an epistemology - to draw a strong line between the positive and the normative; judgements of value have no place in science.

McCloskey's list highlights the pre-eminence of mathematics and statistics within the modernist scientific tradition. Hollis and Nell add the rider, which is central to the debate on the methodology of the social sciences, that 'sciences are distinguished by their subject-matter and not by their methodology'. The world 'out there' is a single entity. Different groups of scientists - from psychologists to physicists - are interested in (observing) different bits of it.

C. Theory and explanation

What is a theory within the modernist methodology; how is developed; and what purpose does it serve? As explained by Benton (1977, pp.64-65) and Caldwell (1982, pp.25-26), a theory is essentially a hypothetico-deductive system involving an hierarchical structure. Its purpose is to generate theoretical generalisations about the world, propositions which can be tested.

In this conception of theory, a higher level of (synthetic) statements consist of axioms or postulates of a deductive system. The mathematical variables at this level often refer to unobservable properties of entities or processes which are termed 'theoretical' concepts, as distinct from 'observational' concepts at the lowest level of statements, which identify properties that can be observed or measured directly. From the higher-level statements, propositions can be deduced which identify quantitative relationships between variables. The lower-level statements, which are deducible from the former, describe observable phenomena and are the propositions which may be tested by observation.

⁶ McCloskey's precept (5) states that '... subjective 'observation' (introspection) is not scientific knowledge'. This is different to the claim that knowledge cannot be acquired *a priori*, since the Kantian view is that *a priori* knowledge is not subjective:

In order to make the system empirically meaningful, there must be a means of linking the theoretical concepts at the higher level (which often refer to unobservable entities) to the lower-level observational concepts which express empirical generalisations. This is achieved through linking statements, designated 'correspondence rules' or 'bridge laws', which express functional relations between the two classes of variables.

The acceptance of non observable theoretical entities as part of scientific discourse means that not all statements or assertions within a theoretical system can be directly tested. Instead, theoretical statements acquire their validity - as claims to knowledge - indirectly, when the theory as a whole is confirmed by testing the deduced consequences against the data.

This concept of theory covers both of the meanings that are generally ascribed to the term in the modernist tradition, and are identified by Hollis and Nell (1975, p.8). 'Theory' is either the set of hypotheses in the hypothetico-deductive system, or the means of transforming the hypotheses into testable predictions about data. Often, however, the meaning is left implicit and this is a source of possible confusion.

In the light of this discussion of modernism, there are two questions that need to be examined: in what sense is it the task of theory within the modernist paradigm to explain what happens in the world out there; and, do neoclassical theorists adopt the modernist standpoint on the tasks of theory?

According to the canons of empiricism, scientific explanation involves bringing a phenomenon or a law under a higher-level law. This is known as the 'covering law', or deductive-nomological (D-N) conception of explanation. The D-N model, which dates from the forties, is explained by Caldwell (1982, pp.28-29). (See also Benton (1977, pp 53-54) and Losee (1972, pp.158-161)).

[A]ny legitimate scientific explanation must be expressible in the form of a deductive argument in which the explanandum, or sentence describing the event to be explained, is a valid, logical consequence of a group of sentences called the explanans. The deductive nature of explanation is stressed; if the initial conditions along with the general law(s) obtain, the phenomenon described by the explanandum *must* occur.

This notion of explanation enables the scientist to establish where something (that exists in the world) *belongs* in the world out there. It fulfils the role of classifying phenomena. The thing is 'explained' because it is recognisable as part of class of other phenomena: it has similar properties or 'behaves' in a similar way.

In addition, judging science by what it produces makes prediction a focal point of scientific endeavour. The D-N model establishes the logical, structural symmetry of explanation (in the particular sense in which the term is used) and prediction. The only difference between the two is a temporal one. If the phenomenon described by the explanandum has already occurred, the theory 'explains', if it is still to occur, the theory 'predicts'.

Besides taking cognisance of the resonant voices that have been raised against this notion of explanation, it is worthwhile noting that for instrumentalists - represented in economics by Milton Friedman (see Boland (1979 and 1982a, Ch.9) and Caldwell (1982, Ch.8)), whose methodology is widely imitated - even the connotation of classification in explanation is irrelevant. What matters simply is the practical, predictive success of a theory⁷. As the means of producing predictions a theory is a 'black box', in that the content is immaterial as long as it produces the right results.

Although the hypothetico-deductive model of theory treats theoretical statements (about unobservable entities) as valid if the theoretical system as a whole is

⁷ Benton (1977, pp.69-70) states that instrumentalism rejects 'the "underlying" or "generative" mechanism conception of cause, as against the positivist conception of causality as "constant conjunction" or "necessary and sufficient condition".'

confirmed by testing it, Benton (1977, p.67) argues that the instrumentalist conception of scientific theories is the only one strictly available for verificationists of the logical positivist Mach-Carnap school variety.

D. What do scientists actually do?

In the course of the last thirty years - inspired by the seminal contributions of Kuhn (1962), Lakatos (1970) and (1976), and Feyerabend (1978) - the study of the nature of scientific progress and change has become something of a growth industry.⁸ The question of what it is that scientists actually do has been subjected to detailed examination. Naturally, the positivist-empiricist paradigm has not escaped this scrutiny. Does the methodology intrinsic to modernism really reflect the nature of scientific endeavour? Is it about a neutral, 'observation language', 'correspondence rules', 'covering laws' and prediction?

Rorty (1980, p.321) says that '[w]e will be epistemological where we understand perfectly well what is happening but want to codify it in order to extend, or strengthen, or teach, or "ground" it'. A view that is attracting increasing support is that, even if some of what scientists do fits this description, scientific practice

⁸ There is now also an extensive literature analysing, comparing, and evaluating the contributions of these authors, particularly the work of Kuhn and Feyerabend, which has provoked the greatest reaction. Initially, a general response seemed to be that, in criticising the positivist view of rational science, these authors were either advocating an approach to science, or documenting a scientific community, which had abandoned objectivity for relativism. Philosophical discourse today, reflecting the development of post-Wittgensteinian analytic philosophy, stressing the importance of language and adopting a hermeneutical position, holds that there are other directions beyond objectivism and relativism. These are only treated as 'natural' opposites from the standpoint of a philosophy which seeks the certitude of an epistemology (in Rorty's sense).

Accepting the 'subjectivism' of a hermeneutical position does not preclude intersubjective consensus or agreement, based on a variety of criteria including aesthetic ones, on what constitutes an acceptable theory. In this view consensus is not contingent upon discovering 'the world out there as it really is' - permanent and immutable - but upon institutional structures and social approbation which will change over time. A useful and fairly up-to-date examination of these issues in the philosophy of science, which includes an analysis of the contributions of Kuhn and Feyerabend and explores the origins and assesses the implications of the hermeneutical turn in philosophy, is Bernstein (1983).

is much more about trying to find out why something is happening, *interpreting*, and discovering through discourse and interaction, than about generalising over what exists out there.

Significantly in order to reach this point in the critique of the nature of scientific endeavour, philosophers of science themselves have had to step outside the framework of logical positivism and logical empiricism of formulating hypotheses about, observing, and testing, what was going on. Instead, they rely on interpretation and understanding.

One of the reasons why the positivist tradition has had such a hold over philosophers and scientists is explained by Natanson (1962) in contrasting naturalistic and phenomenological methodologies.⁹ He observes that phenomenological methodologies, which recognise that social action is founded upon intentional experience, permit 'questions about the nature and status of intentional experience... [to] be raised and resolved within the same framework' (p.158).

At the conceptual level,... the method of natural science and the method of social science [phenomenology] are radically different; the former is rooted in a theoretical system that may never take itself as the object of its inquiry without transcending its own categories; the latter, in its phenomenological character, necessarily becomes self-inspecting yet remains within the conceptual system involved.... Furthermore, whereas the phenomenological approach begins by raising the question of its own philosophical status, the naturalistic standpoint cancels out the possibility of self-inspection by *its own claim that natural science provides the essential method for stating and evaluating philosophical claims.* (p.159. Emphasis added).

The 'official rhetoric' (the term is McCloskey's) of neoclassical economics is modernism. By implication, 'doing economics' involves applying the precepts described above. The purpose of economics is to mirror the economic laws which

⁹ In this quotation Natanson, who is espousing the methodology of phenomenology, equates phenomenology with the method of social science. There are certainly many social scientists, even among those who accept a methodological dualism between the natural and social sciences, who would not agree with this equation.

exist in the world out there, with the object of being able to predict. The knowledge gained will serve to master that world, and perhaps to transform it.

In the next section, the object is to examine the practises of economists. To do so, they are divided into two groups - 'applied' and 'theoretical' - and the methods that they employ and problems that they pursue are analysed. This provides a means of determining whether, and how far, the methodology of modernism actually influences their activities. When we deal with the hermeneutical turn in neoclassical theory, the analysis serves as a foil to establish whether those with a hermeneutical bent are reneging on a strong modernist tradition.

III. WHAT IS NEOCLASSICAL ECONOMICS ABOUT?

A positivist methodology was 'officially' propagated as the method of economics in Hutchison's (1938) *The Significance and Basic Postulates of Economic Theory*.¹⁰ From the time of its publication, the methodological precepts of this work were criticised, a particularly vicious attack being launched by Knight (1940).

In fact, as noted by Caldwell (1982, see p.135, Note 1), before this, Pareto brought a Comtian, positivist conception of scientific rigour to economics. Tarascio (1968, Ch.3, pp.30-38), argues convincingly for the influence of Comte's methodological approach on Pareto, despite the latter's accusation that Comte's principles were 'pseudo-experimental' and that he had regressed from the 'experimental' (positive) phase of intellectual evolution to the lowest, 'theological' (supernatural) phase (pp.34-35). Pareto has had a marked impact both on the formulation of general equilibrium theory and, more generally, on the methodology of economics.

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The contrast between the methodology advocated by Hutchison (1938) and that associated with Robbins (1949, 1st ed. 1932) should be noted. Paradoxically, it is Robbins's definition of economics that has stuck, while Hutchison's methodological prescriptions found favour. See also Caldwell (1982, Ch.6).

Many factors appear to have combined to create the situation where catallactic problems (see Chapter 1) were squeezed into the mould of logical positivism or its logical empiricist successor. Tarascio says that '[d]uring the nineteenth-century development of economics, there was a kind of intellectual interregnum during which the procedures used by economists were vague, shifting, and tentative'. He goes on to add (p.4) that 'economists, as well as sociologists, felt the need to "rationalise" their aims and procedures'.

Among various influences on the methodology of economics, empiricism was the prevailing view of science. Classical Newtonian mechanics had achieved enormous success in opening windows on the physical universe and the newly emerging discipline of economics no doubt gained respectability by adopting the empiricist mantle.¹¹ In addition, with the social sciences still in their infancy, many early catallactists had their training in engineering or natural science (see Boettinger (1967, p.53)).

Although the subject-matter of economics changed in the eighteen-seventies a notion of equilibrium remained and the methodology was shaped by the language of equilibrium theory. Later logical empiricism seized the imagination of economists and Hicks (1946) and Samuelson (1948) and others enthusiastically adopted a mathematical approach as a means of extending equilibrium models and of investigating their logical properties.

As an assessment of what motivated the evolution of modernism, McCloskey's (1983, p.486) irreverent view is worth noting. 'Modernism', he says, 'is influential in economics not because its premises have been examined carefully and found good. It is a revealed, not a reasoned, religion.' McCloskey's assertion applies to

¹¹ The view that scientific respectability depends on social approbation derives from the arguments of Kuhn (1970). See also Katouzian's (1980, pp.117-118; also pp.119-132) comments on Kuhn's sociological view of the 'invisible college'. Hermeneutics identifies theorising as a social activity so economists adopt the 'language' of their peer and colleagues.

economics. The insight of Kuhn (1962) is that induction into a paradigm is like training for the priesthood.

However, the superficial impression, reinforced by the contents of 'methodology' chapters of introductory textbooks, that the heart of positivism beats as vigorously as ever, is belied by a closer examination of what economists actually do. Moreover, it was certainly not inevitable that economists should have chosen the positivist path, and the nature of the problems that occupied them in the early years of the catalystist revolution made this seem unlikely. Indeed, at the time that the seeds of the orthodox approach were being sown, the tradition of *Verstehen* was beginning to emerge in opposition to Comtian philosophy. Max Weber was proclaiming the desirability of methodological plurality, with different methods for the natural and social sciences.

To ascertain what methods economists practise, following Coddington (1975b, p.544), it is appropriate to divide the practitioners into two categories. Those 'using theories as an instrument of applied investigation; and [those]... developing, refining, and extending them as a theoretical exercise or contribution to analysis.' These two groups are referred to as 'applied' and 'theoretical' economists respectively.¹²

Our main interest is in the second group, which includes the individuals most closely associated with the development of general equilibrium (GE) theory. Answering the question as to whether or not orthodox economists are doing what they claim to be doing in terms of their modernist methodology, affords an opportunity to identify some of the main varieties of criticism levelled against neoclassical theory.

¹² The categories are not rigid, and the contributions of some mainstream economists - Friedman and Samuelson come to mind - puts them firmly in both groups. It is also necessary to distinguish between those theoretical economists whose interest lies in 'pure theory' and those whose goal, ultimately, is to apply the concepts and to establish empirical relationships.

A. Applied economists

There are various assessments of the methodologies of applied neoclassical economists (see, *inter alia*, Boland (1982a), Caldwell (1982), Katouzian (1980), O'Sullivan (1987)), and the characteristics of 'typical', modern, contributions in this category are identified by Boland (pp.116-119). All these writers agree that it is essential to distinguish between what economists *say* that they do (the methodologies they espouse) and what they actually do.

McCloskey (1983) highlights the contradictions. As far as the claims are concerned, having noted that 'few in philosophy believe as many as half of... [the] propositions' that he identifies as the main tenets of modernism, he suggests that 'a large majority of economists believes them all.' (p.485). Yet, having argued that the modernist paradigm is unacceptable and that economists could not, anyway, hope to pursue the positivist goals (pp.486-493), McCloskey also notes that, fortunately, they do not try very hard to do so. Economists have a 'workaday rhetoric', which is an important element in their arguments, explanations, and 'proofs', and which diverges from the official rhetoric.

Coddington (1975b, p.545) argues in a similar vein. Discussing economists' attitudes towards the 'scientific' criterion of falsifiability, he states bluntly that '[a]s far as what economists actually do with theories is concerned, "falsity" is simply an irrelevant category' (see also Katouzian (1980, pp.55-71), O'Sullivan (1987, Ch.11, esp. pp.165-168), on the methodology of positive economics in practice). Caldwell is somewhat kinder. He offers various reasons as to why applied economists' reputations (as scientists) should not be determined by the consistency with which they uphold the tenets of modernism, especially that of testing (or attempting to falsify) a theory. His arguments include the consideration that the subject-matter of economics, as a social science, does not provide the conditions for evaluating unambiguously the outcomes of tests (see pp.238-242).

in discussing whether it is important that economists are scrupulous in rejecting a theory when it fails to pass a test, Caldwell notes that empiricists 'recognize that empirical criteria are often insufficient for unambiguous choice among competing theories. Their solution is to supplement the empirical criteria with other criteria.' (p.231). If economists do not practice what they preach is there anything to be had from advocating an empiricist or modernist research agenda? Caldwell adopts an ambiguous position on this question. 'The invocation to try to put falsificationism into practice in economics need not be dropped, though it seems that there is little chance for its successful application' (p.242).

If neoclassical theorists neither accept nor reject theories on the basis of what they find, then Boland's (1982a, p.128) interpretation is well worth considering.

[I]f the usual published positive neoclassical articles... are actually considered contributions to 'scientific knowledge', then it can only be the case that the hidden objective of such positive economics is a long-term *verification* of neoclassical economics. Specifically, each paper which offers a confirmation of the applicability of neoclassical economics to 'real world' problems must be viewed as one more positive contribution towards an ultimate inductive proof of the truth of neoclassical theory. Our reason for concluding this is merely that logically all that can be accomplished by the typical application of neoclassical theory to 'real world' phenomena is a proof that it is *possible* to fit at least one neoclassical model to the available data.

B. Theoretical economists

Criticisms of the theoretical contributions of neoclassical economists are wide-ranging and often devastating. A common criticism emphasises the gap between what is said and what is done by economists. This problem has long been recognised in theoretical writings. Knight (1940, p.31) says of Hutchison's (1938) work, which first advocated falsificationism in economics, that 'perhaps [its] chief merit ... [is that] the author ends up by virtually abandoning the "criteria" on which at first he lays so much emphasis'.

Katouzian (1980) vigorously attacks mainstream theory from a number of different directions. He offers his own lucid assessment on the much debated topic of the

use of mathematics, and is particularly scathing about the elevation of mathematics to an almost mystical status in economics (see pp.164-172). Pleading for greater methodological tolerance, he argues not that mathematics is an inappropriate language for exploring economic problems but that,

the irrational, uncritical and authoritarian elevation of mathematical economics is prone to... very serious dangers.... Economic science can afford mathematical economics in a 'peaceful coexistence' or even 'détente' with other approaches. What it cannot afford is the professional hegemony of mathematical economics especially if this is effected by a combination of chauvinism and professional power-politics.¹³

As a conclusion to his critique, Katouzian examines the subject-matter of a sample of contemporary theoretical writings in journals (pp.184-204). His audit is spiced with a good deal of under-stated humour, probably to underscore the exasperation evident in his summary 'analysis of the evidence' (pp.204-206). He says that '[t]here is a rising trend among economic theorists to propose ideas which are *not* empirically testable. It looks as if, in practice, Positive Economics is virtually non-existent.' Also, Katouzian notes the 'precedence of form over content, of technique over problem, of mathematics over economics...' (p.204). Finally he contends that '[m]any - and, especially most of the more mathematical - theories are abstractions with little or no conceivable counterparts in the world of reality' and the subject-matter is 'analytical puzzles as opposed to substantial problems' (p.205). This last point is echoed in arguments later in the thesis.

Hollis and Nell (1975) provide a trenchant critique dealing mainly with flaws in the positivist methodology of economic theory, including the problems associated with prediction (Ch.5). Among their criticisms is a familiar one that neoclassical

¹³ Our standpoint is that the language of mathematics may have a place in a scheme which is associated with the epistemology of the third-person perspective - a complete world that consists only of things and can be represented by symbols and a set of equations. But mathematics is inappropriate in a hermeneutical theory which aims to provide answers to questions about how individuals judgments, beliefs, and interests are associated with their decisions. 'Mathematics', Shackle states (1972a, p.26), 'can explore the meaning of what is already implicitly stated, of what is already *given*. A mathematical model... has no place for... *novelty*.'

economics, with its emphasis on rational economic man, abstracts from (and overlooks) things which are important in understanding the world. To these authors, important considerations that are ignored pertain to a Classical-Marxist description of the world, to which they are amenable.

In summary, there is a reasonably widespread view both that neoclassical theory is not good positivism and that whatever is being practised produces unsatisfactory theory. There is probably much less agreement, however, on what neoclassicists *should* be doing, and the difficulties here are twofold. The problems, generally, are not recognised as methodological ones, so the view is that modernism is essentially sound, but the theory needs to be developed in some way.¹⁴ Nor is it realised that some of the hermeneutical issues of interest are not the sort that Katouzian singles out as typical of neoclassicists' theoretical research efforts.

Though we can sympathise with the litany of complaints that orthodox theory is too 'abstract', the difficulty with this argument is that it presupposes a *particular*, but different, conception of what the *world is really like* and, hence, of what problems theory *should* cover. None of the critiques discussed here touch upon the distinction discussed at the beginning of the chapter - which we attribute to Rorty (1980) but which is also adopted by Bernstein (1983) - between science (in its traditional incarnation) as an epistemology and theorising as a hermeneutical activity.

It is difficult to know why and when the turn to interpretative understanding occurred and it is doubtful whether many economists are aware that it has happened. Fewer still are likely to admit that the methodology of modernism is being made obsolete by the types of questions that are now being posed.

¹⁴

For example, having noted deficiencies of Arrow-Debreu general equilibrium and suggested issues that have to be addressed, Hahn (1982, p.15) feels 'confident enough to conjecture that very shortly a large and rigorous collection of models with these possibilities will be available.'

The questions that some leading orthodox economists are *now* asking, and the demands they are imposing on their theory, are not of the 'traditional' type¹⁶, but are an admission that they do not have firm convictions about what the world is like, and are engaged in a process of interpreting problems. Instead of consensus about the nature of the world and about how to investigate and to describe it, neoclassical theorists are trying to understand and interpret. They are seeking enlightenment, and not - at least not immediately - the ability to predict.

Their problems are essentially hermeneutical and they are not 'legitimate' ones for the modernist to pose. The questions entail *how* to represent and to model conduct. The problems are those of the sceptic and they are self-reflexive in questioning the comprehension or understanding of the theorist. How do individuals learn? What does uncertainty mean, and how can it best be incorporated into economic models? How can these things best be explained?

These questions are not entirely new. Throughout the history of neoclassical economics writers have identified that the theory does not provide an accurate picture of the nature of human conduct and decision-making. In retrospect, one can see what they were getting at. The problems first of comprehending and then of modelling human conduct are reflected in earlier attempts, such as that of the Swedish School, to take account of expectations (see Kregel (1977)).

They are also at the heart of what Shackle (1965, see p.44) identifies as the contrast between Keynes' spirit and the method of the *General Theory*. The hermeneutical problem of how the theorist should interpret and explain human

¹⁶

This point underscores the importance of a hermeneutical framework in exploring the nature of scientific activity, for it is an assertion that the questions that scholars seek to answer are relative to our 'state of knowledge'; influenced by 'what individuals, perhaps with the support of a scientific community, deem to be important at some time, and also by what that community (which may be a very small one) considers to be legitimate techniques for analysis and problem-solving. The social 'consensus' can and does change for various reasons, not least because of new fashions, or 'tastes', within the community. Aumann (1985, in the section 'Science and Truth', pp.31-35) has some anecdotes illustrating the historical relativism of 'knowledge'.

conduct is behind the analogy used by Keynes in a letter to Harrod (quoted by Lachmann (1986, p.160)) to convey the fact that, as a 'moral' science; economists need to take account of 'the apple's motives... and whether the ground wanted the apple to fall, and on mistaken calculations on the part of the apple....' Only quite recently, however, have neoclassical economists shown an interest in the significance of these questions.

IV. NEOCLASSICISTS IN PURSUIT OF HERMENEUTICAL PROBLEMS

Our task, now, is to identify some of the questions which reveal the hermeneutical direction that neoclassical theorists have taken. It is in the contributions of Hahn that the hermeneutical element is perhaps most obvious to the researcher. Not only in the top rank of GE theorists, but also sensitive to the sorts of criticisms of orthodoxy that are itemised above, Hahn has devoted considerable effort to illustrating what GE theory has achieved and to what it can still hope to achieve (see Hahn (1970; 1973a; 1973b; 1978; 1980; 1982)). Paradoxically, the hermeneutical nature of the problems he is grappling with emerge in the context of his defence of GE theory.

Hahn's contribution also characterises the interests of a fairly small but influential group that we term 'reformists' within neoclassical theory. The shift towards hermeneutical issues occurred in the seventies, when a number of articles with similar themes appeared, coinciding with a deepening awareness - reflected in wider discussion - of the crisis in economics.

Although Hahn's contribution is not unique, it is important not to give the impression either that the hermeneutical element is the result of a deliberate choice of method, or that it is widespread within neoclassical economics. Most neoclassicists are modernists, whose methods conform to the stereotype depicted by Katouzian (1980), though there are a few individuals in the top ranks of orthodoxy whose questions take them well beyond the parameters of a modernist framework. Even these are uneasy with the issues they are confronting and

readily retreat into their accustomed theory by defining, or rephrasing, the problems so that these are amenable to analysis within that context - what we have termed the epistemology of the third-person perspective.

It is useful to precede the analysis of hermeneutical questions in neoclassical economics with a thumbnail description of GE theory, the context in which the questions have emerged. Equilibrium is the heart of orthodox economics and GE theory has been through many stages of development and refinement so it is not easy to describe this scheme. Hahn and Arrow (1971) comprehensively examine GE, and their 'historical introduction' (pp.1-15) includes an overview of the central problems of existence, stability and uniqueness. Kregel (1988) describes the scheme as follows (p.129).

General equilibrium theory attempts to explain how the price mechanism in a free market operates to resolve ... [the] seeming paradox of increasing independence in decision making requiring increased co-ordination of economic decisions to produce coherent economic behaviour....

A general equilibrium system provides a sufficiently complete description of individuals' decisions concerning supply and demand to determine the quantities and prices of all goods and services produced and exchanged.

Kregel points out (pp.131-132) that although Walras [1874-77] was the founder of GE, much of the contemporary theory, including the Arrow-Debreu version which was preceded by the contributions of Wald and von Neumann, can be traced to Cassel's *Theory of Social Economy*, first published in 1918. It was the work of Hicks, especially *Value and Capital* (2nd. ed. 1946), that introduced Walras to an audience of English-speakers.

In GE theory various devices are been employed to ensure that agents' independent 'decisions' are co-ordinated. These devices include Walras's notion of '*tâtonnement*' and Edgeworth's (1881) procedure of 'recontracting' (others are identified in the last section of this chapter). Such devices are viewed as unrealistic by mainstream theorists and the hermeneutical questions which we now examine often emerge in the context of posing the question, how is equilibrium

attained without *tâtonnement* or recontracting - when agents have 'limited knowledge' and when they have to 'learn' about opportunities to trade.

A. Hahn's hermeneutical turn:

Hahn (1980) expresses his disquiet at the achievements of GE. Observing that GE continued down the road on which Adam Smith 'started us off', he holds that the Arrow-Debreu version is 'near the end of that road'.¹⁶

Now that we have got there we find it less enlightening than we had expected. The reason is partly... that the road we pursued was excessively straight and narrow and made - we now feel - with too little allowance for the wild and varied terrain it had to traverse. We have certainly arrived at an orderly destination, but it looks increasingly likely that we cannot rest there. (p.123)

Paraphrasing the sentiments expressed in the quotation, and echoing the argument at the beginning of the chapter about the relationship between the type of theory and the questions that can be posed, one might say that 'our conceptual framework was too narrow (or, perhaps, even wrong). It prevented us from investigating the complex issues that we now deem to be important'. What is it that is required of an improved theory? Hahn's answer is that it should 'deal with a larger *range* of questions than it now does' (p.130, emphasis added).

When he identifies how the range should be extended, Hahn reveals that the problems of direct concern are not the traditional ones of existence and stability; although, for the GE theorist, ultimately the problems must be placed within the context of existence or stability.

¹⁶ This statement begs the obvious question of how Hahn knows that the end of the road is near. Is it merely because he feels that Arrow-Debreu GE has little more say about the questions which Smith posed? In addition, linking Smith, the 'invisible hand', and GE, as Hahn is prone to do (see Hahn (1982)), surely indicates a belief that GE *is* able to cast light on 'real', capitalist economies. This inference, however, is confounded a few pages on when Hahn states that while one can describe an economy with certain properties, 'this of course does not mean that any actual economy has been described. An interesting and important theoretical question has been answered and in the first instance that is all that has been done' (p.126).

At issue are questions about *how* 'agents' matter, not only in terms of numbers - of, say, adding more markets and increasing the opportunities for exchange - but also in respect of how their *conduct* ('behaviour') should be *understood* in order better to model that behaviour. What *is* this conduct that has now (in the context of the limitations of Arrow-Debreu GE) forced itself upon the theorists attention? What does it *mean* to say that the individual learns? How does the theorist understand the notion of learning and how should this be represented? (Hahn, 1973a, pp.18-21). Agents hold 'theories'; what causes them to change their theories? (p.25).¹⁷

It is entirely plausible, especially if one reads through the formal language in which the arguments are couched, to suggest that Hahn is grappling with hermeneutical problems. His discussion, which involves the formation of expectations, motives, beliefs, and learning, certainly seems to imply that as the theorist gropes towards a better theory he has to take account of things that we understand - in the sense of *Verstehen* - in the conduct of others (see 1980, esp. pp.132-133).

Even if this interpretation is too radical, it must surely be admitted that his arguments place him well outside the framework of the modernist paradigm. Agents may have to deal with things that they cannot observe (p.132). In entering into new areas, areas with which they should be concerned as theorists who wish to provide a more *enlightening* theory (Hahn's says the old theory was 'unenlightening'), 'we certainly have no axiomatic foundations... and scarcely have we a psychologically plausible account' (p.132). This statement, too, justifies the impression that neoclassical economics has moved beyond the realm of an epistemology and into that of a hermeneutical discipline in Rorty's sense.

¹⁷ In the context of this question Hahn (1973a, p.26) adds candidly, revealing the hermeneutical dilemma, that he is 'at this stage not at all clear of what the precise formulation should be. So I content myself with the ill-specified hypothesis that an agent abandons his theory when it is sufficiently and systematically falsified.' When confronted with such problems the solution is to retreat to the safety of the assumption that agents are logical empiricists!

The type of explanation being sought is not that of rendering a phenomenon familiar by showing that it is one more instance of a covering law. Theorists concerned with these 'new' problems seek enlightenment, insight, or understanding - the second of the two conceptions of theory described by Natanson - which comes not from applying a particular predetermined framework, but from discourse (see Chapter 4, below).

B. Examples from other neoclassical writers

By addressing only Hahn's ideas, it may be felt that this is a distorted interpretation of what neoclassical economists are thinking. His arguments, however, are echoed in the writings of others. The examples given below are chosen not only because they exemplify the same type of thinking, but also because the authors are neoclassicists of high standing.

Arrow (1974), in his presidential address to the American Economic Association, holds that 'the uncertainties about economics are rooted in our need for a better understanding of the economics of uncertainty; our lack of economic knowledge is, in good part, our difficulty in modelling the ignorance of the economic agent.' (p.1). This is a formalistic way of referring to what Shackle (see (1983)) terms 'unknowledge'; the fact that much of what we do necessarily involves conjecture. The individual confronts a world with a less than complete set of futures markets and 'he cannot know the future' and 'faces a world of uncertainty' (p.6). Arrow's attempts to deal with the problem - within the context of an equilibrium framework - are edifying in terms of how the equilibrium theorist thinks about the world, but are less than satisfactory.

Both in this article and a subsequent one (Arrow, 1978), the essence of the issues can be discerned, even though Arrow speaks about 'our intuitive understanding, our *verstehen* ..., of the market as an institution' (1974, p.4) but he fails to apply the same notion to the interpretation of human conduct. By doing so, he would

have provided a quite legitimate means of investigating what uncertainty means for the individual.

'If expectations are... important, the mode of their formation becomes critical' (1978, p.158). The issues are not, as Arrow somewhat grudgingly concedes, the traditional problems of equilibrium theory. In his words, the world which he has sketched is not that of the 'pure neoclassical model' (p.7) but one where buyers and sellers are not 'willing to make commitments which *completely* define their future actions' (p.8, emphasis added). In terms of the need for a determinate theory to be complete, the lack of such commitments is a fatal flaw for equilibrium theory.

As an additional example of neoclassical writers confronting hermeneutical issues, Fisher (1976 and 1979¹⁸), is sensible to the fact that old rules do not apply in the area to which his ideas are leading. This is particularly evident in his argument (1979, p.3. quoted below in a different context) about the difference between the way in which the behaviour of agents *ought* to be represented and the way it is actually represented so as to make the problem tractable within an equilibrium framework.

The enigma that Fisher encounters is that of dealing with 'consciousness of disequilibrium'. To his credit, he does not simply resort to ready-made equilibrium models - as Arrow does - in order to deal with, and effectively discard, the problem that has surfaced.

¹⁸ Although this paper (Fisher (1979)) was published in *Econometrica* (Fisher (1981)), the contrast between the two versions is marked, in respect of the arguments that matter to the thesis. The later version (Fisher (1981)) has been 'sanitised'. Many of the arguments which refer to controversial methodological (especially epistemological) issues, such as dealing with agents' uncertainty and their 'disequilibrium consciousness' (1981, pp.3-5) have been removed. In short, the analysis is more safely back within a modernist epistemology and the hermeneutical problems have been circumvented or at least have been partly concealed.

Could we do this adequately [step outside the model and allow consciousness of disequilibrium], it would be a great advance. However, we have no adequate theory of disequilibrium behaviour and all these [neoclassical GE] models impose equilibrium-derived behaviour on a disequilibrium process. This is obviously unsatisfactory wherever it appears. (1976, pp.22-23).

V. AN ASSESSMENT OF THE HERMENEUTICAL TURN

These 'internal' criticisms by would-be reformers of neoclassical theory recognise that some aspects of neoclassical theory are 'unenlightening'. The authors have also posited corrections which theorists should take in order to improve orthodox theory. Their suggestions are supposed to extend or 'broaden' the scope of the existing theory.

But in voicing their concerns, the reformers have begun to explore questions which lie beyond their customary purview. They speak about the formation of expectations, uncertainty, and about the individual's consciousness. These are matters which, from a positivist-empiricist point of view, belong to metaphysics rather than to science. So, the question of whether the modernist paradigm is appropriate to their interests is hardly at issue any longer.

The internal criticisms do not explain *why* the theory is unsatisfactory, except by implying that it is too narrow. Such an explanation is called for. If these issues are indicative of why the Arrow-Debreu theory is unenlightening, it is because *neoclassical theory does not provide an adequate explanation of the basis of individual behaviour (decision-making)*. The matters that are receiving attention concern the individual's consciousness of his world; how he learns about the world; what learning and uncertainty mean for his (equilibrium) behaviour; and how expectations affect his equilibrium behaviour.¹⁸

¹⁸ Proving the existence and stability of equilibrium is *always* necessary in order to support, or to 'test', the postulate that 'no plausible sequence of economic states will terminate, if it does at all, in a state which is not an equilibrium' - which is how Hahn (1973a, p.7) defines the main proposition of an equilibrium scheme. Because equilibrium *per se* has not been identified as the problem, and because our interest is in the limitations of neoclassical (continued...)

The suggestion of the thesis is that the problems can properly be called hermeneutical ones, concerned with interpreting individual behaviour and finding out how to represent that behaviour. How should the theorist 'see' the world out there? What aspects of individual behaviour should be included in (an equilibrium) theory which conveys, more satisfactorily than hitherto, what goes on in an economy?

At first blush the answers appear to turn on how to dispense with the auctioneer or with recontracting, which involve no trading out of equilibrium and which are staple elements in a Walrasian framework. But discussion of these devices, and the problems of removing them, is quickly seen to be a veneer which masks the issues identified ¹⁸ e. Once the surface layer is peeled away, the problems are those of how to deal with uncertainty, with historical time as 'duration' (when things are susceptible to unanticipated change), rather than with time as extension, with expectations, and with learning.

In the literature, the problems are identified as price adjustment problems or as problems of local or global stability. They are actually about what individuals know and how they know, as seen from the perspective of the theorist who has to model the behaviour of those individuals. They are also problems which reflect - as some of the quotations reveal - the *theorist's* uncertainty about how to proceed in the face of the 'inadequate state of our present knowledge'.

This can be taken to mean that there is no clearly identifiable, satisfactory, way of dealing with the issues within an equilibrium framework. Later in the chapter it is shown that such problems *cannot* be resolved within an equilibrium framework. The problems themselves are 'caused' by the epistemology of a determinate scheme (*i.e.*, the third-person perspective).

¹⁸(...continued)

theory as perceived by the theorists themselves, problems of existence and stability can be excluded from a definition of the 'new' problems of economics that are of interest to neoclassical theorists.

There is no suggestion that neoclassical theorists have deliberately set out to explore a previously uncharted region. They have stumbled upon these issues in the process of trying to escape from the 'straight and narrow road' which, Hahn says, lead to such disappointing results.

Accidental or not, these are issues which economists need to pursue. An understanding of conduct and decision-making is a prerequisite for explaining phenomena such as the location of industries, and neoclassicists are flirting with them because, when economists are unencumbered by a modernist framework, they are logical questions to ask.

For the present, however, the reformist authors are doing no more than thinking out aloud. As theorists for whom equilibrium is crucial they realise that detours from the straight and narrow road are fraught with potential dangers, and they are prone to point out that the implications of pursuing a particular idea are too complex, or that the present state of knowledge is too unsatisfactory, to move out of a well circumscribed area.

So when new ideas are mooted (e.g. Hahn (1978), Fisher (1979)) the issues are cast in such a way as to force them back into the GE mould, presenting the problems from the third-person perspective that is examined below. Fisher's reflections (1979, p.3) serve to illustrate this point.

Even allowing agents to alter their expectations in sensible ways does not permit them to take into account the fact that their expectations may be wrong. Simply put, agents in the present model always behave as if they lived in a world of certainty....

I do not see the way towards a satisfactory solution here. Microeconomic theory is primarily an equilibrium subject. We know very little about the individual behaviour in disequilibrium. Further, a full-dress treatment of behaviour under uncertainty in a disequilibrium situation strikes me as too complex for incorporation into this sort of model at least in the present state of our knowledge.

Compare this with Hahn's view of a few years earlier (1973a, pp.20-21). Defining the equilibrium action of an agent as the action which 'an outside observer, say the econometrician, could describe... by structurally stable equations', Hahn adds that

[w]hen the agent is learning however, then there is a change in regime so that one would require a 'higher level' theory of the learning process. Such a theory is not available at present.... In our present state of knowledge... it is routine behaviour and not behaviour which we can hope to describe.

One may interpret these statements as a tacit admission that there is no single conceptual framework and methodology that can be applied to all the questions that the theorist may pose and which ('in our present state of knowledge') is entirely independent of the researcher's social and cultural milieu. This, in Rorty's view, is a conception of science as a hermeneutical endeavour (see also Warnke (1987, Ch.5)).

These theorists are exploring traditional concerns of the existence and stability of equilibria by using a 'more realistic theory' of behaviour. What happens if the notion of the auctioneer is abandoned and sellers fix prices while buyers search for the optimal price? Will the system converge to a competitive equilibrium (see Fisher (1976, pp.23-25))?. Will the equilibrium still be stable if agents may choose whether or not to exercise their demands in the future?

The purposes of theory, of which reformers speak, are traditional ones. In some degree, however, the *language* they are using is that of the subjectivist-hermeneutical tradition which includes the notion of *Verstehen* - interpretative understanding - reflecting the intentional nature of human conduct. Implicitly, the task of economics has broadened or has shifted because the theorist has had to ask questions about how the agents, as subjects, see the world. It is entirely appropriate that economists, wishing to develop theories based on the decisions of individuals, should do this. But when the theorist returns to the comfort of familiar modernist methodology, he finds neoclassical theory unfit for the task.

In the next section, by exposing the epistemology and ontology identified as the third-person perspective, our object is to understand the limitations of the theory. In order to do so, it is necessary to establish what the scheme of things 'looks'

like. What is the theorist postulating about the world and how is that reflected in what people know?

VI. EQUILIBRIUM *VERSUS* UNDERSTANDING

Arrow (1968, p.376) states that the notion of GE has 'two basic, though incompletely separable, aspects'. They are: 'the simple notion of determinateness', and 'the more specific notion that each relation represents a balance of forces'. Determinateness means that 'the relations that describe the economic system must form a system sufficiently *complete* to determine the values of its variables' (emphasis added).

Completeness is a state of affairs. What does it mean if applied to an economy or market; what would that 'world' be like? One way to clarify this is to get 'inside' the world of an equilibrium scheme, with the object of examining its appearance to an individual who inhabits it. What does it mean to say that the world in which he lives is one where the relations that describe it form a complete system? How would he understand that world? What would he know? The approach exposes both the epistemological premisses of an equilibrium theory and the ontological implications of such a scheme. It helps to reveal the meaning of the third-person perspective.

A. Maximising behaviour

We do not know much about the 'agent' and 'firm' of equilibrium theory except that they are 'rational choosers', which means that they 'aim' to optimise something.²⁰ How does the postulate of optimising arise, and what are its epistemological implications?

²⁰

For the purpose of the analysis it does not matter whether the object is to maximise (*e.g.* profits or utility), to minimise (*e.g.* costs), to find an optimal strategy (as in game theory), or to 'satisfice'. It is argued in the thesis that the epistemological implications in all cases are the same. Each conception of optimising is a third-person perspective.

It is difficult to answer the first of those questions because neither through introspection, nor on an understanding of the conduct of others, does the possibility of optimising arise.²¹ It is not a way that we can think about ourselves. Such a conception is not associated with consciousness in the *durée*, Bergson's notion of the inner stream of duration in which we are immersed (see Schutz (1972, p.45)). The stream of experience is about discovering and continuously becoming aware, the 'world' unfolds as we constitute it in the *durée*. Optimisation is only conceivable if one has a grasp of a complete scheme.

Early catallactists, concerned with explaining market behaviour, would have had little difficulty convincing themselves and others that certain things that individuals do are based on reason. One may even take the view that planning - thinking about doing something, considering the possible implications and, in the light of this, deciding whether it is worthwhile - is the cardinal human characteristic. Yet there is an enormous epistemological gulf between the idea that people sometimes reason about what they do, and that individuals maximise (optimise). Reasoning is understanding. Optimising is the solution to a conundrum - that of visualising the world as determinate and is the product of the epistemology of the third-person perspective. The conundrum has nothing to do with being-in-time.

B. The third-person epistemology of a maximiser

What does optimising imply about the individual's 'knowledge of the world'? Schütz (1943) describes 'the knowledge that a man living naïvely has about the

²¹ See, however, Fusfeld (1980, pp.5 and 6). He explains that in its early development, the neoclassical theory of consumer behaviour was 'explicitly hedonistic, particularly among the English economists' and that this hedonism 'was criticised and ridiculed by prominent institutionalists.... Veblen, in particular, was able to show not only the weak psychological foundations of the theory, but also its ideological bias towards political conservatism and the maintenance of the status quo.' He adds that Pareto and others 'substituted an objective rationality of observed benefits and costs[,] in which net benefits were maximised[,] for the pleasure-pain calculus of hedonistic psychology.' Then, with the revival of GE in the 1930's 'and the rise to dominance of the method of logical empiricism, the hedonistic interpretation of consumer behaviour was replaced by a theory of rational choice based on orderly preferences.' Heiner (1983) offers a useful condensed survey of the literature, highlighting variations of optimising behaviour and providing an overview of the different interpretations that theorists place on the use and applicability of the optimisation hypothesis.

world' (p.136) and he contrasts this with the knowledge that would be required for the postulate of rational (optimising) action (p.142). Schütz also states (p.141, emphasis added) that

we have to distinguish between the rationality of *knowledge* which is a pre-requisite of... rational choice and the rationality of the *choice* itself. Rationality of knowledge is given only if all the elements from which the actor has to choose are clearly and distinctly conceived by him.²²

While noting that he hardly begins to cover all aspects of the knowledge which an individual would have to have in order to be able to maximise, Schütz does list some of these (p.142) and they include knowledge of the 'place of the end to be realised' as well as its 'interrelations with other ends'. Concerning means, Schütz suggests that the actor would have to know 'the different chains of means which technically or even ontologically are suitable' and he would have to know whether and how the means interfered with other ends. Schütz also recognises that the problem merely of identifying what knowledge is implied in the maximisation postulate multiplies once the social context of action is taken into account (see pp.142-143). The implication of Schütz's list of what each individual would have to know in order to optimise is just that *each would have to know everything there is to know about the world*.

The individual who could think about optimising is someone who is able to treat the opportunities available to him in the world, and therefore the world itself, as being utterly *complete*. That means a world where there is nothing beyond what he already knows - nothing that he can even imagine or anticipate. What he confronts 'now' is all there is and all there ever will be. And everything is accessible to him. All the implications of whatever he might 'choose' to do, including the ways in which every other individual will respond to what any one else does, must be known. His knowledge has to be truly comprehensive so that nothing remains hidden from him and nothing is still-to-be-revealed. Even if some of the knowledge about

²² See pp.138-139 for a discussion of the different meanings associated with the term 'rational'.

the world is currently unavailable to him, completeness means that he must know precisely what is 'unknown', meaning that there is a means available *now* of generating the 'knowledge' for 'future' time periods.

An individual who had not yet tried out, and exhausted, all the opportunities for action, and did not know all the consequences of pursuing all the opportunities, would not be able to optimise. He would have to conjecture about what might be the right thing to do, but having done it he could not be sure that it was the optimal.

The idea of optimising must imply a stationary state in which all opportunities could be, and have been, discovered. More precisely, the idea that the world of the optimiser is complete means that it is timeless, one without a future, because this would imply that there are courses of action that are yet-to-be-revealed. In this case the full extent of the world is not known and tested.

Time, uncertainty, expectation, and conjecture are extraneous notions in the world of the optimiser. Time, the *durée* of being, is a continuous unfolding of understanding; *i.e.*, becoming aware, finding out, learning. This 'acquisition of knowledge' means that *I (as being-in-time) did not know this before*. Shackle (see especially 1972a) explores these themes at length in his work, and argues that in a timeless world the notion of choice is meaningless. When he speaks of 'novelty' - change, newness, variation, innovation, uncertainty - the connotations identify all that does *not* pertain to the world of the maximiser (p.424).

Knowledge, novelty, surprise, are correlative terms. There can be no surprise where there is knowledge guaranteed to be complete. Novelty is incompatible with complete knowledge. Novelty... is the revelation of a gap or flaw in what was deemed to be knowledge.

C. The ontology of a third-person perspective

The third-person perspective denotes the comprehensive world view that is associated with the grasp of a complete scheme of things. The most important feature of this epistemology and ontology is that it is literally a *world* view,

embracing at one instant everything that there is to know, and precluding any point of view, or perspective. All conceptions of *determinate systems* rely on a third-person perspective, whether of economies, markets, or even individuals and firms. The epistemology of the third-person perspective is established by the postulate that 'the system' will produce certain results, or have an outcome, and that the workings of the system can be determined in order to define the outcome.

Various authors, including Hahn as quoted earlier in the chapter, interpret the 'knower' of neoclassical theory as a 'detached, external observer' (see, for example, Coddington (1972, pp.12-13)). Our discussion should eliminate the confusion caused by the expression. The term 'detached observer' could refer to someone who watches from the sidelines; someone, not involved in the activities himself, who studies the activities going on over there 'objectively', with all his training and expertise. If this is the conception of an observer, the third-person perspective has nothing to say about such a person, or about what he observes or understands.

The third-person perspective *prescribes* what the world is like, in all its completeness. To know of everything in the world means that the world is *out there*. The ontology of a third-person perspective is that world out there; something which exists entirely beyond (outside of) the individual.

The optimiser must be able to determine how far he is from attaining his goal with each 'choice', or 'course of action', that he could possibly make. He must be in a position to compare the consequences of all 'choices' in order to determine which are best for him. That he is able to do so depends on the world being complete. Everything that pertains to his actions has a *concrete existence* in the world out there. 'Tastes', 'resources', 'technology', and even 'knowledge', have properties which enable them to be compared in respect of the contributions each makes to the agent's 'goals'. The goals are not personal or subjective, they are not associated with impressions, feelings, judgements, or thoughts, but *reside in things* out there; in maximising utility or in minimising costs, for example. It is the thing

itself out there, the bundle of goods, or the investment opportunity, that contains the 'goal' of utility or profit maximisation. When the right one is selected, the individual 'attains his goal'. The ontology of knowledge is the same. Knowledge is something that can be 'acquired' and 'change' - something physical that exists in the world as a *thing*.²³

Shackle (1972a, see p.246) understands that neoclassical theory depicts a world consisting only of things, and argues that economics should acknowledge that actions are 'based on' *thoughts*. This comes as close as any view to recognising the ontological incongruities between the individual and the neoclassical agent. The contrast between a first-person and third-person perspective makes their epistemological roots explicit.

The idea that the individual is only conscious of the moment is what is meant by his *perspective*. Understanding *is* a perspective. His attention is focused on certain things - his interest - and that constitutes his 'world'. The epistemology of understanding is referred to in the thesis as a 'first-person perspective' and a theory that tries to establish the individual's perspective, or how he constitutes his 'world', as a basis for explaining conduct is one formulated from a first-person perspective. This is the epistemology of the 'actor', and the 'observer' is an actor and just as much an 'understander' as the actor, 'seeing' things from his own standpoint.

Associated with this conception of observation, which comes from the tradition of hermeneutics, is the idea that the individual's perspective is one that he *constitutes*, or creates. Understanding, interpretation, insight, is always a personal perspective. The world of the observer is, in some measure, *his own* world, of his own making.

23

These considerations help to explain why mathematics has proved to be such a useful tool in developing equilibrium theories. Each mathematical variable has a 'real' counterpart in the determinate scheme. Conceived as things, knowledge, expectations, prices, and even time ('weeks' or distinct 'periods'), are physically transformed in the way that equations are manipulated. When the values of the variables change, the things in the world change.

Bernstein (1983, p.123), summarises Gadamer's interpretation of the concept of play and of the individual observer's involvement with works of art. By close analogy, Bernstein offers a view of the individual's 'relationship' with the social world, for the argument applies not only to the interpretation of works of art or of texts, but also to his interpretation of events and his interaction with and understanding of other people.

A work of art is not to be thought of as a self-contained and self-enclosed object (something *an sich*) that stands over against a spectator, who, as a subject, must purify himself or herself in order to achieve aesthetic consciousness of the work of art. There is a dynamic interaction or transaction between the work of art and the spectator who "shares" in it.

Even this way of speaking can obscure the fact that a work of art is essentially incomplete, in the sense that it requires an interpreter. And the interpreter is not someone who is detached from the work of art but is someone upon whom the work of art makes a claim. The spectator, then, is present to the work of art in the sense that he or she participates in it.

There is neither an epistemological nor ontological distinction between the 'worlds' of actor and observer. Both are understanders and interpreters. The distinction pertains to the double hermeneutic, as understood by the theorist. The actor's perspective refers to how the individual 'sees' the world. The observer's understanding involves his interpretation of the interpretations or understanding of other people.

The social scientist, whose object is to explain conduct, is always an observer, engaging the double hermeneutic, understanding the understanding of others. Understanding is *discovery*, not claiming to pile fact on fact until the whole scheme is revealed (which is the Cartesian idea of knowledge as objective and impersonal). There is always 'more' for the observer or individual in the *durée*. Later, he will understand differently.

Sometimes we speak of the individual's perspective, as if that was somehow given without understanding or interpretation. But the theorist is as much interpreter as the individuals whose activities are of interest. Interpretative understanding is

always there, both on the part of the theorist, or observer, and the actor. The first-person perspective, though concerned with the individual's understanding, is about how, as theorists, we understand that understanding.

An equilibrium theory is not scheme that explains conduct, or social institutions because the epistemology of the third-person perspective has nothing to do with understanding, therefore nothing to do with observation. The world - tastes, resources, the market, and so on - is merely 'given' and complete.

VII. EQUILIBRIUM THEORIES CANNOT BE REFORMED

The ingenuity and effort that have gone into attempts to construct a complete world are remarkable. The devices for doing so, the primary purpose of which was to eliminate the *durée* - with connotations of novelty, uncertainty, the unexpected - are an important part of the development of GE theory as revealed by the existence and stability conditions of GE.

In this section, we examine these devices and then describe attempts to reform the theory with 'realistic assumptions' about decision-making in time. Since the reforms do not alter the epistemology, they do not bring us any closer to understanding conduct, but they begin to cause 'technical' problems for the equilibrium theorist because the completeness of the scheme is in question.

Shackle identifies a difficulty for equilibrium theory associated with the temporality of decisions, pointing out that the outcomes of a person's 'choices' depend on what other individuals do (and even on how they respond to him). Equilibrium - involving the consistency of 'plans' in the aggregate - requires that 'choices' are 'pre-reconciled' (Shackle (1972a, see pp.53-54, 252-254, 264-266)).

In order to pre-reconcile choice, it is necessary to resolve a paradox: how can individuals choose their own, best courses of action while, at the same time, knowing what other individuals are *going* to do? The paradox is resolved because

equilibrium market prices convey all the information that agents need. They contain information about all individuals' 'choices', and every person, taking his orientation from the equilibrium market prices, can adjust his actions to the actions of others.²⁴

Pre-reconciliation involves a sleight-of-hand, and Coddington (1975a, p.154 fn.

2) identifies the nature of the deception.

[T]he result that... market prices are perfect knowledge surrogates is something of a swindle or, at best a piece of conceptual conjuring. This is so because all the epistemic problems have to be solved in *reaching* equilibrium.... The reason that market prices 'reflect' everything that traders need to know about the market is because - somehow - they have been rigged to do so.

How is 'the market rigged'? Numerous different devices are used to solve the epistemic problems, but the role of each is essentially the same: to abolish time and the consequences of the passing of time.²⁵ For many years, until the late fifties, GE formulations invariably depended upon '*tâtonnement*' processes to ensure stability. A condition of no trading out of equilibrium was imposed, and for the most part the models were confined to situations of 'pure exchange', rather than including production.²⁶

²⁴ The main thrust of Kornai's (1971) critique of general equilibrium theory is that the theory substitutes a 'black box' for the important processes by which information is transmitted in the economy. But, in fact, the mechanisms by which information is provided and transmitted are built into equilibrium theory, no matter how inadequate they may be as a description of what actually happens in the economy. The problem is not that of a black box, but of a set of arrangements which are devised purely to obtain a determinate outcome, irrespective of what implications this may have for the purposes to which the theory may be put.

²⁵ Economists who have wanted to construct determinate schemes have found the notion of a stationary state particularly useful because it removes all the problems (of indeterminateness) associated with time. Marshall (1966, pp.304-306) refers to the notion as the 'famous fiction'. See also Shackle, (1965, pp.19-20 and 1959, p.295) ; and Hicks (1976, p.139).

²⁶ Schumpeter states (1967, p.911) that all three of the protagonists in the catallactist revolution were concerned with *barter* activities. They deal with markets for goods that are already in existence - a pure exchange economy. Neoclassical theorists tend to
(continued...)

If, in 'dynamic' formulations of GE, consumption and production are permitted, which affect the excess demands for goods in subsequent 'periods', what generally happens is that the 'time' in which adjustments of prices to equilibrium occur is separated from the time of consumption and production (see Fisher (1976, p.7)). Another assumption, which negates the element of time, is a complete set of futures markets (see Arrow (1978)).

Edgeworth's (1881, see esp. pp.15-56) process of recontracting, Walras's 'fictive tickets' (Leijonhufvud's (1968) term) or '*bons*',²⁷ the notion of perfect competition,²⁸ and even Pareto's indifference curves - because they prescribe the full extent of all 'preferences' and 'choices' - contribute to the task of pre-reconciling choices and to solving the problem of defining a complete world.

A. More realistic formulations

Those theorists bent on reforming neoclassical theory have discovered that when these devices are replaced by 'more realistic assumptions' about human behaviour

²⁶(...continued)

continue in this vein and to overlook the considerations - especially the implications of uncertainty - that arise when the investment and the production activity precedes the demand for the item, sometimes by many years. See Joan Robinson (1977, p.1321).

²⁷ This was actually a form of recontracting which Walras introduced into later editions of the *Éléments*, with a concept of provisional contracts which he called *bons* ('tickets'). (See Jaffé (1977 and 1981)). The idea behind recontracting is also carried over, in modern formulations of general equilibrium, in the notion of the 'core'. These formulations provide for a process of bargaining amongst economic units which permits a greater number of feasible equilibrium allocations than could be attained under perfect competition. As the number of participants in the bargaining process increases, however, so the number of feasible allocations constituting the core will narrow down until they eventually approximate allocations established in competitive equilibrium. See Arrow and Hahn (1971, pp.183-200) and Chipman (1965, pp.54-59).

²⁸ Perfect competition is simply a set of conditions which enables 'firms', independently, to adjust their output to demand, without having to know what other firms are doing. By stipulating conditions necessary to define a perfectly elastic demand curve for each firm, the notion of perfect competition gets around the paradox of how firms can take the market price as given while determining the price through their combined activities. It is purely and simply a device for pre-reconciling choices and for paving the way for the existence of equilibrium. It has nothing to say about competition among businesses, for which purpose a scheme embracing interpretative understanding is necessary.

(e.g., that people will not wait until equilibrium is attained), and about how the institutions of the market economy work (e.g., there is no auctioneer), problems of time begin to be felt and *uncertainty* (on the part of the agents) enters the picture. The scheme no longer appears to be complete and the existence of equilibrium is in doubt. Existence can only be ensured in many cases by making strange assumptions about human conduct, no less 'unrealistic' than the devices described above.

Hahn (1978) introduces 'conjectures' into an equilibrium scheme in which 'the auctioneer is replaced by the agents who change the prices at which they are willing to trade' (p.65). '[T]he designated equilibrium states depend on the conjectures with which we have endowed the agents - e.g. on their beliefs of the relation there might be between their ration and the announced price' (p.66). It appears to Hahn, and to us, that conjecture opens a Pandora's Box.

Unless arbitrary constraints are placed on what a person can conjecture and how conjectures are 'formed', in inventing a system for conjecturing - as has been done, say, with a distributed lag mechanism in attempts to model expectations - anything is possible. There is no necessary relationship between prices that are announced and the conjectures that people hold. Naturally, Hahn's basic concern is the question of how to make conjectures 'less arbitrary', for only by doing so will it be possible to once again return to the comfort (for the GE theorist) of the *complete world of the third-person perspective*.

Similar considerations are found in papers by Fisher (1976 and 1979), whose notion of 'disequilibrium consciousness' refers to a situation where individuals do not know what is going to happen and have to conjecture.

He notes that stability literature requires the 'present action postulate'. Its purpose is to ensure completeness because any excess demands - which is what 'drives' prices - must be expressed as actual demands and cannot be reserved (for the future) as potential demands, otherwise 'the system will bog down' (1979, p.6).

In the absence of futures markets (which are included to ensure that the scheme of things is complete), 'the fact that I expect to require toothpaste ten years hence is made to propel me into the spot market for toothpaste even if I am having some liquidity problems....'

Fisher's toothpaste example is particularly interesting because it illustrates how the third-person perspective grips the imagination of the equilibrium theorist. In spite of the conceptual problems associated with 'disequilibrium consciousness', there is no difficulty in imagining that the individual has a complete (dated) set of preferences for toothpaste!²⁹

Arrow's treatment of uncertainty (1974) exemplifies the same problem. When he speaks of 'modelling ignorance', Arrow does not proceed to explain what people do when they are uncertain. His starting point is the (third-person) notion that agents could, in principle, know everything. Knowledge is a thing that the agent has, which corresponds to what the world out there is like. Ignorance means that this knowledge is incomplete. Some part of the agent's (measurable, quantifiable) stock of knowledge is missing and does not mirror, fully, the world out there.

Since equilibrium is dependent upon being able to treat the scheme of things as complete, if individuals do not have complete knowledge (*i.e.*, if they are 'ignorant'), then quite logically, in order to make the scheme complete, the theorist must include in his formulation what people *do not* know.

In this context, 'complete knowledge', a defining characteristic of the third-person perspective, means being able to specify, or to define (as knowledge), the knowledge that people *do not* have. The world consists of the 'knowledge' plus the 'ignorance' of each agent. Ignorance is the difference between the world in its entirety and what each individual agent 'knows' of the world out there.

²⁹

To be fair to Fisher, in an earlier paper (1976), he protests at the idea that a household requiring toothpaste in the future should immediately enter the futures market.

These are the consequences of attempting to deal with uncertainty within the epistemology of an equilibrium scheme. The resulting notion of uncertainty or ignorance is nonsensical. The much more reasonable attitude of O'Driscoll and Rizzo (1985, pp.3-4) to the issue of ignorance is directly relevant to this position and should be contrasted with it.

Ignorance is not something that, at least at some level, can be avoided or overcome. It is not a state of imperfect knowledge that some process asymptotically eliminates. As long as we remain in a world of real time, unexpected change is inevitable and ignorance is ineradicable.... Ignorance should not be transformed into a variant of knowledge.

B. The options for neoclassical theorists

The examples given here illustrate that the third-person perspective, and the equilibrium scheme as companion to this epistemology, cannot survive attempts to describe or explain action which has the characteristic that the individual does not know what lies ahead of him. Hicks (1976b) holds that even the dynamic equilibrium theories, while not steady state models, are based on a comprehensive world view where '[t]here is no room for the unexpected' (p.144).

Now, as the reformers recognise, uncertainty cannot be ignored; *a fortiori* when investment decisions are the object of investigation. At this juncture, however, posing questions about the individuals' understanding of the world, they are in a bind. One possibility is to go the whole hermeneutical way, and to take cognisance of the *durée* and the subjectivism of understanding. But allowing different individuals to understand differently means sacrificing completeness and abandoning determinism.

The alternative is to pursue the path that the reformers currently tread. The identification of problem areas, where the treatment by orthodox theory is less than satisfactory, is followed by a superficial exploration of the problem, which takes them to the point where they recognise that any thorough-going attempt to deal with it means leaving the safe-haven of determinism. Scientists who accept the

cannons of positivism-empiricism either should not, or will not, do this. So the desire to understand human conduct is sacrificed in the name of 'scientific rigour'.

As we argued in the first section of this chapter, the idea that science has necessarily to be equated with determinism is now outmoded. Developments in the philosophy of science encourage a more eclectic view of science and it is increasingly acceptable to treat scientific discourse as a hermeneutical activity. Unfortunately these developments have yet to leave much of a mark on economics, although hermeneutics is beginning to get a hearing (see Lavole (1991a)). So economists are reluctant to seek solutions beyond their customary habitat.

The reformists' approach is not a solution for those who seek an understanding of human conduct. All it does is to produce a more complex, but not necessarily a more satisfactory, theory. It is still 'stuck' in the epistemology of the third-person perspective. The economist has little option but to abandon this.

The purpose of the critique of the economic theory of location, in the next chapter, is to show what happens when the epistemology of the third-person perspective is applied in order to explain particular decisions and their consequences. The theory of industrial location is suited to this task because there is no doubt that it is an attempt to construct a determinate theory of decision-making.

Our object is to survey the theory in order to establish what sort of 'story' it tells about how locations are chosen. Later, with an understanding of what a subjectivist approach entails, we can re-examine location decisions from a first-person perspective and compare the explanation of firms' locations. In this way, it is hoped, we can show just how seriously the story told through the language of an equilibrium scheme misrepresents what businesses actually do.

CHAPTER 3

A CRITIQUE OF LOCATION THEORY

Our theories, regarded as tools of analysis, are blinkers.... As we use them, we avert our eyes from things that may be relevant.... It is entirely proper that we should do this.... But it is obvious that a theory must be well chosen; otherwise it will illumine the wrong things.

Sir John Hicks, "Revolutions" in Economics', p.208

I. THE FOCUS ON INDUSTRIAL LOCATION THEORY

Our critique of neoclassical theory, that it is unsuited to its purpose, is based on the acceptance of two important assertions: that neoclassical theorists wish to explain decisions and choices, and that the explanation which they seek is synonymous with obtaining insight and practical understanding.

Though the main interest of orthodox theorists is to examine the implications of agents' 'choices' for an entire system (i.e., to establish whether and how the choices made by different people can be, or can become, congruent), at the heart of the theory are devices to represent decision-making, revealed by the theory of consumer choice and other elements of the neoclassical scheme. The present task is to illustrate why the theory is unsuited to explaining such decisions, by examining industrial location theory that incorporates the epistemology of orthodox theory.

Problems of industrial location are used in this thesis to illustrate the shortcomings of neoclassical theory and also, in later chapters, to explore implications of an alternative approach to decision-making based on interpretative understanding and a first-person perspective.

There are various reasons why location theory was selected for these purposes. The economics of location has been developed in two phases. The initial or

'mainstream' location theory amounted to a straight-forward application of neoclassical theory to 'spatial problems', and there is no doubt that the writers who formulated this theory aimed to explain the location of industry. Since the seventies, neoclassical theory has come under scrutiny from industrial geographers, who draw on that theory in different ways but develop an alternative approach to location decision-making based on behavioural psychology.

Both approaches have been supplemented by empirical evidence of the factors that industrialists take into account when selecting a location (see, *inter alia*, Albert and Kellow (1969); Carrier and Schriver (1966 and 1968); Luttrell (1962); North (1974); Nishioka and Krumme (1973); Stafford (1974); Stevens and Brackett (1967); Townroe (1968 and 1971)). Questions were posed to industrialists and the responses were taken as tests of the validity of the theory and of the rationality of their decisions. Although writers like McMillan (1965) are critical of the value of such surveys, they support our contention that this one part of neoclassical theory, developed and refined over half a century, was clearly formulated to answer *practical* questions about the principles that should guide the location of firms.

In this chapter, we establish whether the theory is successful in this task and whether, as modified by industrial geographers, it escapes the criticisms that we have levelled at neoclassical theory. The epigraph of this chapter warns that theory may blinker as well as guide. When applied to problems of industrial location, how does that theory focus the scholar's attention on what? What are location decisions and how are they explained? The object of this chapter is to reveal, on the one hand, how the location *theorist* 'sees' the world, and, on the other hand, the nature of the location problem that the theory ascribes to the *actors* involved in 'locating a business'.¹

¹ The phrase 'locating a business' is placed in quotation marks because there is a marked difference between the way in which location problems are described when these matters are *discussed* by theorists, on the one hand, and the nature of the problems as they appear in the formal models of location, on the other hand. The latter have no bearing on business problems.

II. NEOCLASSICAL LOCATION THEORY

Models of the location of economic activity had begun to be developed in the first half of the last century. In the context of formulating a scientific theory of rent and in analysing the spatial configuration of production, attention was given to the location of primary producers, specially agricultural production. Among the forerunners of location theory, von Thünen ([1825] (1875)) is concerned primarily with the location of agriculture.

Not surprisingly though, given the growth of secondary activity that occurred in European countries in the second half of the last century, and the social changes that accompanied this growth, it was issues associated with the location of *manufacturing* activity that directed the economic theory of location. Neoclassical economics, as the orthodox theory of the time, provided the conceptual tools for the development of location theory. The contribution of Alfred Weber ([1909] (1929)) represents the first systematic treatment of problems of industrial location and marks the origin of modern neoclassical location theory, which carries on through the work of Palander (1935), Lösch ([1939] (1954)),² Hoover ([1948] (1968)), Greenhut (1956), Isard (1956), and D.M. Smith (1971).

A. The object of location theory

What is the theory of location about? The answer is clear-cut and Lloyd & Dicken (1972, pp.1-2) provide a definition. Although, in general, economists steer clear of spatial considerations, there has, nevertheless, been an ongoing interest in

² Certainly until the end of the war, when American writers took up the problems of location, interest in, and contributions to, the theory of location was much stronger in Germany than elsewhere. Isard (1956, p.27) attributes this strength to the confluence of the ideas of the German historical school, which gave attention to spatial implications of economic development, and to the impact of Walrasian economics upon German economists.

the construction of *general principles and theories* that explain the operation of the economic system in space.... The central concern is the search for the explanation of *general locational tendencies and patterns*.... (p.3)

D.M. Smith (1971, p.5), likewise, describes industrial location analysis as 'the study of the spatial arrangement of industrial activity'. This subject-matter has remained the same from the time of Weber. Smith specifically alludes to the role of *decisions* in location theory.

As the participants in a specific industry make their location decisions, selecting some places for development in preference to others, an areal distribution pattern emerges.... Attempting to understand industrial location patterns, and the individual decisions embodied in them, constitutes the fundamental task of the field of inquiry which is [industrial location analysis].

It follows that the spatial arrangement of economic activity involves two inter-related sets of problems: the issue of the spatial patterns of industrial or economic activity, and also what causes, or determines, the pattern. The quotation also confirms that the theory actually attempts to *understand location decisions*. It is the task of the chapter to dispel such hopes.

B. To a location decision

In the context of the theory, what is a location decision?

Location decisions are made by firms. The firm is generally viewed as small because, like the archetypal perfectly competitive firm, it is treated as a price-and-demand-taker.³ It is also generally viewed as a single-plant operation, though again the rationale for this is difficult to find, because a firm is merely 'a thing' with 'purely economic relationships' with other firms, suppliers of resources, and customers. There is no sense of an organisation, as a manager or other employee would understand the concept, as something that has intersubjective existence in

³ As Stafford (1972, p.189) notes, 'the [usual] simplifying assumption [is] that factor prices are independent of the operation of the enterprise in question.'

terms of people's relationships with one another, with implications of control and authority. D.M. Smith (1979, p.38) identifies the 'traditional focus' of location models as a factor, 'viewed in isolation from other elements of the space economy and society, except for sources of inputs and destinations of outputs. Its individual economic success (usually the level of profitability) is the sole operative criterion of performance.'

Choosing a location means optimising, subject to constraints. The difference between location models and other neoclassical models of choice is that in the former the optimisation problem has a 'spatial' dimension. The spatial element means that the things which are relevant to the firm's 'decision' - resources, other firms, customers - are arranged, or scattered, on a grid in Euclidean space. These factors are not necessarily all relevant in respect of any particular model of decision-making. In some models the focus is resources, including their transport costs, and the locating firm's relationships with other firms are ignored. Other models may highlight the importance of the market.

The firm has to 'choose' the optimal position in space in the light of the prescribed assumptions. Sometimes firms minimise costs, so their proximity to suppliers and raw materials is important, while *revenues* are constant in space. In other models demand and maximising revenue is the object of the exercise, so it is the distance from the market that is crucial and it is assumed that *costs* are spatially constant. The firm may be concerned about its spatial relationship with other suppliers that sell into a predefined market area. Where it locates in relation to customers as well as other firms has a bearing on its sales and revenue.

C. The location models

The core of location theory is thus standard 'axiomatic economics'. The agent is a rational optimiser who must 'choose', but in the face of a different set of constraints. There are 'tastes', 'resources', and 'technology' in the optimiser's world, but wherever he 'goes' in Euclidean space, either costs or revenues, or

both, are different. The values of all variables have a 'spatial' dimension - varying with their distances from points within a system of axes.

From one generation of theorists to the next, the analysis of location decision-making leads to more complex models being developed. This complexity is reflected in the concepts and types of relationships they include and that the theorists seek to explain. The early models tend to focus on the importance for location of one set of factors, say costs of production. Later generations of writers, such as Lösch (1954) and Greenhut (1956, 1963), combine different approaches, which means that their models include a number of objectives as determinants of location. In some cases, for example those of Weber (1929) and Palander (1935), it is a partial equilibrium framework, and the authors deal with the location of a firm or with one market area. In others, a general equilibrium approach is adopted, where the interrelationships and the problems and patterns of location pertain to the economic system as a whole.

Useful overviews of the neoclassical theory of location are contained in Carrler and Schriver (1966, see Ch.2), Isard (1956, Ch.2) whose outline of the literature pays particular attention to the work published in German, and Webber (1972, Ch.2).⁴ Isard, besides sketching a comparison of the models of different theorists, also deals with the concurrent evolution of neoclassical methodology, highlighting the shift from a partial to a general equilibrium approach to location that occurred in the twenties (see pp.31-34).

The variety of contributions can be classified in ways which help to indicate where the emphases of the different writers fall. In the models of Weber (1929), Palander (1935), and Hoover (1937) the main determinant of location is the desire to minimise costs (the 'least cost approach'), while Isard (1956) also utilises a Weberian approach. In these models the firm's costs are a function of its position

⁴ See also Hamilton (1974b), Massey (1979), D.M. Smith (1979), and Stafford (1972).

in space, determined by its distance from raw materials, as determined by transport costs, and so on.

In the twenties and thirties, a number of writers, including Fetter (1924), Hotelling (1929), Chamberlin ([1933] (1962)), and Smithies (1941), produced models that involve locational interdependence. They were influenced by the newer theories of imperfect competition and monopolistic competition that emerged in the thirties⁵ which attempt to model inter-firm 'rivalry' (i.e., interdependencies), a factor that is missing from the perfectly competitive model.⁶ The location models highlight the relationship between the firm's revenue and its proximity to other firms, the former being a functional relationship of the distances between firms that are associated with clearly identified market areas.

Lösch's ([1939] (1954)) 'market area approach' takes account of both production costs and market area (Weber's approach omits the latter), but does not deal with locational inter-dependencies among firms. Lösch, who is responsible for formalising the analysis of market areas - showing how general location patterns emerge - also provides a basis for the development of central place theory in the hands of Christaller ([1933] (1966)) and others (see Beavon, 1977). Central place models, built on a scheme that defines a spatially organised system, have served to explain settlement hierarchies (see Isard (1956, Ch.3)).

⁵ Schumpeter (1967, pp.1150-1152) identifies many of the scholars who contributed, either directly or indirectly, to the formulation of the newer theories based on quasi-monopolistic market structures.

⁶ None of the orthodox models of competition - imperfect, monopolistic, or perfect competition - explain the *rivalry* between individuals associated with competition. Instead, in keeping with the methodology of neoclassical theory, the models of competition deal with interrelationships between various elements of a system - either a market or the economy. The different forms of competition have different implications for *outcomes of the system*, the prices, quantities, and the numbers of producers, associated with equilibrium. The relative 'efficiencies' of different forms of competition are defined using these criteria.

Location-decision models are capable of almost infinite variety by the addition, removal, or changing of assumptions. The differences between models are to be found, for example, in assumptions about the nature of competition, perfect or imperfect; about the nature of the demand curve facing the firm; whether the markets are points or areas; the 'shape' of the market area; and about the spatial distribution of resources. Webber (1972, see esp. Ch. 2) compares many of the contributions and highlights the assumptions of the various models.

Most writers, going back to the earliest years of location theory, criticise the models of previous generations for their lack of realism, or for oversimplification which is seen to limit their usefulness in one way or another (see, for example, Smith (1979, pp.38-45)). In fact, adding or changing assumptions makes no difference to the 'realism' of the models. None is suitable as a basis for *explaining what location decisions are, and how they are made.*

A feature of neoclassical location theory is the similarity of the 'core' of each contribution: the way in which the location problems are conceived and the concepts and relationships (such as cost and revenue functions) used to analyse the problems. These mark the theory as neoclassical and associate the contributions with a single paradigm. The core - the conception of the location problem and the epistemology of orthodox theory (which are interdependent) - precludes the theory from explaining location decisions. In a far-reaching critique of location theory,⁷ Massey (1979, p.58) argues, that

the most important problems of industrial-location theory exist at an epistemological level.... [T]he theory as a whole lies firmly within one major, overall "paradigm". None of the changes in direction in the historical evolution of industrial location theory has produced a reformulation at such a basic level.

⁷ Massey's (1979) fairly recent critique of orthodox location theory is one of the few that establishes epistemological considerations as being at the root of problems with orthodox location theory. While we agree with her diagnosis, Massey's suggestions for the reformulation of location theory (see Massey, 1984) follow an entirely different path. Her approach can be characterised as Marxist-institutionalist.

The questions that we accordingly now have to answer are: what is the epistemological foundation of location theory, and why is the theory unsuited to explaining location decisions.

III. THE NATURE OF LOCATION PROBLEMS

Suppose that you have a conception of the world as a whole, that the world exists out there somewhere, and that you think of it as a 'map' or, rather, a rectilinear system of axes in two-dimensional Euclidean space. Your knowledge-as-map image includes 'industrial activity' (different firms, resources, and markets) as points on a grid. If asked to describe how to locate a firm, your response would be in terms of finding a suitable place on the map. Asked if there are any other issues pertaining to manufacturing activity that interest you, the question of how and why industries 'fall' on the map - the spatial pattern - may arouse your curiosity.⁸ But these two issues appear to exhaust the questions about location that one could ask someone whose knowledge of the world is a map image.

The problems of location in orthodox theory take precisely the form described above. Whether this is the 'right' way of defining the problem of choosing a location depends on how people understand, or 'see', the 'world' when they make location decisions. In the location models, market areas and other economic variables - the things that people 'see' when they make 'decisions' - are defined as patterns or points in Euclidean space. This is in keeping with the epistemology and ontology of neoclassical theory. Both the world-as-map image and the allied conception of the location problem denote the third-person perspective *par excellence*.

This theory, Webber (1972, p.8) suggests, is 'a theory of location patterns, not of individual decisions', and the reason why it is not a theory of *decisions* is explained

⁸ The second set of problems of location theory is of little interest in the thesis. At the end, however, consideration is given to explaining the clustering of industry in areas where there is substantial economic activity.

by the arguments in the preceding chapter: the epistemology precludes an understanding of decision-making. When Hamilton (1974) states that 'twentieth century research on the problem of industrial location has pursued a dominant theme: the explanation of the choice of location of new manufacturing plants', he is wrong. This may have been what theorists wanted to do, but the methodology prevented it.

In identifying the limitations of location theory, it is appropriate to begin with the map image. How did this come to dominate the theory and what are the consequences?

A. Geography and the map-image of spatial relationships.

When theorists endowed *location* decision-makers with knowledge, perhaps it is understandable that they should have been given 'spatial knowledge' and that this should take the form of a map. That the knowledge of agents takes this form is probably attributable to a combination of two sets of factors. One is the geographer's traditional interest in maps. The other is the paradigm of positive science that has shaped the geography of enterprise, no less than other disciplines.

In the context of the third-person perspective, which is the artifact of a modernist methodology, knowledge is about what exists out there and knowledge itself has a physical quality. Because 'space' - as distance and area - is a part of the world out there that the theorist can observe, the agent, too, can have 'spatial knowledge'. What more logical way to represent this than as a map?

Positivism and maps have had a powerful influence on geography up to the present day. In a well-known contribution to the study of peoples' 'images of places', Gould and White (1974, p.46) state that

[h]ow men perceive their physical and social environment is a crucial question for the contemporary human geographer. It is also important for the way it directs the geographer's attention to other areas of the human sciences in which environmental questions are rapidly emerging.

To explain perception, they look to behavioural psychology and its objectivist epistemology. The metaphors used to describe perception are the same as those that are described below, in examining the theoretical framework of industrial geography. Information from the environment (out there) 'impinges' on the individual, whose mind 'filters' the information. The theorist, describing perception, has no interpretative understanding (*Verstehen*) of human conduct and no understanding of how, or what, people understand. He treats the individual, including his 'mind', as a thing that exists in the world out there, perception being determined by how and what the mind records of the events in the world.⁹

Forer (1978, p.233) identifies the map concept of space as 'absolute space *par excellence*: static, independent of the objects within it and unrelated to the processes occurring about it'. Arguing (p.231) that among geographers 'the fundamental definition of space has received scant attention', he adds that 'many usages of space in geography are inspired by a static absolutist viewpoint. Absolute space is exemplified in our infatuation with maps and isotropic plains' (p.233).¹⁰ Thus the map concept is completely compatible with the 'static absolutist' viewpoint, the third-person perspective, that characterises neoclassical theory.

A map is an appropriate metaphor for the third-person perspective and it helps the cause of determinism by suggesting that spatial knowledge about distances and areas is complete. The map seems to depict a complete system in the sense that

⁹ In a more up-to-date contribution to conceptions of space by Sack (1980), there is still no reference to interpretative understanding of space and spatial relationships (*i.e.*, a hermeneutical approach to spatial considerations). His analysis of 'subjective meanings of space' in the social sciences (Ch.4), much like that of Gould and White (1974), deals with different perceptions from an objectivist standpoint, and the discussion of chorology (Ch.4) suggests that the root of a subjectivist analysis is the psychology of perception.

¹⁰ Forer's interest in spatial concepts that are not independent of time and in the problems of representing these concepts, is different from the concerns of the dissertation. Here, given the need to understand what 'spatial issues' *mean* to the individual, the important issue is whether an individual's perceptions of spatial relationships have any bearing on location decisions.

it is constant and unchanging; the world exists on its own, without a knower. It also captures the essence of the whole world out there. Its surface is continuous and, speaking metaphorically, the observer can travel back and forth over, or through, the entire scheme. In this way, all points on the map, all elements of it, appear to be simultaneously present. No point takes priority over any other one because there is no recognition of the observer's spatio-temporal horizon. In addition, it is possible to compare all points in respect of some criterion, such their distance from a particular point, in order to find out which point is optimal. The relative values of those variables that are functions of their positions in space, can be compared at every point.

As a metaphor for complete certainty, the map image appears to offer a representation of *all* the possible spatial interrelationships. The possessor has knowledge which must direct him to the optimum situation. It is the perfect tool for the location optimiser who has to optimise 'in space'. The map metaphor appears to be a useful and acceptable way of describing *economic location* problems, not only because maps are important tools of geographers, but also because, within the neoclassical paradigm, *all optimisation issues have a similar character* to the ones described above.

The economist may have little reason to question whether this is a suitable formulation of the *location* decision problem because it looks entirely reasonable, in that it mirrors the formulation of all neoclassical *decision* problems. The map image is an important metaphor for the third-person perspective, not just in location theory but in neoclassical economics in general. It is the conventional way of representing the complete system about which decisions have to be made.

B. Neoclassical theory employs map analogues

The ontology of the third-person perspective described in Chapter 2 is that all knowledge has an existence in the world. When economists illustrate 'decision-making' in graphic form, the agent's 'knowledge' - the options that are available

for choice - are typically represented as points on a plane. The ontology, if the third-person perspective translates into a diagram describing a rectilinear system of axes in two- and sometimes three-dimensional space, and the options for choice are shown as points on this diagram. 'Spatial knowledge' of location theory is compatible with this ontology.

Everything germane to the problem of decision-making is able to be comprehended, and all relevant interrelationships among the parts described. Everything is 'visible', or accessible, to the 'chooser'. Options for 'choice' exist in the world embodied in indifference curves, isoquants, or - in location theory where 'space' matters - isodapanes, lines of equal cost or expense (for this concept see Alfred Weber (1929, pp.102-104) and *Figure 3.1* below).¹¹ The maximising agent responds to observable changes in prices by finding new points on his preference map.

This convention applies to all aspects of choice, from the 'decisions' of consumers that involve finding the optimal combination of goods to purchase, to the selection of optimal production techniques involving different combinations of inputs. Examining this method of representing choice draws attention to the peculiar epistemological assumptions that are associated with the third-person perspective, and it reinforces the idea that, ontologically, decisions involve picking out things that exist in the world.

In some formulations of the optimisation problem, the values of variables are 'dated' - they are given time subscripts to identify to which 'period' they belong. Location models add a 'spatial' dimension the variables, but all the models embody the same epistemology and ontology. So, in location theory, the map as the basis

¹¹ In an editorial footnote, Friedrich (1928, p.102) explains the meaning of Alfred Weber's term, 'isodapanes'. Bearing in mind that the concept refers to factors which in practice would be influenced by things that people do, the idea that 'equal cost' (or 'expense') is inspired by the geographical term 'isotherm' is revealing with regard to the sorts of analogies which Weber implicitly drew in developing models of human activities.

for choice brings together the geographer's symbol of 'space' and the neoclassicist's metaphor for 'knowledge'.

In assessing the value of this framework as a 'description' of decision-making, Forer's remark (1978, p.233) is applicable neoclassical theory in general, including location theory: 'Faced by the seductive utility of Euclidean space we have allowed an interest in maps to become an obsession.' The reasons why spatial models and metaphors have become an obsession are found in the epistemology of the third-person perspective, which lends itself to the construction of such models. What we have to do is to identify how the metaphor misleads theorists.

C. How the map metaphor misleads

The map image represents an epistemology, and the crucial question is whether this is the way people in their everyday decision-making know, or understand. That question is a hermeneutical one and, as such, cannot be examined with neoclassical theory itself.

The map image, as third-person perspective, disregards the double hermeneutic in a way that no map-maker does. Putting aside the questions of how and what people know, if they have and use maps the assumption is that those maps all mean the same thing to everyone. There is no question of the user's *interpretation*. But the map-maker seldom takes the user for granted and, often, presuppositions and conventions used in drawing the map are articulated to guide the user. Different people, not familiar with the conventions, might misinterpret the map, or might not be able to make any sense of it.

By implication, the world does not simply *exist* out there and neither the map-maker nor the map-user merely reproduce a map image of it. A map is not reality. The features that it conveys are those that one or more people have *selected and decided* should appear. Maps are based on social conventions, which are not necessarily universal and which can and do change over time.

Compare a map drawn by an eighteenth century explorer with a modern one. Both incorporate not just the 'objective knowledge' of the people who drew them, but their ideas, as a product of the social milieu of each, of what *users* ('readers') would *expect* to find and, where the early explorer had no knowledge of what he was supposed to depict, of what *he* would expect. In other words, part of a map is conjecture - 'here be dragons' - but conjecture influenced by social circumstances, by beliefs, the nature of scientific analysis, and the quality of the measuring instruments that are available. Like a work of art or a book, a map is the product of two sets of interpretations or 'understandings' - those of its creator (the map maker) and its reader.

Of course the questions of how and what people know cannot be put aside, and hermeneutics acknowledges this in the idea that knowledge *is* interpretation. But hermeneutics goes further. Following Gadamer, it is not simply that different people interpret the world differently. Rather, the knower '*constitutes*' what he *understands* in a way which makes the 'world' his own.

The issue then is, *how* does he do so. Is the knowledge (understanding) that is useful for making a location decision 'spatial knowledge' of the sort that can either be obtained from a map or supplemented by one? This question is the basis on which, in later chapters, we challenge and rebut the idea that individuals think (or know) in terms of map images, and that such 'spatial knowledge' is useful to the location decision-maker.

Our arguments are supported by Perroux (1950) who adopts the position that an emphasis on a static, absolute concept of space can be seriously misleading. He refers to 'geonomic' space (p.92), or 'banal' space as 'defined by the geonomic relations between points, lines and volumes'. Echoing some of the points made above, his argument is that the emphasis on banal space can mislead the theorist and that the banal space of the firm 'is not easy to locate, except under several [simplifying] conditions'. 'As soon as we eliminate the[se] simplifications which

make our jobs easy, it is no longer possible to locate the firm in banal space'. (p.94).

According to Perroux, it is 'economic spaces', of which there is a number, that matter to geographers (see pp. 94-96). Each of them is an abstract¹² concept of space. One of his concepts, 'economic space defined as a plan', is applicable to a theory of location, which in our view should ask what is a location plan, and what is its spatial aspect. Do spatial considerations form part of location plans or decisions?

Our critique of orthodox theory, that the epistemology makes it unsuited to explaining decisions, requires that we examine the story that the theory does tell about location decisions. But it is appropriate to defer the examination until we have analysed the behavioural approach to location which is also critical of the orthodox theory. Even the proponents of the behavioural approach, however, still find neoclassical theory useful, and the question we now want to investigate is, why is orthodox theory attractive.

IV. THE ATTRACTION OF ORTHODOX THEORY

Of course we must not ignore the pervasive hold that modernism has had on the methodology of the social sciences. But in terms of addressing the particular problems of *industrial location*, two considerations underpin the appeal of mainstream theory. One concerns positive attributes of the theory itself. The other involves the conviction that alternatives to neoclassical economics either appear to be completely out of reach or are too problematic to warrant further effort in their development.

¹² Following Forer (1978), the term a 'relative', as opposed to an 'absolute', concept of space is probably more appropriate than Perroux's use of the word 'abstract'. Euclidean space is an abstraction even though compared with other spatial notions, it is an absolute concept of space.

A typical assessment of the contribution of neoclassical theory (but also its limitations seen from the perspective of industrial geography) is that of Lloyd and Dicken (1972, p.136).

In effect, we have been looking at the behaviour of a very special kind of human being, one who is generally known as *Economic Man*. For many purposes he is an extremely useful individual. Economists have built highly sophisticated economic models around him and, similarly, we have been able to describe how the spatial form of the economic system would appear if the individuals... were to behave perfectly rationally.

It is claimed that despite simplifying and unrealistic assumptions, scholars, including geographers, cannot do without the type of framework that neoclassical location theory provides. Adams (1970) explains why economic man is an 'extremely useful individual'. Reviewing a two volume work by Pred (1967 and 1969), Adams demonstrates the geographer's commitment to the neoclassical framework and, more importantly, provides an indication of why that attachment exists.

Pred finds the present body of geographic location theory unsatisfactory because it is based for the most part on two sets of unrealistic simplifying assumptions, namely economic man and static equilibrium. However, the use of simplifying assumptions such as these is standard practice in the social sciences and must remain so.

it must be recognised that one cannot deal with the total complexity of reality all at once.... One is guilty of oversimplification if one forces more weight on the conclusions than the assumptions will permit them to bear. It is oversimplification that deserves to be attacked - not economic man and static equilibrium. Their limitations are well known but they continue to be used because they provide useful insights and because most attempts so far to make economic man more human and dynamic have become hopelessly bogged down in the complexities of reality.

Taking these as representative views in order to answer the question, what 'useful insights' has the theory provided, it is necessary to understand what Adams means when he says that alternative approaches have become 'bogged down in complexities'.

'Modelling man' to explain human conduct is a complex exercise and, if the object is to construct useful theories, it may be impossible to avoid these complexities.

In any event, the complexity of a theory is not itself a reason for rejecting one approach in favour of another. The theories of sciences like genetics and astrophysics are so complex that the layman cannot understand them, but this does not make them unusable or unsuitable. It seems that behind Adams's sentiments is an unarticulated view about the *type* of complexity that is acceptable and about the criteria that make a good theory.

Both quotations point to the desirability of a simple and elegant theory or an aesthetically acceptable framework. One of the virtues of natural science, in the often-cited example of classical mechanics, is that it 'fits together' flawlessly and a few universal laws explain all the phenomena. These relationships make up a self-contained system and apply to the entire system. The theory is also robust, yielding predictions which can be tested, and which stand up to testing.

It is this sort of simplicity that is being invoked in the call to social scientists to avoid being bogged down in complexities. Theories that do not offer precise solutions or permit propositions to be rigorously tested against the evidence are best avoided. Yet, if neoclassical or a deterministic theory is abandoned, what is left?

There is no doubt that the orthodox theory of location does provide an aesthetically pleasing conceptual framework. This is especially apparent in the maps of isodapanes which originated with Alfred Weber, and in the symmetry of the location patterns derived by Lösch. Both are reproduced overleaf as *Figures 3.1* and *3.2*, to illustrate the aesthetics of location models. Their appeal is in the ability to reproduce the scheme of things as elegant, two-dimensional, spatial models (the appeal of determinism), but it is also in the coherence and of analytical rigour which these models suggest (the appeal of modernism).

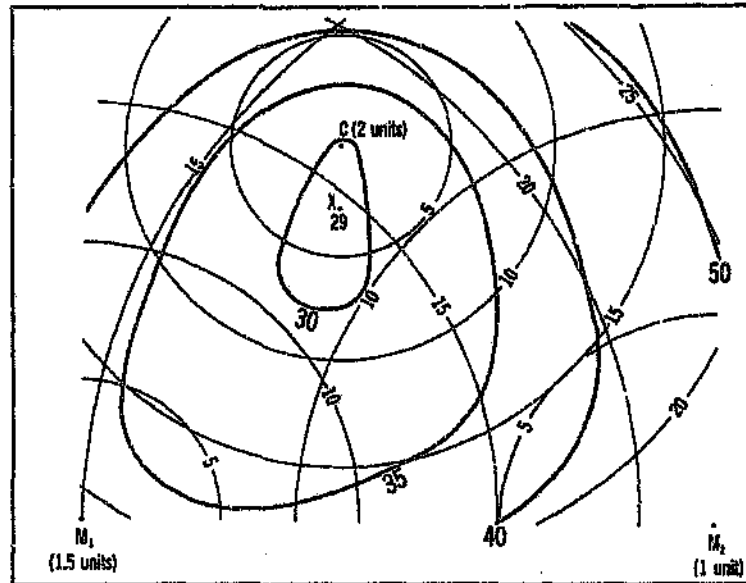


FIGURE 3.1: The Weberian location problem with isodapanes (from Webber (1972, p.12)). 'Lines of equal transport cost (isodapanes) are constructed around [two material sources] M_1 and M_2 and the consumption centre, C . The costs of moving, M_1 , M_2 , and the final product are summed for each location to derive lines of equal transport cost from which the minimum cost location, X , may be found.'

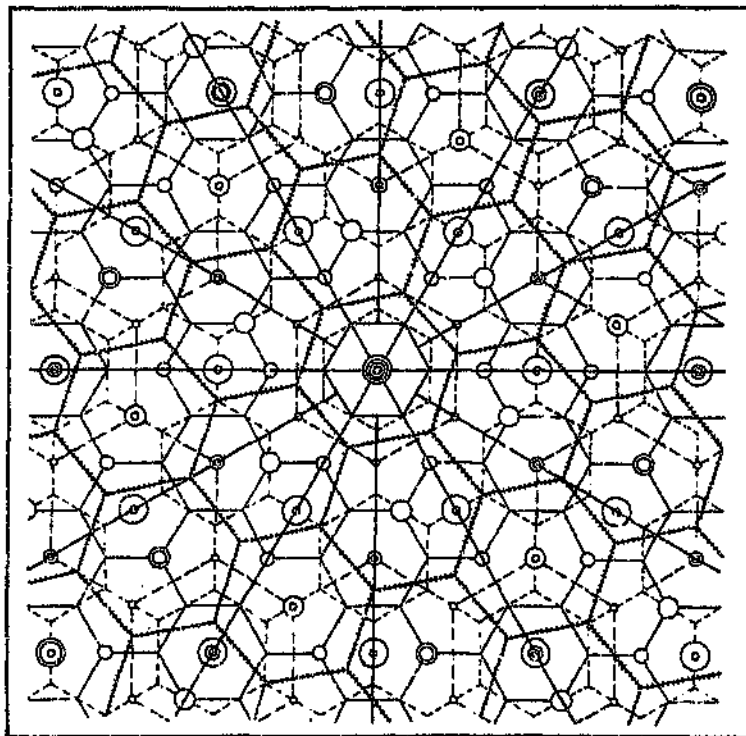


FIGURE 3.2: The theoretical arrangement of market centres and market areas according to Lösch (from Lloyd and Dicken (1972, p.24)).

Preferences for locations are converted into well defined topographical relations, and the essential symmetry produced by 'pure' locational forces is revealed. There is none of the 'fuzziness', 'imprecision' or 'complexity' that one usually associates with human conduct, and scholars who pursue this paradigm are not bogged down in metaphysical arguments. The models disclose the highly structured and logical design that is behind the manifestly unco-ordinated activities of businesses. Truly they reveal an 'invisible hand' at work.

Though it was argued in Chapter 2 that economists only pay lip-service to the tenets of modernism, including that of the need to test theories in order to prove their worth, additional claims made about the value of location theory involve its usefulness in predicting spatial patterns.

Most often, predictive tests involve central place models - where the data is aggregated - rather than the location of individual companies. It is held that the size distribution and hierarchical structure of central places conform quite well to the projections of the theory, while market areas for different 'orders' of goods are structured as the theory predicts. The question still remains whether the theory identifies the factors that account for the geography industry, or whether other considerations explain firms' locations. (See Lloyd and Dicken (1972, Ch. 3) for an analysis of 'tests' of central place theory).

V. THE BEHAVIOURAL APPROACH TO INDUSTRIAL LOCATION

In the course of the past three decades, industrial geographers have attempted to redress shortcomings of the orthodox theory of location and to formulate a 'more realistic' approach to location decision-making. A substantial body of literature now exists around a number of basic themes. These themes are identified and examined in Watts (1987), and the literature is critically reviewed by Krumme (1969), Hamilton (1974b), Kee (1978), Massey (1979), Wood (1981), Carr (1983), Hayter and Watts (1983), and Taylor and Thrift (1983b).

Advocates of the behavioural approach differ in their assessment of the value of neoclassical location theory. Carr (1983, pp.391-392) explains that various behavioural writers including Wood (1969) and Taylor (1970) 'rejected Weber's traditional position as the theoretical basis of industrial geography' (p.392). On the other hand Dicken (1977), D.M. Smith (1970), and Taylor (1975) take the view that there are aspects of the earlier theories that are useful to industrial geographers. Carr concludes that 'although industrial geographers deposed Weberian theory... the theory was not rejected totally, but limited to certain topics where its application was considered justified' (p.392).

To many of its advocates, the behavioural approach is supposed to extend orthodox theory by relaxing some of the restrictions imposed by 'unrealistic assumptions', and by including considerations beyond purely economic relationships (see Hamilton (1974b, pp.4-5)). The lack of an explicit theoretical framework for industrial geography, however, is a theme echoed in a number of evaluations of this literature (see, for example, Carr (1983, p.386), Hamilton (1974b, p.3), Hamilton and Linge (1979b, p.1), Harrison, Bull and Hart (1979, p.337), and Hayter and Watts (1983, p.173)).

Our object, now, is to survey this literature, dealing only with the definition of the scope of the theory and the explanation of location decisions. Do the contributions of industrial geography remedy the methodological shortcomings of neoclassical location theory? We answer this question by examining the methodology of the behavioural approach.

A. Models of decision-making

According to Downs (1970, p.69), the behavioural approach aims to replace the assumptions of the older theory

by ones which are more realistic and adequate expressions of man's nature.... [T]he variable nature of man's capabilities is allowed to intervene between the environment and the spatial behaviour pattern in our attempts at explanation and theory development.

The behavioural approach draws on models of decision-making and industrial organisation from social psychology (Katz and Kahn (1966)) and the work of Simon (1952, 1957, 1959, 1960) and March and Simon (1958) on organisations, Cyert and March (1963), McNee (1960a, 1972) and Wolpert (1964) on the firm and decision-making. Mechanical analogies are a feature of these theories of cognition and perception that were developed in the fifties and sixties under the umbrella of behavioural psychology and, like most branches of social science, that fell victim to some extent to the form of positivism which was in vogue at the time.

Decision-making is conceived of in a mechanistic way. Feedback processes, 'filters' and 'channels' of information, 'stores' of knowledge, and 'searches' for information¹³ are part of the language of that theory (see Lloyd and Dicken (1972, Chapter 8)). The 'real world' is transformed into an 'image' which the individual (or firm) has. The following quotation from Katz and Kahn (1966) in Dicken (1971, p.428), 'explaining' how information is acquired, typifies the discourse that is used.

Systems can react only to those information signals to which they are attuned... [they]... develop their own mechanisms for blocking out certain types of alien influence and for transforming what is received into a series of code categories.

In neoclassical theory, agents have a comprehensive set of preferences. The behavioural approach gives them social and economic characteristics to which 'perception and preference are functionally related' (Downs (1970, p.69)), and perceptions determine behaviour. Like the agents of neoclassical theory, individuals are guided by a desire to 'obtain the "best" location in terms of optimum management satisfaction compatible with public policy. [Although t]his location is... not necessarily the economic optimum derived by [neoclassical] location theory.' (Townroe (1969, p.16)).

¹³ Search theory is also a creature of the ontology of the third-person perspective. It is postulated that the individual goes looking for information, as he would for treasure, thereby reinforcing the idea that information is something that exists in the world.

Explaining location decision-making in an industrial organisation means understanding the interrelationships among the firm's *structure*, its place in the *environment*, and its *decisions*. The internal procedures of the enterprise are deemed to be important, says Steed (1971a, p.324), because

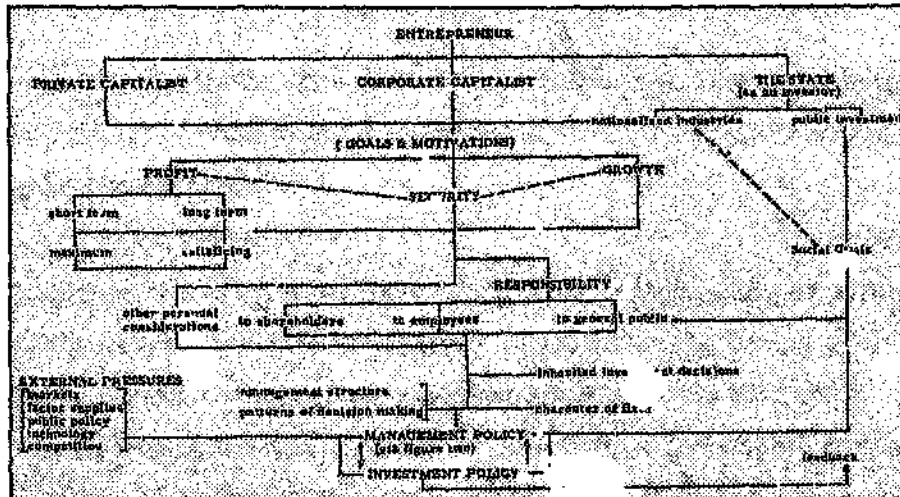
[f]rom the viewpoint of the enterprise, the identification of its relevant environment is a function of two general variables: first, the internal resources and procedures or operations of the enterprise; and second, the qualities of the management team.

It is the 'relevant environment' that influences why, how, and where, the firm locates.

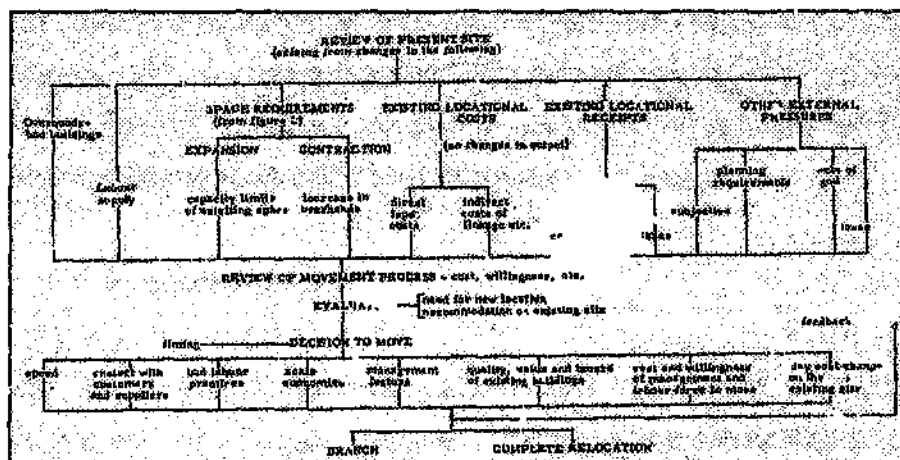
Because the firm's size is seen as a key factor in the relationship between structure and decisions, industrial geographers tend to concentrate on large, generally multiplant, and often multinational, enterprises. The activities of the large enterprise, with a number of plants, are probably not only more interesting to the geographer, but also contributing to this emphasis is the view that '[t]here appears rarely to be a conscious *location policy* except among very large or market-dominant corporations...' (Hamilton, 1974b, p.14).

Location problems arise from the firm's activities and location decisions have to be integrated with those activities. In fact they are made in the context of the firm's investment decisions (see, for example, North (1974, pp.213-214), an approach that we follow in the dissertation). By contrast, in neoclassical theory, there is no *reason* to locate except to minimise costs or to maximise profits (*i.e.*, the 'reason' exists 'out there').

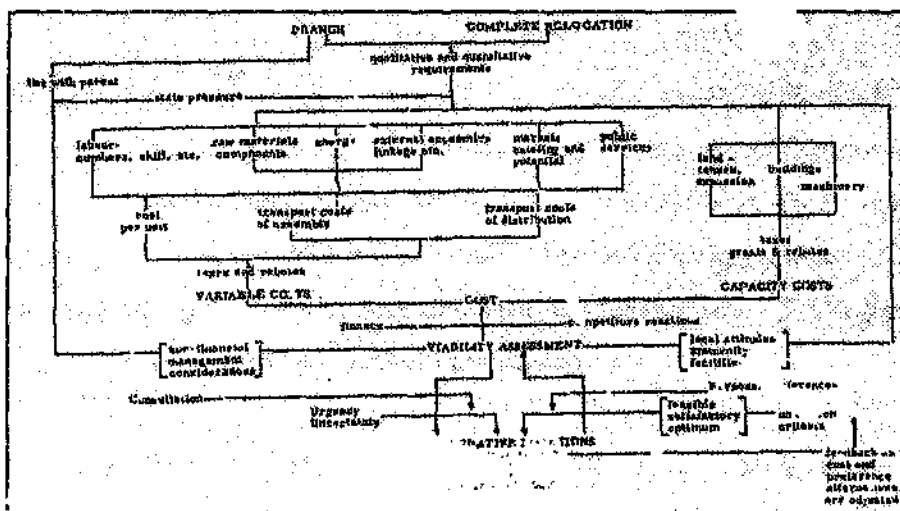
Models of the decision-making process in large organisations, highlighting the factors that play a role in decisions about location, are presented by Dicken (1971), Lloyd and Dicken (1972, see pp.146-151), Rees (1972a, 1972b, 1974), Stafford (1969), Taylor (1975), and Townroe (1969, pp.17-24; 1971, Ch.2), Watts (1987, pp.168-177) and outlined by Downs (1970, pp.69-70). *Figure 3.3* overleaf illustrates the structure of one such model. The diagrams are described (Townroe (1969, p.16)) as treating 'the question of the choice of location for industrial investment as essentially a process of decision-making under the stimuli of factors



(a) The Development and Environment of Management Policy



(c) The Pressures for a New Site



(d) The Search for a New Site

FIGURE 3.3: Choice of location: the process of decision-making (from Townroe (1969, 1971)).

internal and external to the... firm....' (Because *Figure 3.3* serves only to illustrate the models associated with the behavioural approach, one of Townroe's original four diagrams is omitted.)

Decision-making is a lengthy iterative process, with individuals at different levels investigating a myriad of different factors, to ascertain the nature of the problem involving the location of the firm. Decision-making thus involves a structured system that is analogous to following a flow-chart of the company's operations which identifies the types of decisions that have to be taken about each of the operations. The model proposes that location decisions emerge out of this system when decision-makers evaluate and review different parts of it. Eventually 'pressures emerge for a change in space', and these may after further consideration and another set of iterations involving consideration of the firm's overall management policy (*Fig. 3.3(a)*), lead to pressure to find a 'new site'.

B. The location problem

The model reveals that the behavioural approach also conceives of the location problem in the context of a *closed system*. This system is the company's decision-making procedures, the environment within which it operates, and the interaction between the procedures and the environment.

Industrial geographers are not interested in what constitutes a location decision; this is implicit in the structure of decision-making. The location problem is rather how 'pressures', either from inside the company or outside in the 'environment', produce responses through the decision structure which may or may not result in a new location being selected. The decision structure traces the *organisation's* response (as part of a system) to such pressures.

The ontology of these models manifests the third-person perspective. A firm's decision system and individuals' information-gathering mechanisms exist as objects in the world. Information also exists out there and is received as 'signals'. The

theorist is interested in how the system 'fits together' to reveal the operation of the decision structure. The enterprise is still an optimising entity, but does so within a particular decision structure, and is subject to various constraints such as those imposed by existing relationships ('linkages') with other firms. These factors may limit the range of possible solutions which the system can produce.

With a third-person epistemology, an understanding of how decision-makers understand the 'problem of location' is just as much beyond the behavioural approach as it is beyond neoclassical theory. The behavioural approach merely adds a set of concepts to the list of 'givens'. The system is influenced not just by individuals or firms, but by their interaction with an environment. So additional concepts are needed to account for the interaction. These are the decision-making structures of organisations, the information or signals that individuals receive, and the procedures for decoding signals.

The epistemology of neoclassical theory is consistent in defining both the theorist's and the agents' 'knowledge' of the world. The latter know about what exists out there - other agents' preferences, technology, and profit opportunities - through prices. There is one world, but because different agents have different preferences they are predisposed to respond differently to price signals.

The epistemology of the behavioural approach, however, is puzzling, because the theorist's 'understanding' is fundamentally different from that of decision-makers. The former knows of the complete scheme of things, whereas the latter only have a partial view. Only part of what really exists in the world gets through the 'filter' that is the human mind.¹⁴ The theorist, therefore, has two types of

¹⁴ On the nature of the individual's 'perception' that forms the basis of decision-making in the theory geography of enterprise, see Dicken (1971) and Lloyd and Dicken (1972, pp.138-146). The latter show, in diagrammatic form, how the behavioural environment is perceived. In brief, the individual is a mechanism, obliged by his characteristics to respond and behave in particular ways. His 'mind', a part of what (to the theorist) exists out there, is treated as a 'filter' which has to 'decode' the information which (to the individual) exists out there, beyond and separate from him. Once decoded the filtered information is placed into its context in the firm's decision structure, to which we referred, (continued...)

knowledge. First, there is the knowledge of the 'objective environment' (Lloyd and Dicken (1972, p.138)) - the world 'out there' in its entirety. Then, he also knows of the individual's 'filtered' knowledge of *part* of the objective environment.¹⁵

Why and how the theorist should know more than any individual, who only knows his 'perceived' environment, is a question which is neither posed nor answered. The aim of industrial geographers to construct a more realistic theory of location decisions is certainly hampered by the puzzle of the dualism of knowledge, which makes the epistemological foundation of the behavioural approach more problematic than that of neoclassical theory.

Also, though the model builders caution that the elements in a decision structure are not equally important, and that in particular cases some elements are immaterial, there is no way of establishing how and why particular factors do, or do not, play a role. The whole structure is simply taken as given.¹⁶

There is a notable difference, however, between the way in which location decisions are *modelled* and the way in which they are *described* by industrial

¹⁴(...continued)

with the object of producing an efficient response (for the firm). A 'considerable amount' of the information transmitted to the individual is apparently received visually (Lloyd and Dicken (1972, p.139)). The decision-maker is depicted much like a camera that records and stores visual images.

¹⁵ The reformist neoclassical theorists who seek answers to hermeneutical questions (e.g., Hahn (1970 and 1973a)) adopt a similar approach to decision-making. In order to deal with 'learning' (where the agent interacts with the environment) within an equilibrium framework, it appears to be necessary to advance an epistemological dualism. To ensure that plans dovetail 'the world' must be the same for everyone. Every individual, though perhaps initially somewhat ignorant of the 'true' facts, must eventually come to learn the same things as everyone else. This will only happen if we postulate a complete and unchanging 'reality' behind the perceptions and knowledge of each individual.

¹⁶ Wood (1987, p.175) observes that while various writers 'have tried to represent the decision sequence in diagrammatic form..., such is the variety of experience uncovered in investigations of individual firms that it is very difficult to generalise [about decision structures].'

geographers. A number of writers suggest that location decisions are taken within the context of the individual's 'horizons' (see, for example, McDermott and Taylor (1976) and North (1977)), based on his experience, interests and objectives; but this selectivity in perception is not reflected in the models of decision-making.

Carr (1983) identifies that industrial geographers fail to recognise the individual's perspective and horizons (i.e., that the 'location problem' reflects the individual's own interests). He argues (p.389) that researchers misunderstood the purpose of the profit maximisation construct in neoclassical theory. As a result, they attempted

to "prove" satisficing behaviour when the idea of proving it or profit maximization are both meaningless. One of the aims of these satisficing studies was to provide evidence against the idea that an industrialist would consider every possible location to find the proper profit-maximizing location - an unrealistic belief for a school of thought arguing realism!

In developing a model of decision-making, it appears that the theorist has a duty to produce a highly formalised conception of how things work. Writers who simply wish to describe location decisions, however, are under no such obligation. No one has justified the discrepancy. Is it that the formalism of the models serves to circumvent the 'complexity' of location decisions?

VI. THE 'NARRATIVE' OF THE ECONOMICS OF LOCATION

If we look at the economics of location as a narrative, the 'story' told by the theory is wrong. The problem has been attributed to the epistemology and ontology of the third-person perspective of both the neoclassical and behavioural approaches which produces an explanation of human conduct that does not accord with our experience, or understanding.

Although certain of the implications have already been identified in previous chapters, it is useful to examine the connotations of the theory in terms of what it reveals about world. If the 'story' is unacceptable, there are questions which

need to be answered; presumably employing a different framework capable of yielding fresh insights. These questions are adumbrated at the end of the chapter.

A. Public knowledge

By virtue of the ontology, the 'data' on which choices rest is *public knowledge* that exists in the world and is potentially available to everyone and anyone. Individuals are able to 'search' for an optimal location, and the location decision can be made by *comparing alternative locations*. Moreover, everyone should have the same ability to exploit these opportunities.¹⁷

Although in the 'pressures' that induce an investment the behavioural approach gives firms a 'reason' for locating both approaches have an essentially similar story to tell. The firm is merely an institution that exists to produce in order to optimise. Profits exist, to be discovered or pursued, out there. Although they vary with output, they are simply things which firms inevitably pursue. There is no sense of *creating* profits by, for example, taking a chance on new technology, or by gambling on the idea that demographic changes will result in a lucrative market in a particular region.

Both neoclassical theory and the behavioural approach imply that people possess coherent and internally consistent systems for making decisions. The former because people have 'tastes', and the latter because they possess mechanisms for 'decoding' the 'signals' about what is out there. Confronted with the same data, individuals should make the same choices time after time.

On all these issues, the third-person perspective despite being wrong in its ontological premises is insidious in its penetration.

¹⁷ Richardson's critique of the idea of 'public knowledge' is worth noting. The critique is contained in the statement that 'a profit opportunity which is available equally for everyone is in fact available to no one at all' (1971, reprint, p.14). See also (1960, p.14)).

Rather, is it not more plausible to conceive that a manager may *think* that he has the opportunity to run a profitable business, because he *believes* that there are people who will buy his products and he *hopes* that he will be able to produce at a lower cost than those producers whom he has *identified* as competitors. A location decision is necessarily 'founded' on conjecture so, even if a manager had a map of the costs and revenues of other firms it would not enable him to select an optimal location.

From a hermeneutical standpoint beliefs are time-bound, capable of reconsideration from what is literally a different perspective in the *durée*. One's likes and dislikes, too, are relative to what one knows and to one's interests at the moment. It may be that time and interests are anathema to the idea of a complete scheme of things. But they are inescapably relevant to interpretation and understanding, and they make knowledge *personal*, not public.

B. Space versus place

Though different people may be predisposed, by their tastes or decoding systems, to 'know' of different opportunities, in both schemes the location problem merely exists. There is no scope for *understanding*. Yet without an insight into how and what they understand by the 'problem of location', the sorts of factors that may be important to them, including spatial considerations, cannot be established.

The very thing the theory was intended to illuminate - the spatial element in economic decisions - is elusive. Space, like everything else, is part of the data. Though depicted as Euclidean space, to agents it has no form. As a property, or component of things, the treatment of space in neoclassical theory is analogous to the treatment of time.

Shackle emphasises (see especially (1958, 1959, 1969, 1974)) that time - the mathematician's concept of time as extension, or as a continuum - is a purely formal notion that bears no relationship to the experience of time, Bergson's

concept of the *durée*. Shackle is supported in this by Hicks (1976b). In time, we are conscious of new insights, disappointment, or surprise, and this is what experience means. But the only way an agent would recognise the 'passing of time' is that the values of variables are different. Time has passed because prices are higher at t_2 than at t_1 , and so on. In a determinate world, however, he would be able to know beforehand what the values were going to be.

What marks the change from one *spatial point* to another? Wages and revenue are different. If there are two points located the same distance from markets of the same size, and from identical sources of raw material with the same costs of production at each, firms will necessarily be attracted to both points in the same degree.

The subject of perception of spatial relations is important in industrial geography (see, for example, Aangeenbrug (1968), Barr, *et al.* (1980), Barr and Fairbairn (1978), Downs (1970), Forer (1978), Huff (1960), McDermott and Taylor (1976), M.J. Taylor (1975, 1978)). The topic is a central thread, and informs on other areas of interest such as industrial linkage studies. With few exceptions - Forer's (1978) contribution is notable in keeping an open mind about alternative approaches to the conceptualisation spatial perceptions - the analysis of spatial perception employs the same conceptual scheme as the behavioural approach to location (see, in particular, Downs (1970)).

In these studies, map space is not pre-eminent and it is held that 'management teams... may not perceive and learn of the space economy... in terms of Euclidean or geographic space but in terms of more abstract hierarchic space' (Taylor, 1978, p.1171). Yet the individual is still held to possess a 'mental image' of spatial relations (see Barr, *et al.* (1980, p.870), which has a concrete structure and form. This is exemplified by McDermott and Taylor (1976, p.326), in assessing earlier contributions to perception, who hold that

[these contributions] give no indication of the *structure of the image* that management has of places within this space. Yet the nature of the image will be extremely influential for decision making and locational choice... (emphasis added).

So, although the individual's perception of space may not be of Euclidean space,¹⁸ he has a *mental image*, postulated to be a two-dimensional areal picture, that he can call up in a corporeal form to make 'spatial decisions'. Again, reflecting the ontology of the third-person perspective, the weakness of both approaches to location is that neither refers to, or offers justification for, a decision-maker's interest in *particular places*.¹⁹ These latter considerations belong to a different epistemology, and they are a recognition of what Polanyi (1973) terms '*personal knowledge*' as the basis of understanding.

In industrial geography, when the need for a new location is indicated by the decision process, people embark on searches for suitable locations without any

¹⁸ Note, however, that various authors have found it useful to conceptualise this image as an areal one. Taylor (1975) formulated the concepts of 'operational' space (as the area defined by the imaginary boundary drawn around the points representing the firm's linkages), 'action' space, and information' space. These concepts have found fairly widespread acceptance in industrial geography, despite the fact that they involve the transformation of punctiform 'space' into areal space. Harrison, *et. al.*, (1979) offer various criticisms of the analysis of spatial relationships in industrial geography. They argue (p.334) that

there is a fundamental confusion between "space" defined as a continuous areal phenomenon and "space" defined as a discrete, punctiform phenomenon.... [T]he assumption that... points can be taken as boundary points on an imaginary line enclosing a continuous space within which the firm operates... is a logical fallacy.

These authors also go on to criticise the tendency of conflating 'geographical (map) space on the one hand, and a series of abstract spaces which may or may not be directly related to it, on the other.'

¹⁹ Many studies do recognise that 'personal factors' may determine the location of a business, but it usually implied that this is irrational behaviour. Greenhut (1959) holds that, from the appropriate theoretical standpoint, even when decisions cannot be explained in terms of traditional microeconomic determinants of location - when personal factors are important - there is no evidence that industrialists behave irrationally and make inappropriate choices.

preconceptions about where to look,²⁰ about what places might be suitable, or *who* might be able to help them in their search. Actually, when they make decisions, people are wont to ask for advice. They do not typically conjure up two-dimensional images of spatial relations with implicit or explicit economic values built into them. Experience is more usually of a *social* world, shared with friends, acquaintances, and colleagues, who pass on bits of information and know who might be able to assist us.

C. The absence of uncertainty

The 'story' of industrial location theory is that when decision-makers are uncertain they determine the probability of different outcomes and calculate an optimal location given this uncertainty.

The notion of time endemic to the third-person perspective is that of extension or mathematical transformation. In both the comparative-static and dynamic formulations of neoclassical theory, the configuration of 'events' such as prices or expectations at t_1 are *transformed* into a different configuration at t_2 , and that at t_2 into the configuration at t_3 , in some *predetermined way* (e.g., through dynamic equations that specify how events evolve over time). Because the transformation

²⁰

In this area again one finds the dichotomy that is evident between the formal models of structures of decision-making on the one hand, and writers' interpretations of how location decisions are made on the other. North (1974) is an important case in point. His discussion of location decisions, based on analysis of survey data, stands in marked contrast to his model. His analysis not only offers useful insights into the factors influencing location, but indirectly it subverts the basis of the received approach to location which emphasises the 'search' for alternative locations. North argues (p.242) that as far as the locational search and selection process is concerned, two things are abundantly clear. In the first place, it was very rare for firms to perform a strictly objective analysis of alternative locations.... Even where firms did employ objective methods... the ultimate decision was often made on the basis of hunch,... and previous experience of an area.

These arguments are important. See also Luttrell (1962, p.74). A subjectivist approach to decision-making provides a context for such inferences.

is mechanical and the mechanisms are known, any one 'period' contains the seeds for events in all 'future' periods, and completeness is sustained.

In this scheme there is no distinction between the uncertainty of the future and the experience of the past. 'Time is a denial of the omnipotence of reason', says Shackle (1972a, p.27), referring to the ability of agents, who possess complete knowledge, to optimise by 'reasoning' about the alternatives that they face. Shackle holds that this notion of rationality applies to a timeless world, where everything that is 'going to happen' has already been 'foreseen'. 'Time', however, 'divides the entirety of things into that part about which we can reason, and that part about which we cannot.'²¹

Time as *durée* is of the essence of being. The individual has to get things done (he *hopes*) before the opportunity (that he *believes* exists) passes, for then it will be too late. Should he wait because things might improve? Events at moments beyond the present, to which plans and decisions 'point', are not in some sense pre-existing and waiting to be revealed. The future that is relevant is entirely 'open', and depends on what he does, now. Not only will he constitute that future by his activities, but also what he 'learns' - how he understands - depends on what he does now. In all these senses the future is uncertain.

A complete scheme, by definition, excludes uncertainty that is associated with being-in-time, and with expectations about the future. The only form of 'uncertainty' compatible with the third-person perspective is *risk*, related to the statistical probability of different outcomes of, say, a game of chance, or human life expectancy. Expectations belong to interpretation and understanding. Risk,

²¹ In this section and in later chapters, in explaining uncertainty and also the relationship between time and uncertainty, we draw extensively on the ideas of G.L.S. Shackle whose contribution to economics makes these considerations central ones.

and statistical probability, pertains to a scheme of things that is complete, or one can be treated as such.²²

Uncertainty is not removed either by 'acquiring knowledge' or through experience, and it cannot be measured or described by probability statements. Uncertainty, as Shackle puts it, is '*unknowledge*' (see for example (1983)). A probability statement is knowledge (of the workings of a system) and once we have knowledge we are not uncertain. Attempts to approach uncertainty from the point of view of statistical probability theory attempt to conflate the epistemologies of the first- and third-person perspectives, and confuse what Shackle terms 'two opposing and discordant meanings' of probability.

One important difference between the two notions is that, unlike risk, expectations are not determined by drawing from a *class* of outcomes. A class of outcomes is consistent with a complete, self-contained system of things from which a sample of outcomes can be drawn. Expectations are (subjective) feelings or beliefs, based on (subjective) experience. There is no basis for determining how likely it is that the expectations will be fulfilled. They do not belong to a class and do not form part of a complete system.²³

Webber (1972) attempts to *add* uncertainty to location theory, but he goes badly awry. He is familiar with some of Shackle's work and with the work of Knight, whose seminal contribution (1933) introduced the distinction between risk and uncertainty to economists and, in discussing the mathematical theory of probability

²² Although demographic factors and a variable like the rate of morbidity are changing, the changes are for the most part slow and gradual. An actuary will work on the assumption that he does have a complete picture and that any sample used in devising actuarial estimates is part of the same general scheme of things.

²³ For this reason it is not at all irrational for different people to hold completely divergent expectations about a future event, as we find in speculative markets. It is simply not possible to say before hand that the 'bears' are more correct than the 'bulls', or have a better chance, and vice versa. It is not possible to *reason* on the basis of probabilities or by any other means, about what the actual outcome will be.

as a means of modelling 'uncertainty', Webber (1972, Ch. 5) actually highlights the distinction between 'risk' and 'uncertainty'.

Citing various sources, however, he adopts the position (p.95) that uncertainty is either impossible to incorporate into any theoretical framework, or there is really no difference between risk and uncertainty. This leaves the way clear him to apply probability theory to situations of uncertainty and so perpetuate a problem which Jefferson (1983, p.122) highlights in the following quotation.

Despite the pervading mist of uncertainty there is a deeply embedded desire in human nature to impose order on disorder;... to speak and act as if we had knowledge where it cannot exist; to seek firm answers and 'optimum' solutions as if uncertainty were eliminated. There is thus a tendency to live in a pretend world where by... introducing and using techniques, claiming systematic approaches and objective assessments, people can come to believe that their capacity for sound decision-making is far more robust than is the case.

The conditions of risk, under which probability statements can be meaningfully assigned to events, as described by Shackle, pertain to 'a concrete, existing and delimited system' (a 'complete system' in our terminology) and, 'as a *sine qua non* of [the existence of such probabilities there must be], some underlying stability and invariance of the system being described' (1972a, pp.17 and 18). '[S]o long as that system continues to conform to the delimitations specified in the statement of what the measurements mean, these measurements are *knowledge*. They are knowledge in the same sense as measurements of the volume or mass of an object' (p.17).²⁴

²⁴ The issue of uncertainty receives scant attention from industrial geographers. When it does, they are up against the problem of an exclusive scheme. Pred (1967) deals with uncertainty as a motivating factor in the choice of location (firms try to minimise uncertainty). While Lloyd and Dicken (1972, see pp.157-158) deal with the problem only briefly at the end of a chapter on 'The Decision-Making Process'. The strategies which they suggest for minimising uncertainty are important and sensible, but they fail to integrate these insights into the theory of location decision-making. Industrial geographers' questions related to uncertainty, concerning the individual's 'picture' of an area, naturally have to fit the epistemology of the behavioural approach. The type of uncertainty upon which the analysis of location problems is premised is uncertainty about the actual 'real world' circumstances (which are apparent to the theorist) that lie behind the 'perceived environment' (that is known to the decision-maker) (see Dicken, 1971, p.431), or about different possible 'states of nature'. It is postulated that events may
(continued...)

In the quotation below, Shackle (pp.19-20) juxtaposes these conditions with the circumstances of an investment decision. Investment decisions are central to the thesis as the context in which location decisions are made. An investment decision typifies uncertainty, rather than risk. Risk applies to situations where the number of possible outcomes is finite and the frequency-ratios of the different outcomes sum to unity. In contrast, the total discounted value of a series of projected future earnings on an investment is a *conjecture*. The expectation of a particular outcome may be an 'educated guess', but it is a guess all the same (see Chamberlain (1968, p.40)).

Many different numbers of pounds... can be entertained as possibly representing it. The cost of [acquiring the machine] may also of course in some degree be uncertain. But if one or both of the two amounts is uncertain, what is it to be compared with what?

To be uncertain is to entertain many rival hypotheses. The hypotheses are rivals in the sense that they all refer to the same question, and that only one of them can prove true in the event. Will it, then, make sense to average these suggested mutually exclusive answers?... Moreover, the average can be a weighted one There will be a temptation to call such weights probabilities. But what is their source?... The various hypotheses or contingencies to which frequency ratios are assigned by statistical observation are not *rivals*.... All of them are true, each in a certain proportion of the cases with which, *all taken together as whole*, the frequency distribution is concerned.

The probability which can be assigned to one of many rival hypotheses is a 'subjective' probability, it belongs to... "a language for expressing personal judgements" ²⁵

²⁴(...continued)

have more than one possible outcome, the list of potential outcomes is complete and known (to the analyst of decision-making), but uncertainty arises because the decision-maker has to find out which outcomes are most likely. See also Stafford (1972, Section IV).

²⁵

For much of his career Shackle has striven to develop a language of subjective probability, and this may be why the formalism of his work sometimes belies the nature of his ideas. In the suggestion that decision-makers entertain many rival hypotheses, there is an echo of the agent of neoclassical theory calling up a list of all the alternatives from which he is going to optimise. There is a sense in Shackle's work that expectations are more than ideas and that in forming expectations the individual is engaged in constructing a complete *picture* - we use the term deliberately - of different possible states of the world. As far as an investment decision is concerned, there is no expectation of a *particular* outcome;
(continued...)

Some of the models in neoclassical location theory incorporate 'locational interdependence'; the locator has to take cognisance of the activities and proximity of other firms, for they affect his revenue. Webber uses game theory to analyse what he calls (1972, Ch.6) 'uncertainty about rivals', but similar objections apply to its use, in that it is an attempt to substitute knowledge for uncertainty (see also Stafford (1972, Section III)). Game theory, in Shackle's words, is an 'extraordinary paradox', because although it is a product of a 'great mathematician's originaive genius... it assumes away the whole of that aspect of business, science... and contest, which allows originaive genius to exist' (1972a, p.422).²⁶ Individuals who inhabit a world consisting of game-theoretic rivalry, would live a life without surprises (they already *know* the possible strategies that their rivals may adopt), and thus without uncertainty.

A theory that aims to provide an understanding of how people make location decisions cannot ignore 'unknowledge' or how decision-makers cope with uncertainty.

When the future is very uncertain because of political instability or great economic upheaval, it is difficult even to conjecture about business conditions so any investment plans are shelved. At other times, decision-makers take steps to insulate themselves from adverse circumstances that might affect their activities. Some institutional arrangements serve this purpose. While not removing uncertainty, they help to cope with the consequences of not knowing what will happen. Institutions, such as insurance and particular market structures²⁷ help

²⁵(...continued)

only optimism or pessimism.

²⁶ For an interpretation of the objectives of game theory see Aumann (1985).

²⁷ See Richardson (1971) for an illuminating analysis of how oligopolistic market structures contribute to the businessman's ability to cope with uncertainty.

to mitigate the effects of unexpected changes. Maps and contingent plans can assist in novel situations.²⁸

One of the factors that contributes to coping with uncertainty is the firm's location and the business community that 'surrounds' each manufacturer. In general, the larger that community, the greater the sense of security that a location provides. Location decisions involve investment in plant and equipment and have long-term implications. It is therefore important that the conceptual framework is able to recognise uncertainty for what it is. Rather than trivialising the concept or rendering it nugatory, there is a need to explain how and why uncertainty influences decisions.

Either the epistemology of the conceptual framework accommodates uncertainty or it does not. It is not possible to add uncertainty to an epistemology which excludes it, as if uncertainty were another detail that has to be filled in before the picture is complete. The epistemology of the behavioural approach and the neoclassical theory of location excludes uncertainty.

VII. ISSUES WHICH LOCATION THEORY MUST ADDRESS

Preceding sections have identified unfillable lacunae in location theory, unresolved problems that need to be addressed in order to obtain a satisfactory explanation of decision-making. In a way the whole theory is 'wrong', because it tells us nothing about how individuals think about the location of factories, and it needs to be reformulated. Still, it is appropriate to identify key questions that need to be asked.

²⁸ Maps are not keys to 'rational' (in the sense of optimal) decisions, but are means of reducing uncertainty, though not of removing it. Their value is not in directing the user to undertake the correct course of action, but in helping him to *interpret*.

A. Is the problem of location primarily a spatial one?

One of the central questions is whether the individuals who take decisions about a firm's location think about 'spatial issues', or spatial relations, such as the distance from one place to another, or the number of potential suppliers within a particular area or radius from a place. Are these the sorts of issues which pertain to location decisions? If they are, the choice of location might be aided by a map or a map image of an area. Or are such spatial considerations largely irrelevant when it comes to the location of a factory?

The answers depend on an answer to the question of *whether locations are actually chosen*, in the sense that the siting of a manufacturing facility is an important element in the planning process, as opposed to being an incidental aspect of the decision to invest in a plant. If locations are chosen, then how are they chosen? When people decide to invest in a factory, do they think in spatial terms (or constitute the problem as a spatial one)?

Questioning whether locations are chosen may seem absurd because each industrial undertaking has a location and someone made a decision about the location, either to build or to buy a factory at a particular place. Yet, this does not mean that the location was examined to see whether there was anything to gain by putting the factory in a different place, or whether the factory was appropriately positioned in relation to suppliers, or buyers, or to a transport route.

Hamilton (1974, p.6) explains that, as far as most small businesses are concerned, 'often the question of *any* location, let alone any *alternative* location, never enters [the entrepreneur's] mind.' Does this also apply to large businesses?

B. Aspects of decision-making that need to be considered

The first task, in tackling these questions, is to examine the nature of decision-making in general, and apply this to location decisions. The following is an outline of the considerations that guide the analysis of location decision-making in Chapters 6 and 7.

Familiarity with neoclassical economics leaves an indelible impression that choice means consulting and evaluating a huge list of alternatives which are easy to identify. To the economist, whose territory is the third-person perspective, making a choice is synonymous with optimising, in the process of which the individual rejects other (well-defined) opportunities. But what does it mean to choose to do something? Choosing to do something is not necessarily associated with showing a preference for that thing over something else.

Although a decision to do something is interpreted to mean that the individual *wanted* to do it - it was in his interest - there is no presumption that was in his *best* interest to do so. ('Best', in the sense of optimal, only makes sense in a complete scheme.) Nor is there necessarily an implication that he considered other things that he might have done instead.

When contemplating an investment, the decision-makers may not pay much attention to the issue of location, and they may not be particularly concerned with 'spatial issues'.

It is important that location be contextualised, in order to determine whether, or how and why, spatial considerations play a part. Townroe (1969) and others refer to location in the context of an investment by the firm, although there is seldom more than a mention of the interconnection (see, for example, Krumme (1969, p.32), Rees (1972a, p.204)). The investment decision, however, should be the substance of the analysis and an examination of location decisions must establish how they fit into the process of planning an investment.

The issue of location may come to the fore when an investment decision is made, but explanations of location decisions cannot start with the assumption that the location is of singular importance (Rees (1972a, p.204) makes a similar point), let alone the sole consideration that led to the factory being established at a particular place. The theorist who does so may overlook much of what he is trying to explain.²⁸

Even when considerable thought is given to a location, that location need not have been selected from amongst a number of potential sites. The issue is whether decision-makers evaluate the prospects of locating at more than one possible place.

Consideration of the circumstances surrounding the identification of an investment opportunity ought to cast light on whether locations are chosen. A subjectivist framework highlights the importance of the social context of location (investment) decisions. Business *networks* are useful in creating new opportunities (see Chapter 6). There is reason to believe that social networks also play an important role in the identification of investment opportunities, perhaps influencing the location of the business. The more the decision-maker relies on the advice and information of others, the less likely he will be to make comparisons of possible alternative locations.

Whatever the basis for identifying a location, it is important to establish what criteria are applied and how people go about 'finding' the site. Do they pay attention to the sorts of spatial relationships that characterise the economics of location? Are the *relative* labour costs at different places, or the number of competitors within a particular area, likely to be important? Even if they are taken into account, do economic considerations make, or break, an investment decision?

²⁸ Unfortunately, Townroe (1969) is guilty of this. Having stated that location issues have to be examined within the context of the firm's investment policy (p.16), he then simply assumes that location is an important element of the policy. His framework lacks the means for examining whether it is, or is not, important.

Spatial patterns of industry form a dominant theme in the economics of location, because the third-person perspective directs attention to the 'spatial system' and to interrelationships among the parts. Spatial clustering is attributed to factors such as economies of agglomeration and the location of raw materials, or simply to the consideration that resources are not spread evenly over the planar surface that plays such an important role in location theory.

Unequal spatial development is regarded as something that happens, sometimes encouraged by unsuitable regional policies which create an 'urban bias'. A general view, however, is that it would be preferable if things were otherwise. Reality imposes imperfections and without these the location of industry would approximate the elegant patterns created by the symmetric arrangement of market centres and areas predicted by neoclassical location models (see *Figure 3.2* above). The object of policy should be to try to offset some of the imperfections and to make location patterns look more like the ideal as indicated by the theory.

A subjectivist approach can shed additional light on 'spatial patterns' and provide reasons why the clustering of businesses is a sensible arrangement from a businessman's point of view. A corollary of these arguments is that an uneven geographic spread of industry is a feature of the growth of industry and attempts to 'redistribute' industry are likely to meet with resistance, and may harm the growth of manufacturing.

Having indicated why orthodox theory is unsuited to the task of explaining decisions and, now, having identified the failings of the theory of location, it is time to turn attention to the foundations of a subjectivist or hermeneutical approach to decision-making. In the next two chapters we investigate the epistemology of subjectivism, in order to explain the first-person perspective. In Chapters 6 and 7 we return to the problems of industrial location and apply the first-person perspective to location decisions.

CHAPTER 4

SUBJECTIVISM AND THE FIRST-PERSON PERSPECTIVE

Hermeneutics is no longer conceived as a subdiscipline of humanistic studies or even as the characteristic Method of the *Geisteswissenschaften*, but rather as pertaining to questions concerning what human beings are. We are "thrown" into the world as beings who understand and interpret - so if we are to understand what it is to be human beings, we must seek to understand understanding itself, in its rich, full, and complex dimensions. Furthermore, understanding is not one type of activity to be contrasted with other human activities.... Understanding is universal and may properly be said to underlie and pervade all activities.

R.J. Bernstein, *Beyond Objectivism and Relativism: Science, Hermeneutics and Praxis*, pp.113-114

I. EXPLAINING 'SOCIAL REALITY'

As a social science, economic theory must take account of people and their activities. In the following quotation Schütz (1977, pp.228-229) identifies the purpose of the social sciences, and few would object to this characterisation.

The primary goal of the social sciences is to obtain organised knowledge of social reality. By the term "social reality" I wish to be understood the sum total of objects and occurrences within the social cultural world as experienced by the common-sense thinking of men living their daily lives among their fellow men, connected with them in manifold relations of interaction. It is the world of cultural objects and social institutions into which we are all born,... and with which we have to come to terms.

The main issue is how to obtain that 'organised knowledge'. By what methods can we satisfactorily come to terms with the 'objects and occurrences within the social cultural world as experienced by the common-sense thinking of men'? Though neoclassical theory tries to provide the organised knowledge, we have seen the respects in which the results are unsatisfactory both in relation to general equilibrium theory and the application of neoclassical economics to problems of location.

We have drawn attention to the importance of Giddens's (1977) double hermeneutic as a defining characteristic of social science. Dealing with the double hermeneutic requires a language of concepts and relationships which help to clarify how individuals experience the 'social world' (in this case, especially, the 'business world'). The language is 'scientific' in that the semantics are not those of ordinary, everyday life, and its purpose, in part, is to understand how the individual understands 'social reality' as a necessary step in explaining conduct.

A theory formulated to serve this purpose is referred to as 'subjectivist', and the epistemology is termed a 'first-person perspective'. This chapter is concerned with describing subjectivism as it is used in the thesis, examining its features, and clarifying the implications of using it. At the same time it is important resolve differences in meaning by examining how subjectivism has evolved through successive philosophical movements, leading up to modern hermeneutics, with which the term, as used in the thesis, is associated.

Equipped with a definition of subjectivism and an understanding of the epistemology that is associated with a subjectivist scheme, we then go on to survey aspects of Austrian economics, which some regard as a candidate for a workable subjectivist theory. This is done in Chapter 5, in order to ascertain whether the subjectivism of Austrian economics is a satisfactory foundation for explaining decision-making and for analysing location decisions. We have to investigate the nature of Austrian subjectivism and how it compares with the subjectivism of a first-person perspective. In defining subjectivism, an important part of the exercise is to contrast the epistemology of the first-person perspective with that of the third-person perspective.

At the heart of this analysis is the tradition of 'subjective understanding', or *Verstehen*, and issues that concern the relationship between the theorist and his subject-matter. How does the theorist investigate the way in which people 'see' the social (business) world? How does he gain insight into their experiences? The answers to such questions have changed over time, with subjectivists posing

different epistemological and ontological questions at different times. In order to explain the first-person perspective, it is necessary to understand how and why the questions and answers have changed.

A. Objectivism and subjectivism

The epistemology of the third-person perspective characterises an objectivist position, associated with positive science. According to Bernstein (1983, p.9) in its conventional or 'dominant' form, objectivism is

the claim that there is a world of objective reality that exists independently of us and that has a determinate nature or essence that we can know. In modern times objectivism has been closely linked with an acceptance of a basic metaphysical or epistemological distinction between the subject and the object. What is 'out there' (objective) is presumed to be independent of us (subjects), and knowledge is achieved when a subject correctly mirrors or represents objective reality.¹

The ontology of objectivism specifies a world that exists, self-contained, at some distance from me, its existence separate from me and known only by observation - what Mäki (1990, p.294) categorises as 'independent existence'. To the objectivist, the theorist's role is to observe and to 'describe' the world as it really exists.

Subjectivism is associated with the clarification of understanding. Its origins are in textual interpretation and, more recently, in the methodological problems associated with the sciences of man. The philosophical movement representing subjectivism includes the considerable contribution of Max Weber on *Verstehen* and the phenomenological writings of Edmund Husserl and Alfred Schütz, as well as modern hermeneutics associated with Hans-Georg Gadamer and others.

¹ Compare the following definition of objectivism. 'One of several doctrines holding that all reality is objective and external to the mind and that knowledge is reliably based on observed objects and events' (*The American Heritage Dictionary* (1987)).

There will be differences of opinion over whether the term 'subjectivist' is justified in this context, so it is appropriate to examine and to defend its use.

B. The use of the term 'subjectivism'

The reasons why the term may prove controversial are twofold. In contrast to objectivism, there is less agreement over what subjectivism means (See Gewirth (1954) on different ways in which the term 'subjectivism' can be used), and there is no generally-recognised subjectivist philosophy. The term is not widely used by philosophers or others, which may account for the fact that in economics when it is used, it tends to be used very loosely,² and is consequently subject to misinterpretation. In short, considerable confusion surrounds its use. In economics, subjectivism is generally, though not exclusively,³ associated with Austrian economics and that, too, is confusing, as we will see in Chapter 5.

In fact, Natanson (1962) warns against applying the term 'subjective' to the sort of methodological approach advocated in this chapter. His objection, that the term is often misunderstood and 'is equated... with personal or private or merely introspective, intuitive attitudes' (p.157), is valid but problematic. The problem is that almost any expression used to describe '[methodological] positions that stress

² See Boehm (1982), Littlechild (1983), Wiseman (1983b) and Chapter 5, below. Coats (1983) says that he had difficulty in finding a definition of subjectivism. That is not surprising, but the definition which he cites - 'any theory which takes private experience to be the sole foundation of factual knowledge' (p.89) - is rather narrow and idiosyncratic. Coats does not provide an alternative definition and, after digesting his review of the revival of Austrian economics, the reader is not much wiser about the meaning of the term.

³ See Coats (1983). As an example of non-Austrian subjectivism, one would look to the work of Keynes, particularly his emphasis on individuals' expectations. But the subjectivism is embodied in a concept such as 'user cost' (a notion which today is largely neglected). User cost also brings to mind the tradition of 'L.S.E. cost theory', on which the work of Lionel Robbins had a considerable influence. Some of the important contributions to this tradition are collected in Buchanan and Thirlby (1973) and, in his introduction to the volume, Buchanan (1973) notes its subjectivist flavour and also identifies ties to Austrian economics.

the primacy of consciousness and subjective meaning in the interpretation of social action' is open to criticism.

The main problem with its use is that the connotations of the term subjectivism are often neither necessarily applicable (*e.g.*, equating subjectivism and solipsism) nor ones that we would want to see applied. The difficulty is to find a readily acceptable substitute for the term. Most alternatives are not sufficiently general to embrace a tradition, and are already associated with a particular type of subjectivism or with a phase in the development of a subjectivist paradigm.

Natanson prefers 'phenomenological' to subjectivist, but admits to the possible confusion that its use may engender. 'Hermeneutic' might serve as an alternative, but the tradition of hermeneutics is more specific than the approach in the thesis, which owes much to the phenomenological ideas of Alfred Schütz.

For all these reasons and also because modern subjectivism, represented by hermeneutics, identifies relativism as the essence of a subjectivist epistemology, the term subjectivist is appropriate provided its meaning is properly specified.⁴

⁴ It is appropriate, here, to comment on O'Sullivan's (1987) defence of subjectivism. While his interests overlap with the themes of the thesis, it is important to point out that there are fundamental differences of an epistemological nature between the methodological position which he advocates and the one adopted in the thesis. His contribution serves more as a foil against which the epistemology of the first-person perspective can be evaluated. O'Sullivan supports a 'subjectivist-interpretive' approach against the 'objectivist-behaviourist' one that is purportedly the foundation of mainstream economic theory. He regards the former as 'the only philosophically defensible approach to the human sciences' (p.161). O'Sullivan apparently also advocates a methodological dualism with regard to the methods of the natural and social sciences.

'Subjectivist-interpretative' to O'Sullivan means a methodology based on Husserlian phenomenology, with the claim to objectivity which Husserl demanded (as discussed later in this chapter), and believed was achieved through the process of phenomenological reduction (see O'Sullivan, pp.13-14 and pp.175-185). Thus, in Rorty's terminology, O'Sullivan propounds a view of (social) science as epistemology, rather than as hermeneutic. O'Sullivan disapproves strongly of the sort of relativist position associated with modern hermeneutics (see pp.26-30), whereas in our view - adopting arguments associated with Gadamer - recognising the relativism of all understanding (and knowledge) is a central consideration in understanding how individuals understand.

II. THE MEANING OF SUBJECTIVISM

Subjectivism is traditionally linked to the social sciences and is associated with questions about how an individual 'observes' the conduct of *other people* and how the observer's knowledge of others should be conceptualised. Another position, outlined in the course of the chapter, is that subjectivism is more fundamental than this and addresses *all* understanding through the question *how does the individual know*.

Subjectivism was initially concerned with what could be termed a 'single hermeneutic', the problem of interpretation occasioned by 'observation' of human activities or the results of such activities where, it was argued, the purpose or intention 'behind' the activities could be understood and had to be recognised and interpreted.

⁴(...continued)

What is problematic, in separating our approach from O'Sullivan's, is that he treats his subjectivism as originating from the Weber-Schütz tradition. The fact that our approach is referred to as *subjectivist and hermeneutical*, and is also seen to derive from Weber and Schütz, *but* - in opposition to Husserl - rejects the idea of grounded knowledge, indicates how much confusion and uncertainty surrounds the meaning of subjectivism. Clearly our reading of Weber's contribution, as set out in this chapter, is at odds with that of O'Sullivan. We emphasise the hermeneutical and 'relativist' leanings of Weber, and believe that Schütz's work, much more than that of Husserl, belongs in a similar category. Schütz (1977) does not stress the ability of transcendental phenomenology to yield knowledge which is apodeictically certain, nor is such certainty central to Schütz's object which is to apply a phenomenological philosophy in order to explicate the individual's life world. Schütz is 'saved' from a relativist position (especially a solipsist one) by his emphasising the intersubjective nature of the life world as the individual constitutes it.

In the light of the difficulties in separating the two approaches based simply on a superficial description of their methodologies and antecedents, it seems to us that the distinction between a first-person and third-person perspective is valuable in resolving different methodological positions. If the arguments in this chapter are accepted then, like neoclassical and Austrian methodologies (both of which O'Sullivan classifies as subjectivist-interpretive as against the *advocacy* by neoclassical theorists of an objectivist methodology), O'Sullivan's methodological position is consistent with the epistemology of a third-person perspective. Understanding is grounded in (given) reality. The epistemology, and associated ontology, stands in stark contrast to the continual unfolding - the knowing *differently*, rather than knowing *more* about the world out there - that is associated with experience in the hermeneutic circle and is at the root of the first-person perspective (see below in this chapter).

The observer automatically recognises purposes 'in' the phenomena and occurrences associated with individuals' activities - such as houses, the business of financial institutions, works of art, money, literature, the country's constitution, shopping in the supermarket, and scientific research.

The term 'house' in the phrase, 'I prefer my house to the new one down the road', has a meaning to the individual concerned, and recognition of that meaning is interpretative understanding (*Verstehen*). A house is not just an observable object made of various construction materials but is a 'home' with connotations of belonging to a family and relationships between family members. Meaning is 'subjective', both because the connotations are intuitive rather than observed, and also because different people understand the meaning differently.

The rationale for calling this 'subjectivism' is explained by Weber (1964). Setting out his framework for sociological analysis, he states (p.88) that action includes 'all human behaviour when and in so far as the acting individual attaches a subjective meaning to it'. In defining 'meaning', Weber (p.89) argues that

[i]n no case does it refer to an objectively 'correct' meaning or one which is true in some metaphysical sense. It is this which distinguishes the empirical sciences of action, such as sociology and history, from the dogmatic disciplines in that area, such as jurisprudence, ... and aesthetics, which seek to ascertain the 'true' and 'valid' meanings associated with the objects of their investigation.

Recognition of a *double hermeneutic* in the 'observation' of human conduct means acknowledging that all knowledge, not just the understanding of other people, is *Verstehen*. To the social scientist who is interested in explaining my conduct, the meaning of the phrase, 'I prefer my house to the new one down the road' depends as much on his interpretation or understanding of things - why the phrase is significant, what it means to him, whether he has reason to pay attention to my utterances - as it does on his understanding of me and why I made such a remark.

The double hermeneutic defines an epistemological 'relationship' between the theorist and his subject-matter that sets apart the social and natural scientist. Both

are engaged in *Verstehen*, but since the former interprets the activities of other people, the answers to his questions - what are they doing, why are they doing it - depend on his understanding of their understanding of 'social reality', of the meaning they ascribe to their activities. We identify a *first-person perspective* as recognising the interpretative interrelationships associated with the double hermeneutic.

More modern interpretations of understanding, adopting Edmund Husserl's ideas, recognise that the individual is actively involved in the construal of meaning, not as observer or as eyewitness to what is happening out there, and not as a passive recipient of information, but as creator of meaning. Interpretation and the *constitution* of phenomena are one and the same. Individuals do not interpret what exists out there. What exists is how they understand or 'see' events. In Bernstein's words (1983, p.126), 'meaning is not self-contained - simply "there" to be discovered; meaning comes to realisation only in and through the "happening" of understanding'.

In the modern, hermeneutical form of subjectivism, attributed to Hans-Georg Gadamer, meaning is the result of a coming together, like a 'fusion' of the text and of the reader's ideas about it (see Warnke (1987, pp.81-82 and 107-108). Meaning is also not fixed, but emerges and changes with the 'understander's' experience, as if through a 'conversation'.

'Knowledge' or understanding is intersubjective, and meaning is always constituted *intersubjectively*. The individual lives and works among and with other people. Even in solitary confinement (his predicament being a consequence of the activities of particular people) or on a desert island (where he is conscious of the absence of 'civilisation' or of company), his 'interests' - whether brooding or working - involve his relationships with, and understanding of, other people and of social institutions.

Understanding is 'prejudiced', shaped by one's *social* history. One's upbringing, education, and so on, are social processes. It is almost impossible to conceive of

an individual who does not 'share' his understanding with other people, unless he has never lived in the company of others.⁵

A. Subjectivism and relativism

Subjectivism needs to be distinguished from relativism. The term 'relativism' denotes an epistemology which asserts that knowledge is relative, based on the individual's culture, experience, or other circumstances, and the term is often used in a pejorative sense. At the farthest extreme of relativism lies solipsism, where the individual's world is essentially *private* (see O'Sullivan (1987, pp.23-30) on different models of relativism and a critique of epistemological relativism).

Subjectivism in its broader meaning has been criticised as relativist, and the implication is that the subjectivist is bound to end up having to defend a solipsist position. It is not difficult to appreciate the nature of this type of criticism against subjectivism but it is based on a twofold misconception. The first is the idea that there is a dichotomy between objectivism on the one hand - held to be the true epistemological basis of science - and subjectivism on the other. Because objectivism is right and natural, subjectivism is wrong and unnatural. Secondly, the espousal of subjectivism puts one onto the continuum of 'degrees of relativism' which ends with solipsism, whereas objectivism means absolute objectivity and

⁵ The caricature of the individual who is unable - because his experience is private or subjective - to communicate with others, is common to critiques of subjectivism, and is associated with the idea that subjectivism leads to solipsism. In fact, this reasoning is a product of the Cartesian ideal and of the belief that there *could be* a neutral and objective language with which to describe the world as-it-really-exists, out there. Individuals' subjective experience and understanding condemns them to solipsistic isolation only because the epistemology of objectivism fails to account for the intersubjective nature of *all* understanding and the fact that people 'share' their social world. From an objectivist standpoint, each individual is a (solitary) observer of the world out there. Knowledge is acquired by observation. Each observes what is happening out there independently of others, and then communicates what he knows. To do so, he needs to 'translate' the observations into a language which means the same to everyone. Without a neutral language with which to describe the sense-data to each other, it follows that individuals have no means of ensuring that others *really* understand what the world, and their experiences of it, really are like. The false dichotomy of objectivism *versus* subjectivism is taken up in this chapter below.

precludes solipsism. A subjectivist can never claim objectivity and any subjectivist position is necessarily not far from solipsism. It is this sort of view which regards subjectivism as nihilistic.

The problem, that the advocacy of interpretative understanding means a lack of objectivity, has plagued subjectivists themselves. Scholars who held that *Verstehen* is a necessary basis of theories in the social sciences bore the responsibility of assuring a sceptical, and sometimes hostile, scientific community that the theories yielded objective knowledge (see the discussion of Husserl's position in section III below). And one can see from the considerable effort that they devoted to this task, which is evident in the writings of Austrian economists, that the responsibility was an onerous one. Their efforts to 'prove' the objectivity of subjectivism had a constraining effect on the construction a subjectivist scheme, necessitated by circumscribing the scope of interpretative understanding.

Because of the importance of this issue and its bearing on our immediate concern, which is the epistemological relationship between the theorist and his subject-matter, the problem of subjectivism and relativism is a theme which runs through subsequent sections of the chapter.

Following Bernstein (1983) and others, we argue that the concern to provide an objective scheme is a misplaced one. Descombes (1985, p.55) suggests that

one cannot abolish the category of fact without abolishing also the category of interpretation; the words "fact" and "interpretation" get their meaning from the contrast between a fact and an interpretation of this fact.

The dichotomy between subjectivism and objectivism is a false one. The contributions of hermeneuticists, such as Habermas and Gadamer, in the course of the past thirty years, offer a possible resolution of what appears to be an essential tension between objectivism and subjectivism. Their standpoint is that the problem is actually a consequence of the legacy of Cartesian science which claims that scientific knowledge *is*, or should be, universally valid. In fact, the

dichotomy is inherent in what Rorty (1980) refers to as 'epistemologically-centred philosophy' which has characterised virtually all philosophical thinking.

The subjectivism-objectivism divide is a consequence of efforts to 'ground' our beliefs by demonstrating that they correspond with what things are really like. The promise of science, in the Cartesian mould, is to provide that grounding. Once it is recognised that science, as a human activity, is interpretative and that it cannot sustain the claim to provide objective knowledge, the tension between subjectivism and objectivism is not resolved so much as it disappears.

B. The mind and subjectivism

Subjectivism sometimes is viewed, misleadingly, as taking account of the *minds* that 'lie behind' individuals' activities.⁹ Attributing to *Verstehen* the connotation of 'exploring the structure of the human mind' is as unjustified as arguing that *Verstehen* is rooted in psychoanalysis. A subjectivist methodology does not require, nor does it involve, any attempt by the theorist to put himself 'inside a person's head', in order to understand the particular thoughts, expectations, ideas, or 'experiences' that underlie his activities.

The aim of subjectivism is to use empathetic understanding to provide insight into human activities. The theorist is interested in how a 'typical' individual under 'typical' circumstances - for example a manager who is involved in undertaking an investment - constitutes the problem of 'undertaking an investment'. (On the

⁹ In Austrian economics, subjectivism has come to be associated with recognising the existence of a human mind. The term is used not merely to refer to the fact that people think, and converse with one another, but 'mind' has acquired the connotation of something that has a real, physical existence, like the notion which Schrag (1985, pp.26-27) attributes to Descartes: one which 'still called upon the classical doctrine of substance to provide consciousness with a stable support, an abiding and ever-present ego, an Archimedian [*sic*] point of certainty.' O'Driscoll and Rizzo's (1985) 'mind construct' (p.20 ff.), which they postulate as the basis of a subjectivist scheme, is confusing. Such a notion is not found in the subjectivist tradition which is under examination here. It may, however, be appropriate in the context in which these authors use it, for their approach involves a third-person perspective.

constitution of interpretive schemes embracing ideal types see Schütz (1972, esp. pp.176-201).) What is the 'world' of the investment decision-maker like? In what issues is he interested? What is the nature of his relationships with other people and how do these relationships bear upon what he does?

The answers to such questions require a framework of categories and concepts some of which are the result of an attempt to reflect on and to understand empathetically the way in which others would constitute their circumstances. The ability to do so is the fact that empathetic understanding is part and parcel of cognition. It is not necessary to have been an industrialist and to have made investment decisions in order to understand the 'predicament' of someone who is one and does make these types of decisions.

There is certainly no presumption that a subjectivist approach to analysing investment decisions requires a knowledge of psychology or an ability to specify the 'contents' of a decision-maker's mind. With reference specifically to Weber's work, Freund (1972, p. 98) states that 'interpretative sociology is not in the least concerned with enumerating the psychic and physical manifestations and elements which accompany, or even result in, meaningful goal-oriented behaviour'.⁷

C. The acceptance of subjectivism

Initially, the subjectivist tradition was narrowly regarded by its protagonists as an enquiry into the methodology of the social sciences,⁸ in terms of which a

⁷ An important difference between subjectivism, espoused as a methodology for a theory of location decision-making, and the behavioural approach to locational decision-making which was outlined in the previous chapter, is that the latter is explicit in looking to psychology for its foundations. Downs (1970) characterises the behavioural approach as being concerned with the 'way in which... knowledge is stored and organised in the mind' (p.70). He goes on to state that 'we can ask several basic questions.... What information is stored in our minds? How is it stored...?' This psychologism has nothing to do with subjectivism *per se*, and in its modern incarnation of hermeneutics, subjectivism denies the mechanistic, or behaviourist, implications of this quotation. Hermeneutics rejects the idea of a world 'out there' which 'sends out' knowledge, or from which the individual 'receives' information, that is then 'stored' in the mind.

⁸ It is worth remembering, as Benton (1977, p.120) points out, that Weber did not regard *Verstehen* as a *method* of social science, 'but an 'objective', an 'achievement' - ... a (continuat...)

subjective element in these sciences was contrasted with the objectivism of natural science. In the middle decades of this century, when positivism was at its height, subjectivism was almost entirely repudiated.⁹ According to Bernstein (1983, p.27):

The prevailing attitude at the time among professional social scientists was that their discipline was now on the secure path of becoming a genuine natural science of individuals in society, a natural science that differed in degree and not in kind from the rest of the natural sciences. Progress in the social sciences,... required adopting and following those methods, procedures, and criteria... that had proven so successful in the natural sciences. They therefore scorned "interpretive sociology", with its appeal to "subjective meaning", *Verstehen*..., and such concepts as empathy and interpretation.

Those who remain wedded to a positivist-empiricist conception of science still treat subjectivism with scepticism and sometimes scorn, and regard subjectivists as misguided (see the arguments of Abel (1977)). As Dallmayr and McCarthy (1977, pp.78-79) put it,

those defending the methodological unity of the sciences typically proffer a rather low estimate of the importance of *Verstehen* for the logic of the social sciences. It is either rejected as un- or pre-scientific, or analysed as a "heuristic device" that, while useful, belongs in the anteroom of science proper.

Such views, however, may be on the way out. Today, the hermeneutical tradition, derived from Max Weber and his predecessors, forms an important ingredient of a much more broadly-based discourse on existentialism.¹⁰ It is now respectable, as indeed it has been from the time of Popper's *Logic of Scientific Discovery*, to

⁹(...continued)

distinctive type of knowledge which may be achieved by a variety of methods, or no 'method' at all'. (See also p.121.)

⁹ For an overview of the impact of positivism on the philosophy of social science during this period see Bernstein (1976, pp.4-24).

¹⁰ According to Dallmayr and McCarthy (1977, p.9) the shift from treating understanding as a method of social enquiry - the prerogative of individual cognition or consciousness' - to 'a basic attribute of man's existential condition or *Dasein*', is largely attributable to Heidegger.

suggest that the scientist *constitutes* the problems that interest him. As ideas - created, communicated, and interpreted within a community of people - science is subjective, not objective.

The reformation of science as epistemology to science as hermeneutics is by no means complete and, perhaps, never will be widespread. Its significance from the point of view of the thesis, however, is enormous. Subjectivism has been brought out of the closet. It is now a serious subject, worthy of the attention of philosophers of the top rank.

For a long time subjectivism was regarded with disdain by the majority of philosophers and scientists. It was the domain of certain social scientists who believed that their subject-matter either could not, or should not, be studied by the methods employed by their natural-scientific counterparts. Today it is acceptable to return to the tradition which began as the attempt to justify a separate method for the *Geisteswissenschaften*, in order to answer questions about the ontology and epistemology of science *per se*.

III. THE EVOLUTION OF *VERSTEHEN*

In order to clarify the relationship between the theorist and his subject-matter associated with subjectivism, we must examine the changing conception of understanding (*Verstehen*) within the subjectivist tradition. The object is to identify changes in the interpretation of understanding, and to show how these are associated with different views about the nature and task of social science and, in particular, about the objectivity of social science.¹¹

¹¹ In what follows the focus falls entirely upon what may be termed mainstream subjectivism. Although the boundaries are not always clear-cut because, for example, a subjectivist in our sense can espouse an objectivist epistemology (Husserl is a case in point), the analysis specifically ignores contributions, such as that of Parsons, which make an effort to assimilate *Verstehen* into a positivistically-inspired methodology. Because the object is to show how the approach embracing *Verstehen* has changed, and what its implications are for the formulation of economic theory, there is no further reference here to the methodological arguments for rejecting subjectivism. By implication, subjectivism (continued...)

A. *Verstehen* as neutral understanding

The tradition of *Verstehen* that concerns us includes phenomenology and, in the work of modern hermeneutical writers, leads to the radical rejection of the epistemological basis of positivist science.

This line has its origins in early nineteenth century, in the writings of Friedrich Schleiermacher (1768-1834) and later Wilhelm Dilthey (1833-1911).¹² The latter was the first philosopher to argue for a separate method of the social sciences, employing hermeneutics, based on the role which interpretive understanding plays in the social sciences. Initially, *Verstehen* was viewed as a distinctive characteristic of the social sciences and, by its advocates, as the essential determinant of a separate methodology of the social sciences.¹³

In the following quotation, concerning the nature of Dilthey's contribution, Warnke (1987, p.2) points to a similarity of outlook between positivists and the initial efforts to develop a theory of *Verstehen* out of the tradition of textual exegesis. (See also Bernstein (1983, pp. 112-113))

¹¹(...continued)

offers a practical and useful basis for constructing social-scientific theories. The criticisms of subjectivism that interest us are the internal ones, those levelled by subjectivists themselves at their predecessors or contemporaries who they believed had, somehow, gone astray or who had failed to see the implications of their arguments.

¹² See Truzzi (1974, pp.8-9) for a brief statement of Dilthey's approach to the social sciences. Warnke (1987, see esp. Ch.1) offers a useful overview, initially from Gadamer's perspective, of the evolution of hermeneutical thinking through "Romantic hermeneutics" - from Schleiermacher and Dilthey - to Heidegger. Different views emerged concerning the purpose of hermeneutics in respect of textual interpretation. For example, from the idea that the role of hermeneutics was to establish the *truth* of the text, to that of establishing the *author's intention*, to shedding light on *where (and how) the meaning of the text is established*, including the idea that the reader does not simply interpret what is already there but actually co-creates the work.

¹³ Freund (1968, p.93) attributes the invention of the 'method' of interpretative understanding to the historian Droysen, 'round about 1850'.

Dilthey had tried to establish the autonomy of the logic of the *Geisteswissenschaften* or of... the investigation of social norms, practices and institutions. That is, his desire had been to illuminate the difference between the structure of these sciences of *meaning* and the natural scientific explanation of events based on the formulation of theoretical frameworks and discovery of causal laws. Nevertheless he conceived of both kinds of study as *objective* sciences; the point of both was to develop a *neutral understanding* of social or human phenomena, an understanding *that would be accessible to all interpreters or observers* from whatever historical or cultural vantage point they might inhabit. The positivism of the mid-twentieth century differed only in denying any distinction in the logics of the natural sciences and *Geisteswissenschaften* (emphasis added).

Individuals responsible for promoting the concept *Verstehen* have long cherished the desire to represent the sciences of meaning as objective, on a par with the objectivity of the natural sciences. We shall see that the requirement of an objective foundation of economics is also a factor that has shaped the subjectivist methodology of Austrian economics. Like Dilthey, most subjectivists have struggled with the problem

that viewing the social sciences as a continuation or refinement of the self-understanding developed in ordinary experience leaves them prey to the same self-deceptions to which ordinary life is subject (Warnke (1987, p.34)).

Bearing in mind the conviction of earlier subjectivists, who held to the objectivity of social science, and feared the problem of relativism identified here, it is desirable to consider Max Weber's position. Although addressing himself to the objectivity of social science and taking care to preserve its *Wertfreiheit*, his arguments take *Verstehen* further away from an objectivist position, the subtlety of which is lost in his epigones.

Examining Weber's views provides a useful bridge from the ideas of his predecessors to a hermeneutical reading of all scientific discourse that is associated with Gadamer's critique of objectivism and with Rorty's (1980) analysis. Such an examination affords a means of identifying how the meaning of *Verstehen* has changed.

E. Max Weber and objectivity in social science

When considering Weber's standpoint on the position of the theorist as observer and interpreter of human conduct and also on the objectivity of social science, it is important to heed Bernstein's argument (1976) concerning the interpretation of Weber's position.

Weber's sociology is probably known to most English-speaking scholars through Parsons's translation and explication (Weber (1964)). In Chapter 1, where reference was made to Parsons's description of the theorist as 'observer', his positivistic standpoint is apparent. Bernstein (1976, p. 26) adds that

Parson's own biases have influenced his presentation of Weber and have affected the way in which a generation of mainstream social scientists have read and interpreted Weber.... Weber saw clearly... that an adequate social theory must not only examine causal relationships.... We are only beginning to realize how Weber was much more profound and perceptive about these issues than those who progressed beyond him.

Much of Weber's writing can be seen as a struggle against a narrowly conceived methodology of science which was becoming more and more dominant and which would culminate in logical positivism. What he objected to was a dogmatic and rigidly prescriptive approach to science which also refused to acknowledge differences between the natural and social sciences.

His open-minded approach produced a fundamental defence of subjectivism in social science and brought him much closer than his predecessors to the position of modern hermeneutics, though Weber was adamant that the subjective basis of social science was not in conflict with the need for social scientists to produce objectively valid knowledge.¹⁴

¹⁴ A particularly useful examination of Weber's ideas on the certainty of understanding and on the objectivity of a science of interpretative understanding is that of Freund (1968, see pp.96-101).

Examining the issue of objectivity in social science (1977, pp.26-27), Weber provides a point-by-point comparison of the methodology of the natural and social sciences. He *rejects* the view that a psychologistic explanation of social phenomena - reducing them to psychic conditions - is desirable, and that, if pursued, would give the analysis of social life a solid grounding, comparable with the objectivity of mechanics.

Weber's argument (see 1977, pp.27-30), that the task of explaining social phenomena is not assisted by the search for causal laws, rests on the consideration that the events or phenomena in which the scientist is interested have a 'significance' to individuals based on an underlying 'value-orientation' which individuals have towards cultural events. When he speaks of the 'cultural significance of a phenomenon' - and Weber provides the example of exchange in a monetary economy - he is saying that the phenomenon is not just a thing in the world which exists out there, but it has a meaning to individuals as a means to ends which they pursue. It has a subjective meaning or significance, based on the individual's appraisal of it in a particular role.

It is not difficult to see Weber's hermeneutical leanings in these arguments, and it is suggested that the views are a foretaste of modern hermeneutics. It is the appraisal by individuals of phenomena that gives them their significance, and allows their nature, function, and importance, to be understood. If we were to take away or to overlook the meaning that phenomena have for individuals - their value-orientation - the phenomena would not be of interest to the social scientist. It is the cultural values of things that makes them social phenomena and it is the examination (interpretation) of their significance in a social context which determines both how and why the social scientist is interested in them.

As meaning depends on context, so significance is specific to a particular period of history. In order to explain phenomena, social theory must reveal what significance they have for individuals in particular circumstances. It stands to reason that an understanding of significance at a particular time or place cannot be

gained through abstract, formal causal relationships nor can it be sought in universal analytical laws.

Regarding these arguments, Weber states (pp.30-31):

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.... [B]ecause knowledge of cultural events is inconceivable except on the basis of the *significance* which the concrete constellations of reality have for us in certain *individual* concrete situations. In *which* sense and in *which* situations this is the case is not revealed to us by any law; it is decided according to the *value-ideas* in the light of which we view "culture" in each individual case.... The transcendental presupposition of every *cultural science* lies not in our finding a certain culture or any culture in general to be valuable, but rather in the fact that we are cultural beings, endowed with the capacity and the will *to take a deliberate attitude towards the world and to lend it significance* (emphasis added).

What is particularly important, if this is a valid interpretation of Weber's ideas,¹⁶ is a hint - which certainly foreshadows the position of Husserl and phenomenologists and after them hermeneuticists - that significance does not *reside in* things; it is *constituted by* the individual. Something has significance because the individual deems it so. So an explanation of the phenomena of the social sciences requires an understanding of the way in which problems or situations are constituted by individuals.

C. The emergence of a 'relativist' position

Weber's arguments prefigure Gadamer's idea that the individual observer, or 'analyser', who is born into and immersed in a tradition and culture, is *already* 'thrown' into the world. Meaning and significance are only constituted through a pre-existing, pre-judged, 'understanding' (see Bernstein (1983, p.142), Warnke (1987, pp.82-91)). Weber makes the point (p.31) that 'knowledge of cultural reality... is always knowledge from *particular points of view*'. What is treated by

¹⁶ The interpretation is supported by Freund's (1968) reading of Weber. See pp.54-55.

the researcher as important or trivial is not determined by the facts of the situation, but by the 'evaluative ideas with which [the specialist] unconsciously approaches his subject-matter,... [selecting]... a tiny portion with the study of which he *concerns himself*' (p.32).

Weber's exposition contrasts sharply with the ambitions of determinism and its complete scheme of things. He points out that to try to embrace, or to analyse, all aspects of 'reality' would be impossible. Freund (1968, p.39) attributes this conviction to Weber's adherence to the spirit of Kantian philosophy, that '[r]eality is infinite and inexhaustible'. Observing Weber's position, one would argue that understanding - linked as it is to the meaning that individuals attach to phenomena as means to ends - 'unfolds'; it involves an ongoing process of interpretation over time. This perspective is the antithesis of a comprehensive 'world view'.

Time frustrates attempts to construct a complete scheme. This is the substance of Shackle's (1972a, p.151; also Preface and p.105) epithet that 'time is alien to reason'. 'Reason' - the ability to find out what course of action will enable one to maximise - is dependent upon having complete knowledge. The same considerations are also at the bottom of Lachmann's (1977b, p.36) statement that '[t]ime and knowledge belong together. As soon as we permit time to elapse, we must permit knowledge to change.'

For Weber, the fact that the theorist always approaches problems in a particular historical context and at a particular time, guided by particular value-ideas, are some of the reasons why a subjectivist approach always yields a partial view and why the findings of social scientists are in some respects always relative, despite being subjected to rigorous analysis. The central role, in orienting understanding, of the individual's historical or cultural perspective and his particular interests, is identified by modern hermeneutics.

From this vantage point, the inevitable 'relativism' of interpretation as a consequence of the individual's 'situatedness', is the essence of subjectivism. This

is not something to be apologetic about or to be avoided, but something upon which to capitalise and to build in order to gain insight into the individual's understanding and the circumstances of decision-making. Explaining Gadamer's position on the importance of recognising the 'prejudices' that shape the individual's understanding, Bernstein (1983, p.128) states that '[t]here is no knowledge without *preconceptions* and *prejudices*. The task is not to remove such preconceptions, but to test them critically in the course of inquiry'.

D. Objectivity: the subjectivist's dilemma

The inference can legitimately be drawn that the epistemological implications of Weber's subjectivism place him at a considerable distance both from the Cartesian objectivism that is associated with modernism and positive science and from the subjectivism of nineteenth century hermeneutics. An important difference between Weber and nineteenth century hermeneutics is that in Weber's analysis the spectre of relativism begins to loom large. Interpretative understanding reveals an epistemology where nothing is certain, where it is impossible to 'test' the validity of one's understanding because each individual has a different perspective on things. Unless scientific knowledge is grounded and is intersubjectively valid, who is to say whether the theorist's interpretation and understanding is correct? Is it not true that if one were to accept Weber's arguments all explanation would have to be treated as either equally valid or equally arbitrary, since there is no objective, correct explanation? In a similar vein, if individuals' decisions merely reflect the way in which they constitute their worlds, what are the possibilities of people making the correct decisions? How do we know whether individuals base their decisions and conduct on a *correct* understanding, or whether they are simply mistaken in their (subjective) assessments of any situation?¹⁸

¹⁸ Benton's critique of a lack of objectivity in Weber's approach is apparently of a different nature. Benton (1977, p.126) argues that Weber's conceptual position (methodological individualism combined with the idea that historical concepts are constructed according to the criterion of value-relevance) prevents one from determining, along scientific lines, whether the techniques and criteria for understanding cultural objects are objective. Benton's suggestion (p.127), to overcome this difficulty, is to have a scientific theory of
(continued...)

A reply to these questions, from a hermeneutical standpoint, would be that the questions are misguided. No one necessarily knows what to do, or what to make of a particular situation. Eventually, but possibly too late to do much about it, people find out whether their understanding of the situation was appropriate.

If the questions involve a presupposition that people could be in a position, by having the right information, to make decisions which are objectively the best, the questions are certainly misguided. In order to take demonstratively superior decisions, the individuals would have to have a comprehensive world view, but no one has a third-person perspective. At the same time, the argument that the individual's understanding *is* relative does not mean that decisions are *arbitrary*.

E. Grounding subjective understanding

Various 'solutions' have been proposed to the apparent dilemma of recognising the subjective nature of experience and of wanting to provide a grounded theory of individual conduct, based on more than private experience. How can this be so?

One approach, represented by behavioural location theory, holds that experience is conditioned by psychological or mental characteristics and these, in turn, might have a physiological origin. In this way, psychology (and perhaps physiology) 'grounds' a theory of decision-making, providing the assurance that there is something real - in the form of, say, dispositions towards different goods - *behind* capricious human conduct. Traits, or even the physiological structures that 'cause' perception, provide a scientific (objective) basis for, and explanation of, human

¹⁶(...continued)

objective techniques and criteria of evaluation, which would produce 'criteria for the construction of concepts and interpretations not dependent upon any relevance to values, or upon any particular ideological standpoint, but upon logical techniques for analysing the structure of conceptual systems'. From a hermeneutical point of view, the weakness of this suggestion, which Weber might possibly have identified, is precisely the problem of providing a value- and ideology-free framework. Once the hermeneutical nature of any conceptual framework is recognised, Benton's suggestion leads to an infinite regress. A framework is needed to evaluate a framework, which is needed to evaluate another framework, and so on.

conduct. As noted above, this is a 'solution' that Weber explicitly rejects (see also Freund (1968, pp.40-41 and 115-116)).

Subjectivists, in the tradition considered here, have usually adopted a different approach. Taking various forms, it involves the idea that 'behind' the individual's (subjective) experience of the world is a structure, which the theorist discerns and can refer to, which shapes peoples' experience and knowledge. For Husserl, access to this structure can only be gained transcendently, by 'bracketing' out the world of everyday experience through phenomenological reduction. From his point of view, by 'showing' that there is a real, unchanging, structure at the core of the individual's (subjective) perceptions of what is, this process provides an objective basis to phenomenology.

Alternatively, it may be proposed that there exists a 'real world' against which experience is tested. The theorist draws a distinction between the reality that exists independently of the individual's ideas (see Mäki (1990, p.294)) on the one hand, and world as the individual experiences it on the other. Although experience is not always a good guide to action and the individual may be uncertain about what to do, in principle he can find out what he ought to do, and the real world acts to circumscribe the range of feasible action. In a similar vein, the social-institutional context of action is regarded as a 'constant', or substructure, providing the parameters which determine the limits within which individuals can operate. Initially, the individual may not realise what things are really like, but over time his knowledge will come to mirror the reality of the world and then his actions will be optimal, conforming to the objective circumstances of the situation.¹⁷

A difficulty with all attempts to ground experience - by way of a fixed structure that forms a background to social life - is that they involve some form of epistemological dualism in relation to the two elements of the double hermeneutic. The theorist's knowledge of the world is different from that of ordinary individuals.

¹⁷ Evidently, it is just such a conception that underpins Kirzner's (1978) concept of error.

This is not a matter of the theorist having an expertise in analysing social situations or employing a language of theory that facilitates a discourse that is not possessed by the ordinary, untrained person. The theorist, who has 'access' to the structure of things as they really are, *understands, or knows, differently*. His reality is different from that of the people whom he observes. How the theorist should have a superior, more sophisticated understanding is not explained. In any event, by virtue of his epistemology, the theorist is assigned a special role. He is not an observer in the ordinary sense of someone understanding the activities of his colleagues.

It seems that the very efforts to ground a subjectivist theory lead to the abandonment of the endeavour to understand how individuals understand. In order to ground the theory it is necessary to demonstrate that there is more to the world than the individual's understanding of it; that understanding is not self-contained but always refers to something beyond understanding itself, beyond what is actually understood.

We discover, thus, that a sort of third-person perspective is at the back of attempts to ground subjective experience. The theorist, unlike the individuals whose activities have to be explained, can see the whole scheme of things. On the one hand he understands the individuals and what they know. On the other, he can 'see' the reality of the entire structure of the world against which the individuals' activities stand out in relief and to which their understanding refers.

Theorists who espouse the cause of subjective understanding in social science, but who also want to ground the theory, are in the predicament of having to conclude that interpretative understanding is not very useful either to individuals or the theorist. For the former it is an insufficient basis from which to act, or to decide, for it may lead to the wrong decisions being taken. For the theorist, without recourse to the underlying scheme of things, it is not possible to explain human conduct and to show that conduct does have a rational basis.

IV. VERSTEHEN AND MODERN HERMENEUTICS

A fundamental critique of all these efforts, as explained by Warnke (1987), is that in the eyes of a modern hermeneuticist like Gadamer they are misplaced, because their foundations are wrongly conceived.

In this section we examine the ideas that have been most closely associated with the emergence of the epistemology defined in the thesis as a first-person perspective. These ideas, which lead to the complete rejection of attempts to ground understanding, treat knowledge as hermeneutical, and provide the foundation of a thorough-going subjectivism embracing the relativity of understanding. In examining these ideas, we also define the notion of 'weak subjectivism' as a contrast to the subjectivism of the first-person perspective.

The desire for an objective social science is the Cartesian ideal of science as epistemology, providing knowledge which is a mirror of the true nature of things. Influenced by the Cartesian search for certainty, social scientists who seek universally valid knowledge and who wish to put the inferences which they draw beyond doubt, look at the social world from a false perspective and so they ask the wrong sorts of questions. Reflecting Gadamer's views, Warnke notes (1987, pp.32-33),¹⁸ that social scientists failed

to distinguish between two different kinds of doubt: the doubt that arises in the course of life and a methodologically sanctioned doubt. In life itself certain experiences can cast doubt upon one's conceptions, prejudices and self-understanding. Such doubts can lead to further reflection, revision in one's interpretation of one's life or one's projects.... This kind of doubt is thus *part of the connection between experience and understanding*.... In contrast, the methodological decision to doubt all of one's experiences in advance - the strategy of Cartesian doubt - does not have its roots in life but is rather directed "against life". Gadamer suggests that such doubt is overly intellectual; it does not arise in response to the interpretive conflicts embedded in actual experiences but tries to resolve all conflict in advance.... [T]he goal is to achieve not a better under-

¹⁸ See also Bernstein (1983, pp.36-37).

standing of oneself or the history of one's culture, but rather a definitive understanding, an understanding secured against the need for future revisions. The knowledge attained through this kind of doubt is thus to have *nothing situational, contextual or partial left in it* (emphasis added).

The implication is that a theory concerned with explaining human conduct cannot be grounded, in the Cartesian sense of having an objective basis, because understanding is not grounded, except in understanding, in history or experience.

Understanding is universal in several sense . It is not just one activity which is to be distinguished from other human activities, but underlies all human activities. It is universal in the sense that nothing is in principle beyond understanding, even though we never exhaust the "things themselves" through understanding.

This quotation is from Bernstein (1983, p.144). When he says that 'nothing... is beyond understanding', he means that understanding is all there is: knowledge *is* understanding (and reflects a particular perspective). Uncertainty and doubt are a necessary part of understanding. We do not come to know more, but in the course of time we understand differently, and so the 'things themselves' are never exhausted. A subjectivist theory must, *at both levels of the double hermeneutic*, reflect the doubt and uncertainty that people feel.¹⁹

Taken in their proper context of Gadamer's explication of the hermeneutic circle, the consequences of this reasoning are as devastating for the 'old' subjectivism (the belief that interpretative understanding can have an objective foundation) as the hermeneutical turn has been for the positivist-empiricist view of science as epistemology. The methodology of 'old' subjectivism is turned upside down and the idea of *Wertfreiheit* in social science loses its foundation.

¹⁹ The idea that all knowledge is understanding (from a particular perspective) and that, in this sense, nothing exists beyond understanding, is conveyed in Winch's 'relativist' standpoint which Benton regards as extreme. See Benton (1977, pp.121 ff.). See also Bernstein (1983, pp.25 ff.).

A. The hermeneutic circle²⁰

Recognition of the hermeneutic circle - of the interrelationship between part and whole - is attributed to Dilthey who credits the formulation to Matthias Flacius, a Lutheran, working at the time of the Reformation (Warnke, 1987, p.5). In rejecting Catholic teaching as a guide to the meaning of the Bible, Flacius had to create its meaning from an understanding of the individual parts. But in order to understand the parts it was necessary to be guided by, and to have an understanding of, the work as a whole.

The circle has most often been treated as a *vicious* circle (Bernstein (1983, p.133) and to the theorist who seeks grounded understanding this characterisation may seem to be a just one. The circle is one more example of the problem of relativism which a sound theory must seek to avoid.

Bernstein, however, argues that the circle is 'seen as such only when judged by the mistaken and unwarranted epistemological demands for empirical verification - the appeal to some "brute data"' (p.134). He goes on to note (p. 135) that, in general, references to the circle of understanding are '"object" oriented.... No essential reference is made to the interpreter, to the individual who is engaged in the process of understanding and questioning, except in so far as he or she must have insight, imagination... and patience to acquire this art.'

An important distinction is drawn here. On the one hand there is the idea that the circle applies to what exists 'out there', to things which have an independent existence in the form of, say, books, works of art, societies, or traditions. On the other hand, there is the idea that the circle is what interpretation is about, that its 'existence' is bound up with the understander and his understanding, and to understand is to do so within the context of a hermeneutic circle.

²⁰ Bernstein (1983) and Taylor (1977) refer to a *hermeneutical* circle, Warnke (1987) to a hermeneutic circle. The latter seems to be the correct usage.

The distinction is a fundamental one from the point of view of subjectivist methodology, for it serves to separate two conceptions of the position of the theorist, each embracing a different meaning of the concept of *Verstehen*. Before completing the discussion of the circle, it is necessary to identify the first of these conceptions.

B. 'Weak subjectivism' and *Verstehen*

Until the advent of phenomenology, the main methodological question that the subjectivist tradition sought to answer was: what is the appropriate way of explaining the individual's conduct and his situation *in* the world. That question reveals the idea of the individual with his motives and historical-cultural perspective, confronting a set of circumstances. Over here is the individual, over there the cultural world which has meaning to him.

The idea that individuals live in a (pre-given) world 'out there', albeit one which is conditioned by historical-cultural circumstances and in which certain things have meaning to individuals, is what enables the theorist to demand that subjectivist theory should accurately convey what really happens in the world. The emphasis on understanding implies that the theory is founded upon the subjective experiences of individuals, but this should not, and need not, be an obstacle to obtaining a faithful representation of the scheme of things that constitutes the social world.

The notion of 'weak subjectivism', a term used in Chapter 1 in conjunction with Austrian economics, applies to this epistemology and ontology. The arguments of the past few pages are intended to clarify both the meaning of the term and the tasks of social science that are associated with it. There are two inter-related tasks. The one is that of explaining social phenomena, taking cognisance of the role of interpretative understanding and, allied to this, is the need to produce a grounded theory.

What is the meaning of *Verstehen* within a weak subjectivist theoretical framework? To the theorist who has a third-person perspective, rational action means that the individual has understood what is really happening in the world and acts in accordance with this reality. Understanding consists of *transferring* what happens in the world to the apprehension of the individual. Social phenomena in the world have meaning as means to ends, and through the process of interpretative understanding the individual comes to understand the meaning that things have.

The third-person perspective of the theorist, who stands between the reality of the world and the individual understanding the world, precludes attempts to understand understanding. The question that a third-person perspective seeks to answer is *what* do individuals understand (about the world out there) - rather than *how* do they understand. The latter issue is already resolved by the epistemology of the third-person perspective: understanding means 'learning', or 'acquiring information', about the world out there.

Although weak subjectivism recognises the individual's subjective understanding of his world, the thrust of our argument is that the third-person perspective undermines and, in fact, destroys the explanatory role of subjective understanding. *Verstehen* becomes just something that people do in order to get access to the meaning of the world out there.

The *Verstehen* associated with the subjectivism of modern hermeneutics is markedly different. Given the distinction in meanings, it is probably inappropriate to use the term 'subjectivism' in association with weak subjectivism. It will also be apparent that, on our interpretation, Weber escapes classification as a weak subjectivist.

C. Phenomenology: the contribution of Alfred Schütz

It was the contributions of phenomenologists in general and Schütz (1972) in particular that, breaking with weak subjectivism, set the course towards the

modern hermeneutical position with a radically different concept of *Verstehen*. This suggestion, that phenomenology undermines the foundations of weak subjectivism by casting doubt on the ability of social science to yield an objective view of the world, may be received with scepticism and needs to be substantiated.

One reason for scepticism is that Husserl regards transcendental phenomenology as a method capable of yielding knowledge that is apodeictically certain²¹ (see, however, Warnke (1987, pp.34-41)). Yet in phenomenology the world is not pre-given. What the individual understands or knows is what he actively 'constitutes' in his consciousness. This marks a radical departure from the spirit of earlier subjectivist thinking.

Although Husserl tried to find a way out of the dilemma posed by the relativity of individuals' life-worlds, postulating a world of 'transcendental subjectivity' beyond the different life-worlds constituted by the ego,²² the last are relative to the individual's historical and cultural circumstances. In addition, since for Husserl the natural sciences are projects that arise out of the circumstances of the life-world, science is inevitably situated in history. In his words (Husserl, (1970, p.332)),

[n]atural science is a culture, [and] it belongs only within the cultural world of that human civilization which has developed this culture and within which, for the individual, possible ways of understanding this culture are present. (See also Warnke (1987, p.36)).

Where Husserl provides the concepts and methodology of phenomenology, Schütz makes it his goal to apply these to the social sciences. His contribution to the formulation of a subjectivist scheme is an important one.²³

²¹ Husserl was definitely not a relativist but an objectivist because he claimed that it is (transcendental) subjective structures, gained through the philosophical act of pure reflection, the transcendental *epoché*, that form the basis of knowledge of the life world and of science (see also Bernstein (1976, pp.128-131)).

²² The concept of the life-world, which is central to Schütz's phenomenology, was only introduced by Husserl right at the end of his life, in '*The Crisis of European Sciences....*' (1970).

²³ For an overview of Schütz's contribution, see Bernstein (1976, pp.135-169) and also O'Sullivan (1987, Ch.14).

Schütz adopts the position that Weber left his notion of subjective meaning ill-defined and unexplored (1972, p.xxvii). Schütz uses phenomenological categories, including Husserl's notion of 'internal time-consciousness', or Bergson's *durée*, to examine *Verstehen*, the constitution of meaning and experience, and the concept of action. The conceptual tools which Schütz develops are valuable in explaining decision-making especially his increasing emphasis on the importance of social relationships and the intersubjective nature of the life world (see Dalimayr and McCarthy (1977, pp.219-220)).

Explanations of the phenomena of the life-world are rooted in the constituting activities of the individual and, for Schütz, the life-world into which individuals are born is a shared social world of contemporaries and associates. He states this succinctly (1972, p.32, emphasis added).²⁴

[E]very act of mine through which I endow the world with meaning refers back to some meaning-endowing act... of yours with respect to the same world. *Meaning is thus constituted as an intersubjective phenomenon.*

In this respect Schütz's approach represents a substantial, and welcome, departure from the subjectivism of his predecessors in which the *individual's* understanding is naturally a key element, but who overlook the reciprocal nature of social relationships. Earlier formulations of the problem of subjective understanding have the individual as an interpreter of what is happening out there, rather than as someone who is aware of, and influenced by, his relationships with other people.

Modern hermeneutics disposes of the problem of relativism which, as we have seen, was a vexed issue for subjectivists, by emphasising the intersubjective nature of understanding. It is really only once this is recognised that the difficulties faced by earlier generations of subjectivists over the problem of relativism can be clearly appreciated. Treating the individual as a solitary figure, who interprets a world that

²⁴ In places, Husserl's ideas foreshadow Schütz's emphasis on the social nature of understanding. See, for example, Husserl (1970, p.327-328).

exists around him but who lacks the social relationships of family and business associates, obviously opened them to the charge of relativism.²⁶

For Schütz, time, as *durée*, is an inseparable element in constituting meaning. Analysing experience in the life-world, he argues that '[a]ll action takes place in time, or more precisely in the internal time-consciousness, in the *durée*. It is duration-immanent enactment' (p.40). The individual, immersed in activity or engaged in the process of constituting meaning, is a stream of consciousness with a temporal element. The awareness of duration is only achieved, as Schütz puts it, when we 'turn back', or 'reflect', on that stream.

As long as my whole consciousness remains temporally uni-directional and irreversible, I am unaware... of any difference between present and past. The very awareness of the stream of duration presupposes a... special kind of attitude toward that stream, a "reflection". (p.47).

Consciousness, however, is of a 'world that is at every moment one of becoming and passing away' and as such is always being constituted, never completed (p.36).

In the constituting process, 'meaning is a certain way of directing one's gaze at an item of one's experience. This item is thus "selected out" and rendered discrete.... Meaning indicates, therefore, a peculiar attitude on the part of the Ego toward the flow of its own duration' (p.42). What is experienced is always the present, but action involves projection; so consciousness - the present - has an orientation towards the future. Constituting is a constant shifting of consciousness, of becoming aware of different things which are then one's experience. In the constituting process thoughts turn to the future with which experience (of the present) is bound up.

²⁶ As a supreme irony, Apel (1977) accuses the proponents of positive science of the sort of solipsism which they hold to be the problem of subjectivism. The sentiments that lie behind the charge are similar to the point made in the text about subjectivism's failure to recognise that understanding is *intersubjective*. Apel states that 'modern analytical logic of science, based on semantical reconstruction of the language of science, ... [has] *methodological solipsism* as its tacit presupposition' (p.297). The problem, in his view, is that positive science assumes that '*objective* knowledge should be possible without *intersubjective* understanding by communication being presupposed' (p.298).

The *durée* gives an additional dimension to the 'situatedness' of experience and understanding. Earlier it was suggested that the constitution of meaning is always within an intersubjective, cultural-historical context. Now we recognise that understanding has a more personal and temporal dimension. The individual's experience is constituted through his own focus or interests, as he 'directs his consciousness'.²⁸

Meaning changes as his perspective alters in the light of *experience*. Where there was uncertainty there is additional insight, doubt and scepticism give way to hope. Where only recently the prospects seemed good, there is now a feeling of despair. It is the nature of being-in-time that consciousness and meaning are part of the temporal sequence, and we cannot help but understand differently in the light of experience.

This brief examination of Schütz's contribution to interpretative understanding brings the discussion back to the hermeneutic circle and to the point where the meaning of *Verstehen* begins to intersect with the ideas of modern hermeneuticists. After dealing with the circle, we can once again give attention to the epistemological relationship between the theorist and his subject-matter.

V. HERMENEUTIC CIRCLE AND FIRST-PERSON PERSPECTIVE

From one point of view, the subjectivist tradition that is under examination takes us further and further down the road of relativism. But, according to Gadamer, the concern with relativism is only the result of being indoctrinated with Cartesian objectivity. On that mistaken view, relativism means uncertainty about whether we have arrived at the truth, and whether our understanding is correct. Science must dispel doubt.

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This is not to give the impression that the individual is alone or acts alone. Subsequent chapters stress that activities, such as the day-to-day 'business' of managers, arise out of the interrelationships between people. How any individual constitutes these relationships - what he sees in them, how he decides to cultivate relationships, and even up to a point the relationships he forms - depends on his understanding and his choices.

The position of modern hermeneutics is that the Cartesian ideal is a deception and is a consequence of *turning away from understanding*. The dichotomy between objectivism and relativism is a false one. When the theorist attends to the nature of human understanding, it is appreciated that the world does not just exist 'out there', but that meaning is constituted and the constitution of meaning is intersubjective.

The modern view is conveyed by Bernstein (1983, p.137) when he suggests that 'we are essentially beings constituted by and engaged in interpretative understanding'. The implications of this statement extend the phenomenological notion of meaning being constituted, because in the process of understanding (*Verstehen*) the individual not only actively shapes his 'view', but in the process *the individual - as an understanding, interpreting, sentient being - is himself being constituted*.

The hermeneutic circle, the inter-relationship between whole and part in the process of interpretation, is seen to be not just a problem or puzzle that applies to, say, texts or works of art, but is the essence of all understanding. An appreciation of the circle, 'clarifies the relationship between the interpreter and what he or she seeks to understand' (Bernstein (1983, p.137).

What he seeks to understand concerns the activities of other people - friends, colleagues, suppliers, managers. The individual brings to the process of constituting his history, culture, tradition, language, and his understanding of other people. These shape the meanings that he ascribes to *particular* phenomena, events, and activities. But in the light of experience, in the course of events in the *durée*, the *prejudices* that shape understanding are themselves changed.²⁷

²⁷ Gadamer sees prejudice and tradition as playing not only necessary, but also positive, roles in interpretation. For a very readable analysis of Gadamer's standpoint, which includes a discussion of how he treats the question of assessing, or evaluating, the 'adequacy of prejudice', see Warnke (1987, Ch.3).

Understanding, in this view, is always relative, not only from one individual to another, but - allowing for hyperbole - from moment to moment.²⁸ The important conclusion is that the relativity of understanding is what understanding is about; it cannot be otherwise. The conceptual schemes of social science should recognise this and enable the implications to be examined, including the many questions related to the nature of the communication, co-operation, and other inter-relationships among people. Once the hermeneutical nature of experience is understood, and the idea of science as a hermeneutical activity is grasped, subjectivist social theory, in the fullest sense of the word, becomes the basis for examining the methodology of science rather than natural science providing the paradigm for social science.

The meaning of *Verstehen* has undergone a considerable change as subjective understanding has been re-interpreted at successive points in the evolution of a subjectivist paradigm. Initially the notion of understanding emphasised strongly how the individual attached meaning to events which were seen to exist out there.

In this incarnation, subjectivism treated individuals as 'producers' of actions, the meanings of which (including their motives) could be understood by others, and the purpose of *Verstehen* was to do just that. Interpretative understanding was what individuals, the objects of the theorist's investigations, did to the actions of others out there. The theorist's position, as observer and explorer of social life, remained unaffected by the application of *Verstehen*.

Under the influence of phenomenology, the emphasis shifted to highlight the constitutive and intersubjective nature of meaning. To constitute the meaning of phenomena was necessarily to understand the motives of others whose activities were interwoven in what was 'intuitively' a *social* world.

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Sometimes it would seem that this statement is literally true. In dealings in financial asset markets, such as a stock market, the individual's changing perspective, in the light of developments in or outside the market, may be associated with a sudden change in sentiment almost from one moment to the next.

With modern hermeneutics *Verstehen* is not about recognising and clarifying peoples' *motives*, but is about with the nature of, and also the obstacles to, intersubjective understanding. Interpretation is the essence of understanding, of being-in-time. *Verstehen* is not understanding you, but is *my* understanding (of you and everything else). In interpreting, I not only come to understand *you*, I come to *understand*. My perspective is shaped or transformed by understanding, which takes me on to other things. The focus of *Verstehen* now includes the theorist and involves the recognition, as well as a clarification, of the double hermeneutic of social studies. By exploring their activities, we make people part of our world. We engage with them in understanding and they become part of our hermeneutic circle.

A subjectivist methodology is one that serves to illuminate and to explain how and what the individual knows. Its starting point is that understanding conduct means understanding how the individual understands. The first-person perspective, an epistemology of which recognises the intersubjective nature of understanding, is the foundation of a subjectivist methodology. The theorist brings the individuals into his sphere of understanding. Like the individuals whose activities are the object of his interest, he is engaged in a continuous hermeneutical process which involves moving from particular to general and back again.

The notion of a *discourse*, in which ideas are exchanged and evaluated and positions reassessed, provides the analogy for the hermeneutical view of individual conduct and the theorist's condition.²⁸ At the 'start', he brings a particular interpretation to the problem and, in the course of the enquiry, his perception of the nature of the problem is modified, and his questions and focus change.

VI. IMPLICATIONS FOR SOCIAL SCIENCE

As a conclusion to the exploration of subjectivism, it is worthwhile identifying some of the implications of adopting a hermeneutical form of subjectivism. We

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The discourse is contrasted with a *lesson*, in which knowledge is supposed to be accumulated, transmitted, and acquired.

distinguish between what is 'lost', or has to be abandoned on the journey from the older to the newer subjectivist paradigm, and also what is gained.

A. Forsaking *Wertfreiheit* in science

What is lost is not inconsequential. One implication of this post-modernist view of scientific activity is that there is no value-free science. The distinction between positive and normative science, so much a part of the modernist paradigm discussed in Chapter 2, falls away.

Taylor (1977, p.130), in noting that a science which is developed within the context of the hermeneutical circle cannot be *Wertfrei*, suggests that such an idea is 'still radically shocking and unassimilable to the mainstream of modern science'. What matters from the point of view of the thesis is that important contributions to the Austrian subjectivist tradition, such as those of Robbins (1949) and Mises (1949), have been formulated around the advocacy of economics as a value-free science.

For these authors, the boundary between economics and other disciplines is determined by that fact that economists, *qua* economists, have to remain on neutral ground. Anything which induces them to make value judgements - for example, a desire to comment upon the relative importance of the ends that individuals seek - takes them into territory in which they do not belong. So the consequences for Austrian economists of throwing off the mantle of value-free science are considerable.

The thrust of hermeneutical subjectivism is that understanding is prejudiced in a way that no scientist can escape. One's perspective is literally pre-judged. Prejudice is *recreated* and perhaps *revised* over time, but understanding remains prejudiced. Economists, like everyone else, bring these prejudices to their inquiries. Their questions also reflect the value-judgements of a community of colleagues

who condemn or sanction a particular type of research, set norms and impose standards, or establish conventions, to which scholars must adhere.

B. Abandoning prediction

Some economists set great store by the ability to build models which have predictive capabilities. If prediction was ever a legitimate pursuit of economists, adoption of the methodology of interpretative understanding rules out prediction as a goal of social science. Prediction, like equilibrium, demands a determinate, closed system.

The questions of whether a hermeneutical view of science supports prediction as a goal of science, and of what prediction means in the context of a philosophy which holds that the quest for certitude is misplaced, raise a number of thorny issues. Indeed, Rorty's (1980) arguments are challenged on the basis that we may be able to argue, by appeal to facts, that Galilean astronomy is better than the dogma of the Catholic church about explaining the relationships between heavenly bodies (see Warnke (1987, pp.151-156).

What matters for the thesis is the issue of prediction in the social sciences. Although these more general concerns are pertinent, there is a sense in which they are distinguished from the main issues of the thesis by the matter of whether modernist methodology of orthodox economics has ever been compatible with prediction (as understood in terms of the deductive-nomological model).

Economists' predictions are not based on being able to claim that certain phenomena fall under particular covering laws, but rely on discovering regularities in historical data explained, perhaps, by models which postulate theoretical relationships among variables. If the data 'fits' the relationship postulated by the model, the forecasts are based on statistical relationships found to exist in historical data (see Caldwell (1982, p.22)). So, in arguing that economists who embrace interpretative subjectivism have to give up the possibility of predicting, it

could be held that they have never possessed that ability anyway, and that their efforts at predicting were 'illegitimate' (see Coddington (1972), Katouzian (1980, Ch.3), McCloskey (1983), O'Sullivan (1987)).

The unpredictability of human nature is one of a number of reasons put forward by Taylor (1977, see pp.128-129)), in denying the possibility of 'exact prediction' for the science of interpretation. His position is certainly worth considering, as he argues that 'only if past and future can be brought under the same conceptual net can one understand the states of the latter as some function of states of the former, and hence predict' (p.129).³⁰ An implication of this argument is that because the individual is transformed in the *durée* (he understands differently with the passage of time), past and future can never be brought under the same conceptual net.

A first-person perspective, however, provides a different, compelling argument as to why prediction is precluded as a goal of theory, which gets to the heart of the epistemology. There is no sense of a general scheme of things against which to formulate predictions. Predictions are based on the idea that as the world works in a particular way, they rely on knowing the system and the relationships which operate within that system. It is not in the nature of a first-person perspective to ask questions which presuppose a 'systems view', and the type of explanation which is sought through interpretative understanding is different. The issue of prediction is simply irrelevant to this epistemology.

In the first chapter we referred to the epistemologies of the third-person and first-person perspectives being incommensurable. The question of prediction and understanding (or, rather, prediction *versus* understanding) illuminates the divide and indicates the two mutually exclusive options that are available to the theorist. By formulating his scheme, as neoclassical theorists do, from a third-person

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Taylor's position is that 'it is much easier to understand after the fact than it is to predict. Human science is largely *ex post* understanding' (1977, p.129). This view has much in common with the standpoint of Lachmann (see, for example (1978b, pp.15-17)).

perspective he *might* be able to discern those regularities which are a basis for prediction. The cautionary note is sounded because, considering the arguments above, the nature of his subject-matter probably precludes prediction. From this standpoint, however, he will not be able to explain individual conduct; that is beyond his epistemological 'grasp'. The alternative, first-person perspective, is congruent with interpretation, but precludes prediction.

C. Giving up an objective standpoint

For many economists the most unsettling aspect of embracing a first-person perspective will that of abandoning an objective basis of theory. We have seen that some subjectivists have sought the best of both worlds. Recognising the importance of interpretative understanding for theories intended to illuminate social reality, they have tried to assure themselves, and others, that their theories are truly scientific and do not paint the theorist into a corner of relativism. They will surely wish to anchor understanding to something firmer and more permanent than ideas that are formed in an ongoing 'conversation'.

Those who are sceptical of modern hermeneutics (including Rorty's interpretation of Gadamer's work), and are concerned that it represents a position of irrationalism, will find ample support. Warnke draws attention to the idea that Gadamer's exposition of the hermeneutic circle is an attempt to move beyond objectivism and relativism, and this is also the position adopted by Bernstein (1983) with regard to Gadamer's work. These authors and others, nevertheless, express their concerns about placing too radical an interpretation on modern hermeneutics - one which undermines any attempt at grounding the theory (see Warnke (1987, Ch.5)).

We cannot, here, resolve the question of whether abandoning the quest for an epistemology - as Rorty intends that we should - is irrational. The ramifications are undoubtedly enormous, and the question has implications for the foundations of social norms (see O'Sullivan (1987, pp.26-27)).

Our conviction is that, through modern hermeneutics, the sort of position which Rorty adopts constitutes a powerful challenge to conventional views of the distinction between the natural and social sciences. In addition, the iconoclastic stand against the conventional wisdom removes barriers to an examination of the foundations of knowledge and understanding.

By pointing to the discursive nature of understanding, the position that theorising occurs within an historically-based hermeneutic circle is an appealing one. Adopting the view of science as hermeneutic means accepting that the scholar is open to, and receptive of, new ideas. One of the least admirable aspects of modernism is the dogmatism that accompanies its claim to offer the path to truth and knowledge. The methodology itself is chauvinistic and denies adherents the opportunity to question its foundations.

Because modernism was transformed from methodology into ideology, it came to represent a rejection of the rational ideal of scholarship. A hermeneutical conception of scientific discourse offers the prospect of restoring a sense of enquiry and challenge to methodology, where before the only things worth investigating were the scientific problems themselves.

D. Replacing narrow individualism

For the social sciences in particular an important consequence of adopting a first-person perspective is that the narrow individualism of economic theory is supplanted by an emphasis on social inter-relationships. Although both the natural and social sciences recognise that each successive generation of theorists, as Newton put it, 'stands on the shoulders of giants', positivism cultivated the idea that all that was necessary to discover the truth was for someone, in isolation, to observe what goes on out there. The advance made by Popper consisted of recognising that science was not discovery in isolation but in critical discourse. Hermeneutics, of course, emphasises that what we learn, we learn in a social context, through discourse.

In the social sciences, the narrow individualism covers both elements of the double hermeneutic. The third-person perspective has underpinned the idea of an isolated individual who is hardly aware of the existence of others. This caricature is particularly strong in economics where the agent has no relationships with other people except through impersonal 'market forces', as a supplier, distributor, or anonymous consumer. He communicates indirectly, through the medium of 'market signals'.

Hermeneutical subjectivism, the basis of a first-person perspective, recognises that understanding is intersubjective, and so must establish who the others are who 'share' the world of the individuals whose activities are of interest to the theorist. Why does the individual consider them to be important, what is the nature of the relationships, and what sorts of roles do they play in influencing his activities?

The recognition of the intersubjective nature of understanding, juxtaposed with the nature of understanding itself in the hermeneutic circle, requires the theorist to attend to the nature of the discourse between individuals at both levels of the double hermeneutic. How do individuals communicate? How well do they do so? To what extent do they understand each other, and why do they do so? Coming as these do on top of the linguistic turn in analytic philosophy, such questions point to exciting areas of study for all the social sciences.

In the last two chapters of the thesis, where the object is to analyse location from a first-person perspective we will have an opportunity to examine how social relationships bear upon investment decisions. Having established what a subjectivist theory is and outlined its purpose, what is needed now are the conceptual tools that can be applied to 'social reality' in order to investigate decision-making. Austrian economics, as a subjectivist scheme, has been thought to be able to furnish those tools. Our immediate object, therefore, is to examine the subjectivism of Austrian economics in order to determine whether it is compatible with the epistemology of a first-person perspective and capable of serving the ends of interpretative understanding.

CHAPTER 5

AUSTRIAN ECONOMICS AND SUBJECTIVISM

One knew there was much wrong with modern economics, but one did not yet know how to put it right. It was necessary first... to figure out what difference this "Austrian perspective" made for understanding the real world. To the much asked question "What is Austrian economics?" there was simply not a ready answer.

Karen Vaughn, 'The Mergerian Roots of the Austrian Revival', p.402.

I. IS AUSTRIAN ECONOMICS SUBJECTIVIST?

We have defined subjectivism as a methodology and epistemology of social science. To be useful subjectivism needs a 'language'; a conceptual scheme to serve as a framework for interpreting the life-world or 'social reality'.

In looking for a suitable framework it is natural to go to the Austrian School. 'Austrian economists', Kirzner (1976b, p.40) says, 'are subjectivists....' (See also Hayek (1955a, p.31); Lachmann (1977b, p. 28); Littlechild (1978, p.19); O'Sullivan (1987, pp.152-155)). Although subjectivism is identified as a distinguishing feature of Austrian theory and the factor that separates it from neoclassical economists,¹ Vaughn's question, in the epigraph to this chapter,

¹ O'Driscoll and Rizzo (1985, see Ch.2) suggest that neoclassical theory constitutes a 'static' form of subjectivism because it recognises 'tastes' or 'preferences' (subjective notions) as the basis of individual choice. Individuals are assumed to have given tastes, hence the static nature of neoclassical subjectivism. O'Sullivan (1987) characterises neoclassical economics as 'subjectivist-interpretive' with a 'teleological mode of explanation'. The 'unmistakably interpretive character of economic theory... arises from the pervasiveness and centrality of the 'optimization' or 'maximization' principle to all economic explanations.' (p.74). What is puzzling about this characterisation is that no one does any interpreting. The whole scheme of things is given. Discussion of the epistemological and ontological distinction between the third-person and the first-person perspective serves to underscore the argument that it is misleading to refer to neoclassical economics as in any way subjectivist. The epistemology of the third-person perspective dictates that the 'subjective' elements - tastes and so on - are as much objects in that scheme as prices or commodities. Mäki's (1990, p.294) classification of Austrian economics as 'ontic subjectivism' combined with 'ontological objectivism' (see below in this chapter) may help to resolve the paradox of O'Sullivan's characterisation of neoclassical theory.

shows the uncertainty among some members of the school about what it is that makes Austrian economics different.

For us, this is a key question. Neoclassical theory is unsatisfactory so a scheme with a different epistemology is required. Does Austrian economics fit the bill? The question needs to be investigated not least because others express doubt about the accuracy of the subjectivist label. Boehm (1982, p.43) says that '[a]t the risk of being stamped on for heresy I venture to propose that there are some important obscurities in the thesis that Austrians adhere to the principle of subjectivism.' Indeed, Mäki (1990, p.294) goes so far as to suggest that Austrian economists are *objectivists*, basing his justification on a realist interpretation of Mengerian economics.

In this chapter, again taking cognisance of the double hermeneutic, the relationship between theorist and subject-matter is the initial focus, after which we examine how the individual and his knowledge is conceived by Austrian economists. In doing so we are able to clarify the nature of Austrian subjectivism and to reveal that it is associated with a third-person epistemology. Besides resolving an important practical problem - whether there is a ready-made framework embracing a first-person perspective - the investigation into Austrian subjectivism reveals the value of distinguishing between third-person and first-person epistemologies. The distinction helps to classify Austrian theory and to show why there is confusion about the relationship between Austrian and mainstream economics.

A problem arises, however, in identifying a definitive 'Austrian position'. The reviewer of neoclassical theory is on fairly safe ground in addressing 'orthodox', or 'mainstream', economics particularly in its modern, and modernist, 'axiomatic' embodiment identified in Chapter 1. Because of its dominance as the language of economists and its long history, there is a conventional notion of what constitutes neoclassical economics. With Austrian economics the position is somewhat different.

Since its beginnings, in the catallactist revolution, Austrian economics has experienced mixed fortunes. After the eclipse of the 'Older Austrian School' - comprising Carl Menger, the founder, and immediate followers like Friedrich Wieser and Eugene von Böhm-Bawerk (see Mises (1969); Kauder (1957); White (1977)) - the school enjoyed a brief, but conspicuous, revival in the nineteen-thirties. Various factors led to the subsequent decline of the school's fortunes (see Coats (1983, pp.95-96)) and they were revived again only in the seventies.

Since then Austrian economics has gone from strength to strength. The difficulty is that, because the school has enjoyed only sporadic support, there is an inevitable lack of continuity of ideas. Apart from the diversity of opinion and method amongst its protagonists in earlier periods during times when the fortunes of the school were at their height, today in the Austrian revival when the ideas of the leading members are being re-evaluated, an even greater variety of methodological views is in evidence.²

In the literature Menger is often regarded as an Aristotelian and methodological essentialist (Hutchison (1973, p.18)), although his allegiance to Aristotelianism is now called into question.³ Mises is viewed by various authors as a neo-Kantian (Lachmann (1982, pp.35-36), B. Smith (1990)) who faced the problem of protecting economics, as a social science, from positivism, while Menger's task, certainly in his later major work the *Untersuchungen* ([1883] (1963)) in which he clarified his methodological position, was to defend a theoretical science of

² Compare, for example, the methodological underpinnings of O'Driscoll and Rizzo's work (1985) with contributions to Lavoie (1991a). Evidence of the extent of the divergence over different conceptions of Austrian economics is Kirzner's (undated) 'An Overview-Comment' of O'Driscoll and Rizzo.

³ A common source for many writers crediting Menger with being an Aristotelian is Kauder (1957). More recently, however, scholars have begun to re-assess this claim. See the contributions in Caldwell (1990), especially Mäki (1990) who classifies Menger as a realist sowing the seeds of realist Austrian theory; Milford (1990); and Silverman (1990), who is particular critical of the Kauder interpretation, and identifies the cameralist roots of Menger's ideas.

economics against the attack of Gustav Schmoller, the main figure in the German Historical School (see Bostaph (1978)).

Hayek, whose predicament was not dissimilar to that of Mises, had support for his ideas from a group of economists at the London School of Economics where his work first attracted real attention. In the thirties in England, Hicks suggests that Hayek had a popularity to rival Keynes (see Machlup (1974) and Shackle (1981)). Mises lacked the support of a devoted audience, having moved from country to country after fleeing from Hitler. When he settled in the United States, he was not accorded any great esteem and he wrote for a largely unknown audience. This may account for the polemical character of much of his work.

Later generations faced different problems and adopted different methodological standpoints. Lachmann (1970), seeing Weber as a kindred subjectivist spirit, asks Austrians to adopt *Verstehen* as a method of Austrian theory. The last few years have seen a sprinkling of efforts to marry Austrian economics with phenomenology and hermeneutics (see Lavoie (1986, 1990, 1991a)). This heterogeneity of ideas and methodologies makes it difficult to identify an 'orthodox' Austrian position. Even the task of establishing who belongs to the school is not straightforward.⁴

⁴ As this chapter shows, classifying economists in terms of the criterion of their espousal of a subjectivist methodology is problematic, and additional problems of definition arise from the fact that in the school's formative years, when its members did indeed live in Austria, there were many economists of Austrian nationality who did not, and would not, claim any affiliation to the Austrian School. (See Schumpeter, 1952, pp.844-849 for a list of members of the 'older' Austrian School, including biographical details. Some of the points made below are also discussed by Littlechild, 1978, pp.14-17). Friedrich von Weiser, both on account of nationality and academic affiliation, is categorised as Austrian, but his contribution does not fit the mould of Austrian subjectivism. Then there are economists who are commonly associated with the Austrian School, but incorrectly so when their methodological positions are considered. Schumpeter is sometimes referred to as a 'second generation' Austrian, as are Fritz Machlup and Gottfried Harberler. Individuals like G.L.S. Shackle have influenced Austrian thinking, but would not consider themselves Austrian. Littlechild views Shackle as a kindred spirit and has done much to incorporate Shackle's ideas into Austrian economics. In a similar category, but a more extreme example, is Keynes, whose writings on expectations ally him with Austrian subjectivism (see Lachmann (1991)).

The Austrian revival, the start of which coincided with the centenary of the publication of Menger's *Grundsätze der Volkswirtschaftslehre* (Menger [1871] (1950)), provides ample material on which to gain an understanding of Austrian themes. An early English commentary identifying a distinctive Austrian contribution is Bonar (1888). More modern surveys and appraisals, that also provide insight into Austrian methodology include: contributions to *Atlantic Economic Journal*, Sept. 1978; essays in Caldwell (1990); the contributions to Dolan (1976); essays in Grassl and Smith (1986); Hayek, (1968); contributions to Hicks and Weber (1973); Kirzner, (1973, 1976); contributions to Kirzner (1982a) and (1986); Lachmann, (1973a, 1973b, 1976, 1977b, 1982, 1986); Littlechild (1978, 1990a, 1990b); Mises (1949, 1960, 1969, 1978); Nozick (1977); O'Sullivan (1987); essays in Spadaro (1978); White (1977).

O'Driscoll and Rizzo (1985, pp.1-2) provide an excellent definition of Austrian subjectivism that is worth quoting in full.

On the most general level, subjectivism refers to the presupposition that the contents of the human mind, and hence decision-making, are not rigidly determined by external events. Subjectivism makes room for the creativity and autonomy of individual choice. Dealing as it does with the individual mind and individual decision-making, it is also intimately related to methodological individualism. This is the view that overall market outcomes ought to be explained in terms of individual acts of choice. Thus, for the Austrians, and for subjectivists generally, economics is first and foremost about the thoughts leading up to choice....

What are the origins of Austrian subjectivism, and how does it differ from hermeneutical subjectivism? While recognising that this may mean overlooking differences between Austrian scholars that are sometimes important, our object is to identify *an* Austrian methodology and epistemology and then to look more closely at the Austrian conception of the individual in economic theory.

II. THE BASIS OF AUSTRIAN SUBJECTIVISM

Menger, regarded as one of the great economic thinkers, is also the forerunner of Austrian subjectivism. Although generally seen alongside Walras and Jevons as a

founder of catallactic economics - *i.e.*, the 'marginal revolution' - it is now conceded that, methodologically, Menger is some distance from them as regards his eschewal of equilibrium and other considerations (see Gram and Walsh (1978); Jaffé (1976); Shackle (1972b); Streissler (1972); and other essays in Black, *et al.* (1973)). In acknowledging that Menger and Walras in particular are at variance, and in regarding Walras as the originator of neoclassical general equilibrium theory, is it correct to view Menger as a proto-subjectivist?⁵

The evidence of Menger's subjectivist leaning revolves around his 'atomistic', 'compositive', or 'causal-genetic' (see Silverman (1990, pp.70-71)) method - which today would be referred to as methodological individualism (Hayek (1973, p.8)). The elements out of which the 'complex phenomena' of economics evolve (Menger (1950, pp.46-47)) are the 'individuals and their efforts, the final elements of our analysis, [that] are of an empirical nature' (Menger (1963, p.142, fn.51)).

The 'goods-character' and value of things in exchange - things that are capable of satisfying an individual's needs - are derived from the needs (*Bedürfnisse*) themselves, and the individual's knowledge of the ability of the good to satisfy a need (see Menger (1950, p.52)). The classification of goods (as first, second, third, or higher order) depends on the good's proximity, in the production process, to being able to satisfy a need (pp.55-67). This proximity, in turn, hinges on the individual's *knowledge* and 'is nothing inherent in the good itself and still less a property of it' (p.58).

⁵ One obvious methodological difference is Menger's eschewal of mathematics (see K. Menger (1973, esp. pp.52-55) on the differences between Austrian and mathematical economists including arguments concerning the limitations of a mathematical approach). Jaffé (1976, p.521) quotes from Menger's correspondence with Walras and states that the former

declared his objection *in principle* to the use of mathematics as a method of advancing economic knowledge.... For the performance of this task what is required... [is] a method of process analysis ['the analytic-compositive method'] tracing the complex phenomena of the social economy to the underlying atomistic forces at work.

This quotation is also suggestive of Menger's objection to the use of the concept of general equilibrium which is documented (in Streissler (1972)).

Such considerations - whether something is a good and its classification as being of a high or low order - which constitute the foundations of Menger's conceptual scheme, are taken as evidence of subjectivism in that they indicate an evaluating and appraising human mind at work.

According to a modern Austrian interpretation of subjectivism, 'social phenomena... [are] the outcome of human action guided by plans (even though these often fail) and *prompted by mental acts*' (Lachmann (1986, p.23)). In Menger there is that element which O'Driscoll and Rizzo refer to, in their definition quoted above, as 'room for the creativity and autonomy of individual choice'. Milford (1990, p.218) draws attention to this.

Menger perceived the economic agents not as passive, but as active, problem solving individuals. He depicted a world in which individuals do not simply react to their changing surroundings in a passive way [as one would interpret the agent of neoclassical theory to do] but try to discover new possibilities.... These individual agents continuously solve problems and... they will err in this process.

Seeking out new possibilities is the essence of Kirzner's (1973) formulation of the entrepreneurial element in human action. Entrepreneurship, meaning an 'alertness to new opportunities for profit', is regarded as a characteristic of the agent in Austrian theory from Menger to Mises and beyond. While Menger's classification as early subjectivist is associated with the conception of subjectivism as a theory that recognises an active human mind at work, this notion of subjectivism is an unconventional one viewed next to the tradition of *Verstehen* in phenomenology and hermeneutics.

Boehm (1982), warning of the proliferation of definitions of subjectivism in economics, identifies various notions, 'entertained in the literature by economists of very different persuasions' (pp.43-44). While a number of Austrians do associate subjectivism with the tradition of interpretative understanding that gained stature and credence through the work of Weber (Lachmann, 1970), Austrian subjectivism on the whole does not correspond with the subjectivism of hermeneutical or interpretative understanding. This gives rise to the apparently

paradoxical situation where Menger is seen by some as a 'subjectivist', while Mäki (1990) classifies Mengerians (and Austrians) as objectivists.

Arguing that Austrian economics is realist,⁶ Mäki explains how the apparent contradiction between the self-characterisation of Austrians and his own classification can be resolved. The reconciliation is achieved by understanding Austrian economics as a combination of 'ontic subjectivism and ontological objectivism' (p.294).

Ontic subjectivism says that the economy is at least partly constituted by individual's subjective valuations, expectations, purposes, etc. *Ontological objectivism* says that the economy as the object of economic theories is unconstituted by those theories and exists independently of them.

An additional and useful dimension to understanding Austrian subjectivism is found in Mäki's suggestion (p.308) that the Austrian conception of the 'agent' - *homo agens*, or acting man (to be contrasted with the neoclassical notion of *homo oeconomicus*) - belongs to what is referred to as 'folk psychology'.

Folk psychology is the conception of human action deployed by ordinary folk and also by scientists in ordinary life situations. This conception is formulated in a framework of minds with thoughts, emotions, desires, motives, intentions, beliefs. Within folk psychology, human action is explained and predicted as an emanation from these mental entities. Indeed mental entities are the ultimate explainers; they are not to be eliminated in favour of something else, unlike some radically materialist approaches that seek to substitute neurological or computational accounts for the intentional accounts of folk psychology....

Reference to 'ordinary life situations' in the quotation, indicates simply that Austrian economics depicts action as a manifestation of thoughts, motives, and

⁶ Mäki (1990, pp.289) identifies realism as a 'family' of philosophical doctrines opposed to doctrines such as instrumentalism, phenomenalism, idealism, conventionalism and others. He defines various kinds of realism including ontological realism: 'X exists... "X" is a variable that can be given many qualitative values, such as the world,... physical objects and mental states'. Mäki also refers to semantic realism, commonsense realism - the view that everyday experience has access to what is real - and scientific realism. According to the latter scientific theories can represent entities in the world, although common sense may not provide access to these (see pp. 292-293).

expectations. It does not mean an interest in exploring the 'life world', or world of 'social reality', in the manner suggested by Schütz; for whom doing so entails understanding how the individual constitutes the life world. In general, Austrians make no commitment to do this.

According to Lachmann (1977f, pp.261-262) the task of (Austrian) economics 'is to make the world around us intelligible in terms of human action and the pursuit of plans'. How does the Austrian theorist make the world intelligible and, in particular, what is the epistemology of the theory?

III. THE THEORIST AND WEAK SUBJECTIVISM

Plans, knowledge, expectations, and motives are manifestations of a human mind and are things that *exist* in the world. The Austrian theorist's task, in explaining economic phenomena in terms of human action, is conceived as relating what is happening out there (the observable phenomena of the social world such as markets and prices) to the mental acts (of people out there) - the choices, the expectations, and plans - that give rise to the observable phenomena.

Subjectivism, here, refers to the fact that different people, or different 'minds', possess different 'facts'. Because the knowledge which each one has is different, they make different plans. In the course of time they also acquire new, and different, knowledge - they interpret the world out there differently - and so they continue to do different things.

The knowledge that is acquired and the expectations that are formed through mental acts do not correspond in a determinate way with what happens out there - /i.e. there are no known functional relationships linking the individual's knowledge and expectations to the world out there. So knowledge and expectations are described as subjective, and the methodology is identified as subjectivist.

This is the weak subjectivism discussed in the previous chapter. The theorist stands between an 'external world' and an 'internal world' of the mind - associated with the formation of expectations and the acquisition of knowledge - observing *both* and relating one to the other. Mises's (1949, p.18) description of the two worlds, or 'realms', that are known to the theorist supports this interpretation.⁷

Reason and experience show us two separate realms: the external world of physical, chemical, and psychological phenomena and the internal world of thought, feeling, valuation, and purposeful action. No bridge connects - as far as we can see today - these two spheres. Identical external events result in different human responses, and different external events produce sometimes the same human response. We do not know why.

The distinction between the external and internal worlds is an important aspect of the epistemology of Austrian economics which embraces the mind, and its associated 'doings', as *objects*. Ontologically the internal world is private and subjective but it exists and, to the theorist, it is part of the world out there. Other things that happen in the world are known to depend on events in the internal world; so, for example, when knowledge - which belongs to people out there - changes, people do different things and prices change.

In this regard, the theorist is a peculiar type of observer and we must clarify the way in which he 'sees' the world and, also, the notion of understanding. The world is a system out there, that consists of *minds* - with their associated activities - and things. The theorist's grasp of the world involves linking the observable phenomena (things) with the mental phenomena (plans) that give rise to them, and then drawing inferences about the system.

Even though some Austrians may not associate themselves with the *a priorism* of Mises's methodology (see section IV below), as O'Sullivan (1987, p.160) notes, *a priorism* of some sort is present in the work of 'all the Austrians' and *a prior*

⁷ According to Barry (1979, p.12), Hayek makes use of a similar distinction 'between the objective physical world and the phenomenal world, that is the world we perceive through our senses'.

categories seem to be important for the process of 'observation'. These include the category of action itself, involving means and ends, as well as manifestations of the alert human mind, such as plans, expectations, and knowledge. Their *a priori* nature provides the means of '*understanding*'.

Watching people buy and sell shares or build a factory, and '*understanding*' stock market activity or investment decisions, means '*seeing*' knowledge and expectations at work. The individual is purposeful and chooses means to specific ends; that is human action. What he does depends on his '*stock*' of knowledge or the expectations he holds. The *a priori* existence of knowledge and expectations - the internal world - is necessary to explain why particular actions are observed.

Based on this '*understanding*' the theorist can pose questions about the relationships among individuals or, specifically, their plans. Are these compatible or incompatible? If what is observed is people competing, then the plans are incompatible. Are the expectations of different individuals convergent or divergent? If what is observed is speculative activity, then the expectations are divergent. In the light of these questions conclusions are drawn about the *consequences of action* for the state of the world. The actions will lead to an equilibrium or will induce other people, with divergent plans, to revise them.

The epistemology is that of the third-person perspective. The world is '*given*', though it is not necessarily all directly observable. Some of what exists, the mental phenomena, are only known as *a priori* categories, known through introspection, but known to all.

As Mäki's (1990) arguments suggest, there is a presumption that all the phenomena that economists seek to explain - such as money, prices, entrepreneurs, or pieces of machinery - have a real, unambiguous existence. Except for asserting that the categories of action are known *a priori*, Austrian economics does not ask how or what the theorist knows or observes.

Menger (1950, see Ch.5), for example, treats prices in much the same way as neoclassical theory does. Prices manifest the subjective values that people place on things that they exchange. Menger's object is to explain how prices are related to individuals' valuations. Both prices and values are things that exist in the world and the theorist's task is to show how they are linked. There is no recognition of either the theorist or the actor as an 'understander', interpreting prices or price changes.

Lachmann's (1978) analysis of the capital structure provides an similar example. The theorist's object is to explain changes in the structure of capital, with reference to values, expectations, and plans; but the structure itself is there. The theorist is not interested in how the stock of capital is understood or what it means, other than as something that manifests peoples' plans.

Similarly, in Austrian theory money is a social institution, but there is no recognition that it may have meaning for people. Money exists in terms of peoples' plans to transact, without reference to their understanding of institutions, as implied in a notion like Keynes's 'liquidity preference'.

The absence of *Verstehen* is also reflected in the notion of entrepreneurship which is defined by the existence of gaps in the market out there because plans do not 'dovetail' (Kirzner, 1977). Individuals are 'alert to price differentials', they do not conjecture about or understand the requirements of shoppers in the neighbourhood, nor are they out-of-work actors struggling to make a living; motives are not part of the picture. As far as the theorist's knowledge of the world is concerned, the Austrian scheme is not hermeneutical.

IV. THE CONCEPTION OF THE INDIVIDUAL

This general characterisation of the epistemology and ontology of Austrian subjectivism is important as a backdrop to our next task of examining the other

aspect of the double hermeneutic, the individual. How is he conceived? What role is ascribed to him? How and what does he know?

Because they espouse different philosophies, the treatment of the individual is different in the contributions of principal Austrian writers. In the context of a brief examination of some of their views, however, the object is to identify a general conception of the individual in Austrian theory. There seems to be sufficient common ground to permit this.

A. Mises on action and equilibrium

Although he acknowledges his debt to Menger, the foundation of Mises's methodology is his conviction that praxeology, the deductive science of human action, is *a priori* valid and its axioms are 'self-evident truths' (1978, pp.11-21).

Mises's *a priorism* has made his methodology a subject of extensive debate and it probably has more detractors than supporters amongst economists and philosophers, though not necessarily amongst Austrian economists. Because the thesis is concerned with the epistemological implications of Mises's methodology, the methodology itself is not scrutinised in detail here.⁸

Mises's concept of action (1949, see esp. pp.92-98) is similar to Weber's notion of economic action (1964, see esp. pp.158-164) and probably owes much to the latter, but Mises's analysis of action - choosing means to attain 'given' ends - will

⁸ Listed here are some more recent assessments of Mises's methodology. Caldwell (1982, see esp. pp.117-124) is critical of Mises's methodology but is sympathetic to Austrian ideas, and he refers to Kirzner's view that Mises was almost forced into giving his Kantian *a priorism* more prominence than he would have wanted (see p.137, fn.45). Nozick (1977) gives Mises's views an impartial hearing from a philosopher's point of view, while Smith (1986b) and (1990) also brings a philosopher's perspective to bear in examining Austrian *a priorism* and the relationship between the ideas of Menger and Mises. O'Sullivan (1987, see pp.155-158) regards Austrian *a priorism* as 'extreme', 'philosophically challengeable', and 'not even an accurate description of the general practice of economists' (p.161). See also Boehm (1982); Katouzian (1980, pp.39-44); Lachmann (1951, 1976, 1982). On Hayek's *a priorism* see Hayek (1948d, pp.67-68).

appear quite orthodox to economists. Individuals are not omniscient, they have to speculate, and they make mistakes, but otherwise they appear to be quite good, rational agents who would maximise if their essential condition permitted it. They choose in accordance with a subjective and changing scale of preferences which they have (Mises (1949, pp.94-95, 118)) and their actions are geared to *removing uneasiness* (p.97, 120).⁹ Substitute 'increasing utility' for 'removing uneasiness', and add the idea of the attainment of an equilibrium (a determinate outcome), and Mises's analysis bears a striking resemblance to the neoclassical theory of choice. It is important to acknowledge, though, that Austrians have repudiated the Paretian idea of a complete preference field (see Rothbard (1956)).

In his conception of human action Mises does not postulate that individuals' activities are equilibrating and people are not in a position to optimise - which in his terms would mean removing the *most* uneasiness. At the same time Mises holds that equilibrium is an indispensable notion when analysing action and he states (1949, p.245) that

⁹ Mises's conviction that the 'only method of dealing with the problem of action is to conceive that action ultimately aims at bringing about a state of affairs in which there is no longer any action' (1949, p.245) appears, at least from a hermeneutical perspective, completely idiosyncratic. It is certainly not consistent with the way in which we understand the activities of others. There is no presumption that our colleagues or friends do things in order to remove felt uneasiness. Mises's adoption of this approach is puzzling but, perhaps, can be explained in terms of an adherence to Benthamite principles. Action is an attempt to overcome feelings of unease or of deprivation, possibly caused by hunger and other symptoms of physiological distress (see p.245).

Mises's justification for postulating tendencies towards equilibrium and his interest in the 'final state of rest' derive from the idea that, rather than trying to achieve something, people act to remove something to end up in a position where they no longer have to act. 'What makes it necessary to take recourse to this imaginary construction [the final state of rest] is the fact that the market at every instant is moving toward a final state of rest' (p.246). The difference in emphasis between the neoclassical concept of general equilibrium and Mises's final state of rest is interesting. In neoclassical theory, what would happen if equilibrium were established and all agents' decisions were compatible? Presumably a stationary state would prevail where people would go on doing the same thing in period after period. For Mises, however, if everyone succeeded in doing what they are trying to do, namely to remove uneasiness, there would be no need for further action. Perhaps individuals would simply languish and then have to act again to overcome the 'felt uneasiness'.

[t]he only method of dealing with the problem of action is to conceive that action ultimately aims at bringing about a state of affairs in which there is no longer any action.... Action thus tends toward a state of rest, absence of action.

Furthermore, in order to understand how an economy works, it is necessary to resort to the 'imaginary construction' of an 'evenly rotating economy' (essentially a stationary state)¹⁰ and of a 'final state of rest' (general equilibrium). The former serves as an *argumentum a contrario* (p.251) in order to highlight the differences between the imaginary and real worlds, while the latter identifies the direction in which 'the market' would go if it were not perpetually disturbed. The market 'is always disquieted by a striving after a definite final state of rest' (p.246).

The assertion that a notion of general equilibrium assists the theorist in making sense of the changing real world is an odd one indeed, and underscores Mises's adoption of a third-person perspective. Paradoxically he is saying that the theorist needs a conception of a scheme of things that is complete and, indeed, one that is in equilibrium, in order to understand the real changing world out there.

According to Mises, the difference between orthodox, 'mathematical' economics and 'logical', praxeological economics is this: the former postulates a determinate outcome and makes equilibrium its centrepiece; the latter is concerned with processes and treats equilibrium as makeshift (see pp.352-353).

Mises regards the difference as significant because logical economics recognises the importance, for explanations of human action, of time and uncertainty, whereas mathematical economics does not. Yet in respect of the epistemological bases of the theories, there is not a lot to separate the mathematical and logical approaches as Mises conceives them.

Logical economics still implies that the individual confronts a world out there, which reveals opportunities to him, but which he can never quite grasp in its

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See, however, Mises's objections to equating the two notions (1949, pp.251-252).

entirety. Contrasted with the neoclassical theory, either the individual is not 'given' complete knowledge or the world changes anyway, so there are always 'unexploited opportunities'.¹¹ And, because he never gets exactly what he wants and his uneasiness is never fully removed, there is always scope for action. Tendencies towards equilibrium are never allowed to assert themselves, but in order to explain human action the world has to be conceived transcendentally¹² as manifesting tendencies towards equilibrium.

Mises does not embrace subjectivism. His methodology is not that of interpretative understanding of individuals' understanding. Individuals and their conduct are there in the world. Explaining conduct involves superimposing on the observation of action the *a priori* categories and tendencies towards equilibrium. The individual (over here) forms judgements about the world (over there). The task of social science is to connect economic phenomena with individuals' judgements, to explain what happens in the world as a consequence of the fact that people *form* judgements and *have* expectations, to explain the *conditions* under which action takes place; but not to understand, or to obtain insight into, action itself.

Mises's 'subjectivism' rests on judgements and expectations as part of a world, but separate from another physical, world. The world out there means different things

¹¹ It is just this foundation on which Kirzner (1973) builds his theory of entrepreneurship. These unexploited opportunities provide the scope for entrepreneurial activity which is characterised by attempts to exploit such opportunities for profit as are discovered to exist (out there) by 'alert' individuals. The puzzle which Kirzner's analysis does not resolve is, where do the unexploited opportunities come from? If entrepreneurs are alert, why have they not spotted them before? If they have spotted them, why have all the profitable opportunities not disappeared by now? Or, if new opportunities can be 'thrown up' as a result of changes that occur, how does anyone know that existing opportunities will last? (If they may not last, then speculation is an important element in entrepreneurial activity that has been ignored.) Schumpeter's analysis of the entrepreneur as a force of 'creative destruction' makes the entrepreneur a disequilibrating agent, while competition works to restore equilibrium (see Schumpeter (1955, esp. pp.74-94, 128-156, 217-236)). By contrast, Kirzner's scheme leaves one half of the implied sequence of events unexplained. Of course this does not deny the importance of an analysis of entrepreneurship. The question is whether anything is gained by placing that analysis in the context of tendencies towards (or away from) equilibrium.

¹² The term is used in the Kantian sense of what is beyond the limits of experience.

to different people. Why it means different things, and what it means, cannot be established. As Lachmann (1982, p.37) puts it, for Mises subjectivism really means 'no more than that different men pursue different ends.'

Others have noted that at times Mises's position borders on behaviourism (see Lachmann (1982, p.38)). This is ironical because praxeology was supposed to serve as an alternative to the positivist conception of science which behaviourism exemplifies, and because behaviourism is the epitome of an attempt to construct a modernist, non-subjectivist explanation of conduct. Yet the following quotation certainly bears out such a view and illustrates the enormous gap between Mises and the subjectivism of modern hermeneutics. Mises (1978, p.37) states that 'valuing' is

man's emotional reaction to the various states of his environment, both that of the external world and that of the physiological conditions of his own body. Man distinguishes between more and less desirable states.... He acts when he believes that action can result in substituting a more desirable state for a less desirable.

Does this approach to the concept of valuing and decision-making go beyond neoclassical theory? There is no hermeneutic, let alone a double hermeneutic, of social science. The theorist confronts a world and his understanding of it is given *a priori*. Individuals are objects that possess certain properties, such as the ability to value. Endowing them with such characteristics does not alter, or disguise, an objectivist epistemology.

B. Hayek and equilibrium of the individual

In common with that of Mises, Hayek's work reflects the idea that individual conduct has to be studied against the backdrop of equilibrium. Indeed, the notion of equilibrium features more prominently in Hayek's contribution to economics.

Though he pioneered the analysis of epistemological issues in economics, Hayek (1948c) takes it for granted that an equilibrium framework is the proper context in which to pose questions about what individuals know and how they acquire

knowledge. This severely constrains the scope of any epistemological enquiry. His economic writings reveal a strong attachment to the notion of equilibrium and this brief analysis, dealing with the notion of equilibrium of the individual, shows that they harbour a third-person perspective.¹³

Hayek is credited with conceiving the notion of inter-temporal equilibrium (Milgate (1979); Petri (1978)). In his earlier writings he held that the task of economics is to explain the *unintended* or 'undesigned' consequences of human conduct (see Hayek (1948c, pp.39-40)). His is a Walrasian conception of decentralised market activity exhibiting coherence, in the form of a co-ordinated equilibrium solution. Co-ordination emerges out of the myriad of independent decisions made by individuals, where no such co-ordination was intended.

One analysis of Hayek's economic writings (O'Driscoll (1977)) presents his contribution under the title, *Economics as a Co-ordination Problem*. Rather than just wanting to show the logical possibility of equilibrium, Hayek's interest (e.g. (1948c) and (1948f)) is in showing how equilibrium is related to individuals' decisions or plans. Although he refers to the subjective nature of social science (1955c, p.28, see also pp.29-30), as with Mises, that subjectivism has to be congruent with a conception of the economy as a series of equilibrating (and possibly also, disequilibrating) forces at work.

The epistemological underpinnings of Hayek's scheme constitute a typical Austrian approach. Economists, unlike natural scientists, should attempt to take account

¹³ Ludwig Lachmann recounted a saying of Terrence Hutchison that 'there are at least five Hayeks'. Hayek-the-economist almost disappeared from view in later years in favour of Hayek-the-social-philosopher and, when he is there, Hayek-the-economist is not always an equilibrium theorist. Sometimes Hayek makes much of interpretative understanding, and sometimes when advocating an evolutionary theory of social change he is hard to distinguish from a modernist. Our contention, however, is that tendencies towards equilibrium are an important component of his economic thinking and also characterise his political philosophy, where the evolutionary nature of the social order is a strong element (see Hayek (1973)). Lachmann (1976, p.58, fn.5) notes Hayek's early attachment to general equilibrium. See also Barry's remarks (1979, pp.42-43) on Hayek's position in respect of the notion of equilibrium.

of 'what men think and or do about [things]... [t]he views people hold about the external world' (1955a, p.23). Yet economists do not attempt to *understand* those views, nor do individuals themselves understand *their* 'worlds'. Different people have different views and this is important for the analysis of conduct, but it is a given. For Hayek the important issue is that the market system produces coherence from these divergent views. The theorist's task is to explain how this happens.

'Economics and Knowledge' (Hayek (1948c)) contributes to fulfilling that task and Hayek's explanation of the co-ordinating process rests upon a dual epistemology (see Addleson (1984a, pp.514-516). There is one world view for the theorist and another for the individuals whose decisions are the object of study. The theorist's is a 'typical' third-person perspective. He can discern the equilibrating forces at work and knows about the whole scheme of things. Individuals, however, have a limited view, but are concerned to find out what the world *out there* is really like. They have to come to know 'the facts of the situation'.

A central question to Hayek is how and through what mechanisms does the individual's knowledge come to correspond with the facts of the world out there. This, more than any aspect of the analysis, identifies an objectivist epistemology and a third-person perspective.

Hayek also supports Mises's idiosyncratic approach to human action. Criticising the Walrasian notion of equilibrium because it is static, Hayek's view is that the notion of equilibrium is relevant in economics in the context of the plans of a single individual. He proceeds to explain how, spelling out the implications of equilibrium including its time dimension. The actions of the individual are in equilibrium, Hayek holds, if they form part of a single plan. As observers of individual conduct, we need to recognise that only actions that are part of a single plan can be treated as equilibrium actions.

Now, according to Mises, the postulate that people act rationally is true *a priori* (1949, pp.18-20). To be able to draw inferences based on the proposition of rational action, about individuals' 'observed' actions, all actions must be part of the same plan. Otherwise, actions may appear to be contradictory because the goals of one plan, on one day, are not the same as those of another plan formulated on another day.

Yet, what does it mean to say that all actions form part of a single plan? Perhaps the implication is that a 'plan' is something like a set of Paretian indifference curves. What seems to be implied is that Paretian curves, representing the 'choices' available on a particular *day*, are fine for describing the nature of planning and decision-making but the curves *change over time* and orthodox 'static' analysis fails to recognise this.

The statement that equilibrium actions must be part of the same plan suggests that a plan, like a blueprint, is something that exists in the world. This is consistent with the way plans are conceived in Austrian economics. A realist conception of a plan with 'elements' and 'shape' is clearly identified in Lachmann's statement (1970, p.31)) that

[i]n social theory our main task is to explain observable social phenomena by reducing them to the individual plans (their elements, their shape and design) that typically give rise to them.

Hayek's logic is impeccable. If equilibrium of the individual means that actions are consistent (and we know of no other conception), and if actions are planned, they must form part of a single plan. But the notion of planning that is compatible with this logic has nothing to do with how a person plans or with what a planner *understands* by planning.

This is a concept of a plan as a complete system, within which different 'actions' can be consistent. And each part of the plan has a counterpart in an action out there. Every observation of an action - and it is not clear what this means - is the observation of a piece of plan being carried out. Hayek's notion of equilibrium of

the individual involves the epistemology and ontology of the third-person perspective as much as any other notion of equilibrium.

Equilibrium, even that of the individual, involves a transcendent conception of the scheme of things. An interest in equilibrium constructs means turning away from understanding (*Verstehen*) and from insight into planning and choice. The *subjectivist*, then, cannot go along with Lachmann (1986, pp.140-141) in arguing that '[e]quilibrium has its legitimate uses' and that the notion of equilibrium is unambiguous when it refers to actions that are 'under the control of a single mind'.

C. Lachmann and radical subjectivism

Looking to the 'radical subjectivism' of Lachmann - what he calls 'the subjectivism of the active mind', we find that this does not change the nature of Austrian subjectivism but, as is Lachmann's object, extends its scope. That extension involves incorporating the subjectivism of plans and expectations, in addition to knowledge. What does this mean in terms of the conception of plans and expectations?

In the following quotation (Lachmann (1970, p.30, emphasis added)), reference to 'comprehensive surveys' echoes Hayek's ideas discussed above.

One trait distinguishes all cultural phenomena from natural ones. When men act they carry in their minds an image of what they want to achieve. All human action can be regarded as the carrying out of projects that are designed to give effect to imagined ends.... To act at all, men have to make plans, *comprehensive surveys* of the means at their disposal and the ways in which they might be used, and let their actions be guided by them.

Plans, expectations, and knowledge are things that co-exist within the individual. Each individual acquires particular knowledge, forms particular expectations, and makes particular plans. Different individuals have different, and sometimes divergent, expectations. As the individual 'changes' - as he has new experiences of the world - so his knowledge and expectations change.

The theorist has a duty to reflect the existence of knowledge, expectations, and plans in his scheme because they are an essential *part* of the individual and what he does. Just as the economist would fail in his duty to provide a satisfactory theory if he did not recognise and take account of prices, so he must also build in plans and (sometimes divergent) expectations. Plans and expectations are a part of the world, even though they cannot be seen. The theorist understands that individuals have plans. It is this that makes the theory a subjectivist one (incorporating the Weberian notion of *Verstehen*).

However, in the conceptualisation of these attributes of the human mind and in the 'explanation' of human conduct - which involves relating the activities of individuals, their knowledge, and expectations, to an ongoing 'market process' - the epistemology is that of the third-person perspective.

The world exists out there as a system that contains both equilibrating and disequilibrating forces. It consists of individuals who themselves experience a world 'around' them and respond to changes with new knowledge and revised expectations. Their responses are not always consistent, and the result is that the system produces ongoing changes over time.

Like Lachmann's idea of 'the market as an economic process' (1986), Shackle's concept of a 'kaleidic society' (see Shackle (1972a)) embodies a similar view of the world as a complete *system*. In contrast to Lachmann's explanation of the market process which rests upon such considerations as divergent expectations, Shackle does not attempt to explain what makes the world kaleidic except to say that expectations suddenly shift and change.¹⁴

The distinction between these two concepts on the one hand and general equilibrium on the other, concerns *what* - rather than *how* - the theorist knows.

¹⁴ Shackle does not examine the notion of a kaleidic society at any length (see (1972a, pp.76-79 and 427-428)) but the idea of a course of affairs that is bounded while offering a 'rich manifold of rivalry and indeterminism' (p.77) suggests a variant of Lachmann's market process.

The theorist confronting a kaleidic 'world' and to an extent also a market process, does not have knowledge - and may not be able to acquire it - of *mechanisms* that would enable him to classify and to separate equilibrating from disequilibrating forces and, therefore, to tell which 'way' the process is going at any time. Although these systems do not possess the formal structure of a general equilibrium scheme, their epistemological basis is the same as that of general equilibrium.

V. FROM RADICAL SUBJECTIVISM TO INTERPRETATIVE UNDERSTANDING

How do we get from this weak subjectivism to interpretative understanding and the first-person perspective? Should Austrians reject weak subjectivism? What are the consequences of doing so? These are the questions that we now address.

The answer to the first question is that embracing interpretative understanding requires adopting a different epistemology and ontology. Thus the difference between Austrian subjectivism and hermeneutics is not in *what* the theorist or individuals know (*i.e.*, what is there in the world), but in *how* they know. To speak of understanding something means that the thing has become part of one's being or of one's awareness of the moment. So understanding is personal, reflecting the understander's prejudices.

A. What is 'observation'?

A scheme based on a first-person perspective of interpretative understanding begins with questions which Austrian subjectivism - by virtue of its epistemology - glosses over: how does the theorist, or an individual, 'observe' or understand; what does 'knowing' mean?

'Observation' (finding out what is happening) is interpretative understanding. Understanding is always within the hermeneutic circle, coloured by interests and beliefs. Using the example of factories and their location, observation is never neutral as in 'I see a factory over there'. Interest or curiosity is prejudiced and

influences the 'questions' that are asked. For example: This factory is a blot on the landscape; how was it granted planning permission, and what is going to happen to the values of the houses nearby? Or, this is an attractive building, I wonder why it is going up in an industrial area, can it really be a factory? Or, it looks as though there has been some rapid industrial development, why out here?

Being conscious of a new factory means that I have reason, or am *predisposed* to be interested in it, and the reasons or predispositions establish in what I am interested and what questions are going through my mind. They also shape the answers and my understanding.

Neither neoclassical theory nor Austrian economics in its present form is capable of dealing with interpretation, in this case of what constitutes the problem of location. Factories exist, the theorist's task is to 'explain' where they exist (in space), and the language of neoclassical theory prescribes what sort of explanation is appropriate. The explanation will take the form of equilibrating forces working upon economic data.

Although there is no Austrian theory of location, it is not difficult to imagine what it would be. It would include - as objects in the scheme - the expectations and plans of 'locators', asking whether these were compatible with other interrelated plans, and under what circumstances. Perhaps, it would also highlight a particular type of innovative locator who is alert to new, more profitable opportunities for location.

In both neoclassical theory and the hypothetical Austrian example, the central issues is whose view of the location problem is this, and whose understanding of the factors involved in location. Once it is appreciated that the theorist is a prejudiced observer, the same sorts of questions have to be asked of the individuals who are involved in locating factories, in order to understand their prejudices.

Who is the 'locator' and how does he 'see' the 'location problem'? What is his interest and why does he 'see' things that way? What motivated his decision? Did he make an estimate of costs and profits? Until such questions are answered, economics does not have a conceptual basis for explaining location decisions, and has not performed the task that Lachmann requires of it - 'render[ing] the [social] world intelligible in terms of human plans'.

B. Changing direction

Should Austrians adopt a methodology of interpretative understanding? Austrian theory has been associated with a number of philosophical turns in its cyclical history, and awareness of problems with the epistemology may be reason enough for re-evaluating the methodology and deciding whether a hermeneutical turn is now warranted.

This chapter reveals that Austrian and neoclassical methodology have much in common, although Austrians are outspoken in their criticism of positivism and modernism. Hicks (1976b, p.214, fn.13) states that '[t]he Lausanne and Austrian versions of catallactics are by no means identical.... But it is noticeable that as time has gone on, these versions, at first distinct, have grown together.'¹⁵ His view is that many modern writers do not readily identify a well-defined Austrian paradigm, but 'draw upon Menger and upon Walras in equal measure'.

The distinction between first- and third-person perspectives helps to identify why there are greater methodological similarities between the two approaches than first meet the eye. Austrian theory tackles the terminology but not the epistemology of economic theory. Though the language is less 'mechanicalist'[sic],¹⁶ the

¹⁵ Mises (1969, p.41), himself, holds that by the twenties Austrian economics had been absorbed into mainstream theory.

¹⁶ It is characteristic of Austrian economists that they do attempt to avoid what Mittermaier (1986) appropriately terms 'mechanomorphisms', though not always successfully. In the nature of the Austrian conceptual framework, mechanical analogies are probably (continued...)

transcendent epistemology of the third-person perspective constrains the scope of inquiry in the same way.

Whether it is Hayek's interest in the unintended consequences of conduct (1948f), Kirzner analysing the implications of entrepreneurial activity (1973, 1985), or Lachmann reflecting upon the character of the market system (1986, see 'Appendix'), like neoclassical equilibrium theory, the object of the enquiry is the whole scheme of things.

Though Austrians generally eschew the idea of optimising, because people do not have the complete knowledge that is needed to do so, the reasons why people act are essentially the same, and they are guided by the same 'external' considerations. They take advantage of opportunities for profit or for attaining greater satisfaction, revealed in the relationships between prices, or costs and revenues, out there.¹⁷ The similarity between the types of explanations of human conduct offered in the two schemes is not coincidental but is a reflection of the underlying epistemologies.

There is a *sense*, and it is hardly more than that, that some Austrians have found the framework restrictive but were unable clearly to identify the constraints. A reason for this, as Boehm (1982) infers, is that insufficient thought has been given to the meaning of subjectivism. More than half a century on, since the previous generation of Austrians - which includes Hayek, Lachmann, and Mises - laid down their first thoughts on Austrian methodology, we are better placed to put Austrian subjectivism into methodological and epistemological perspective.

¹⁶(...continued)

unavoidable, since explanation - the linking of particular economic phenomena to individuals' plans and decisions - is really about showing correlations between things. See Mittermaier on the use of metaphors as means of explanation, and on the questions of whether, and why, the use of mechanomorphisms is problematical.

¹⁷ See, however, the discussion in the text regarding Mises's views about what motivates individuals.

In any school there is an understandable reticence to be regarded as a revolutionary. Even if the scholar recognises that his ideas take him away from his intellectual roots, there is a desire to emphasise the continuity of ideas, to stress the importance of the heritage of previous generations, and even to refashion parts of an existing conceptual framework to suit new purposes for which they may prove to be inappropriate.¹⁸

If it is a conceptual framework rooted in interpretative understanding that some Austrians have been after, then Lachmann's work in particular falls into this category. His contribution is characterised by the effort always to reach beyond the boundaries of his contemporaries' interests, forging links with economists and others outside the Austrian tradition. His discussion of 'subjectivism of interpretation' (1986, see Ch.3, esp. pp.54-55) supports these claims (see also Lachmann (1991)).

In Hayek's contributions, too, the evidence is there that the author is predisposed towards *Verstehen*. In addition, the current generation of Austrian economists has actually turned to hermeneutics, realising that their interests take them away from the mainstream of Austrian economics, but perhaps not appreciating the full import of their pursuits (see Ebeling (1986), (1991); Lavoie (1986), (1990), (1991b)).

C. The importance of the Austrian contribution

The significance of the Austrian contribution to economic theory goes far beyond the 'visible' impact of Austrian economics.¹⁹ At a time when positivism was

¹⁸ It is recognised that in an academic environment which stresses conformity in order to meet the requirements for tenure, and which places weight on such measures of performance as a citations index, scholars certainly will want to avoid being seen as dissenters.

¹⁹ O'Sullivan (1987, p.161) argues that in devoting a whole chapter to the school, he has given Austrian methodology an amount of attention 'which is quite disproportionate to the influence which it has had on the methodological precepts of most mainstream economists'.

rampant it was the Austrians who fought a limited, but spirited, battle against a methodology that was perceived by them to emasculate social theory. Recent developments in the area of methodology have vindicated those efforts. At the same time they reveal that the methodology of the Austrian resistance is somewhat rickety.

With hindsight we can say that the counter-attack on positivism was not well-directed. The cause was a just one but, without identifying the issues as epistemological ones, in many cases Austrians were right for the wrong reasons. Not wanting to disparage their stand nor to underestimate its value, this analysis shows that having once been in the vanguard of subjectivism, today Austrian economics is struggling along with ideas that are rather dated and which should, perhaps, be jettisoned.²⁰

Austrian theory still represents the only consistent attempt to provide a subjectivist approach to economics, and for some this may be a sufficient reason to continue down the present path. Another view is that in its current form, and with other options open, Austrian subjectivism is ambiguous and confusing. It is meant to provide an economic theory of decision and human action that does away with the formalism of neoclassical economics but fails to do so, and its brand of subjectivism is esoteric.

Over the years, the questions that Austrians posed have yielded insights which are useful in exploring decision-making. An approach that extends our understanding and also puts the subjectivism of economics on a conventional footing, one that conforms with current thinking on interpretative understanding, ought to be welcomed.

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Vaughn (1990, see esp. pp.400-402) puts forward a similar argument. She notes that in the early days of its revival, from the mid-seventies, Austrian economics had the 'aura of crusade', and goes on to suggest that scholars devoted themselves to preserving old ideas rather than to developing new ones. More recently, however, progress has been achieved by taking Austrian economics in new directions.

VI. CONSEQUENCES OF MAKING THE CHANGE

There are many good reasons for Austrians to take a hermeneutical turn but there are costs involved. As a conclusion to this chapter it is useful to identify the changes that Austrian economics would have to undergo in pursuing interpretative understanding. A theorist adopting a first-person perspective abandons the idea of 'grounding' his theory and, with this, the possibility of pursuing a value-free science. The notion of equilibrium and a third-person perspective go hand-in-hand. A first-person perspective entails abandoning equilibrium. It also involves a rejection of the narrowly-conceived notion of individualism which is associated with a third-person perspective. For reasons given in Chapter 4, a theory based on interpretative understanding does not offer the prospect of constructing predictive models.

A. Abandoning a grounded theory

Given their long-standing opposition to a positivist-empiricist methodology for economics, and their willingness to accept a heterodox methodology, Austrians will not necessarily reject the sort of arguments, associated with Rorty and Gadamer, that attempts to produce a grounded theory are misplaced. Given their history of opposition to mainstream methodology, one expects that these arguments will find a readier ear in Austrian than in other circles.

B. Abandoning a value-free science

Wertfreiheit and interpretative understanding belong to two different conceptions of the scheme of things. Each is the product of a different epistemology and ontology.

Defense of the *Wertfreiheit* of science rests on the need for a scientist to maintain an arms-length relationship with his subject-matter so that he does not bring his

own prejudices, values, and moral precepts to bear in drawing inferences or conclusions about the relationships that he is investigating.

The rejection of a value-free theory is bound up with the question of grounding the theory and rests on twin assertions, associated with the work of Gadamer. The first is the idea that each individual does not arrive to undertake his theoretical investigations with a clean slate, but is 'thrown' into the world and, therefore, into his research. In addition, understanding - within the hermeneutic circle - is a process of interaction, a dialogue, or conversation. This applies as much to the theorist as it does to those interpreting the work, supporters and critics alike.

Although it was suggested that giving up the idea of a value-free science may be 'radically shocking', there may be Austrians who share the view that the pursuit of the ideal of *Wertfreiheit* is an obstacle that restricts the development of Austrian theory by limiting the range and type of questions which can be posed.

Kirzner (1976c) offers a useful overview of the principle of *Wertfreiheit* and an appraisal and defence of its application to Austrian economics. He highlights the embodiment of the principle in Mises's definition of economics, a definition that has become the standard definition of the subject-matter of economics, and which is usually attributed to Robbins (1949), but which is in fact a typically Austrian conception of the scope of economic science (see Addleson (1984a)²¹).

That definition is generally interpreted (note our emphasis), as 'the science which studies human behaviour as a relationship between [*given*] ends and [*given*] scarce means which have alternative uses' (Robbins, p.16) . The spirit of the Robbins-Austrian definition is inexorably bound up with the adoption of a third-person perspective. Although Mises (1949, p.92) argues that '[m]eans are not in the

²¹ The arguments in this dissertation represent a substantial modification of the position on Robbins's contribution adopted in Addleson (1984a), where the distinction between first-person and third-person perspectives, and the significance of the distinction for Austrian economics, is ill-defined and is not associated with different epistemologies.

given universe; in this universe there exist only things'. in the context of an economic theory constructed around Robbins's definition it is impractical to treat means and ends as anything other than things which simply exist in the world.

In this definition, all matters that are of interest to the 'interpretative understander' - why individuals choose to do certain things, how they make their choices, what exactly it means to 'choose ends' or means - are ruled out. They are defined away partly because, in order to maintain his value-free standpoint, the economist should not be interested in the nature of the ends that people choose.²² *Wertfreiheit* is only compatible with a third-person perspective and, in maintaining this principle, the theorist is precluded from *understanding*. Relinquishing the principle broadens the scope of economic theory immeasurably.

The defense of *Wertfreiheit* in economics which Kirzner offers fails to recognise that the hermeneutic circle applies as much to the reader, or to the scholar interpreting the work, as it does to the author or theorist himself. Naturally this is not a criticism of Kirzner, but even if the theorist was able to distance himself and his beliefs and values from his analysis, he would still face the problem of the audiences' interpretations.

A work, constituted intersubjectively, is reinterpreted as the hermeneutical conversation among scholars leads to new insights and to different ways of understanding it. The passage of time, the *durée*, is important to how the meaning is constituted. Accepting the principle of a value-free science means either that there is only one *real* interpretation of any work or that different interpretations are attributable to factors (perhaps ones like neural pathways) which are known to be independent of the individual's beliefs and value-judgements.

The Austrian response to the radical suggestion of abandoning the principle of value-free science could be to take encouragement from Hayek's argument that it

²² We noted earlier that Mises's desire to avoid psychologising leads him to adopt a behaviourist position, not realising that an analysis of decision-making or choice in its social context can avoid psychology.

is important for economists to explain how individuals find out about the facts of the world. For Hayek, equilibrium is the natural domain of economists and these questions refer to gaining knowledge about the (real) world out there. From a first-person perspective the questions appear somewhat similar although the epistemological and ontological connotations are entirely different. What do individuals know about the world? What do they treat as facts? how they agree on what constitutes 'the facts' of any situation?

C. Abandoning equilibrium

Whether Austrians would readily reject equilibrium - and disequilibrium (see Rizzo (1979b)) - is a matter of conjecture. For despite the appearance of various notions of equilibrium in the contributions of virtually all Austrian economists, throughout the history of the school their attitude to the relevance and the role of equilibrium has been one of ambivalence. General equilibrium is rejected by most Austrians, but equilibrium of the individual is seen to be important, and there is substantial, if tacit, agreement that market equilibrium - Marshallian partial equilibrium - is a useful notion.

Lachmann explores the role of equilibrium in many of his contributions, but in a recent work (1986) conveys something of the dilemma confronting the theorist whose interest lies with interpretative understanding but who wishes to find a place for equilibrium in economic theory (see also Lachmann (1977b, pp.37-38)). Lachmann holds that '[e]quilibrium of interaction between individuals, households and firms, i.e. between different *minds* is clearly a problematic notion'. He goes on to argue, however, that

[e]quilibrium has its uses. For all that has... been said, it would be quite wrong to conclude from it that all use made of the notion of equilibrium *outside the sphere of action of the individual* must be illegitimate. Marshall's partial equilibrium concept is a striking counter-example... (1986, pp.141-142, emphasis added).

Equilibrium has no part in the epistemology of the first-person perspective. Equilibrium designates a complete scheme, a self-contained system with clearly

designated parts and well-defined interrelationships. Whether that system constitutes the economy, or a market, or the plans of an individual, makes no difference.

By the same token, it is immaterial whether the theory postulates an equilibrium outcome or a process, where equilibrating forces are dislodged by their continual interaction with disequilibrating ones (see Rizzo (1979b)), or even 'pattern co-ordination' (O'Driscoll and Rizzo (1985, pp.85-88)). All these involve the epistemology of a third-person perspective.

In arguing that an equilibrium scheme takes as 'given' the very things - such as the concept of the market - which a theory of interpretative understanding must explain, we echo a view expressed by Hayek (1948f, p.93). How do individuals constitute 'the market'? What does the notion mean to them? How does one person's understanding of 'the competition' - of who is competing with whom - differ from that of another? What are the implications for the competitive strategies which each formulates? In response to the potential criticism that rejecting equilibrium amounts to 'throwing out the baby with the bath water' - which is Hahn's argument (see 1973a and 1973b) - economists still have a lot to say without equilibrium. The idea that equilibrium is indispensable stems from the view that the only good economic theory is one which follows the canons of positive science, and that there is only one sort of 'explanation'.

A theory that explains decision-making and the activities of individuals must take cognisance of the social nature of decision-making and conduct. Understanding is intersubjective and social in its orientation. One may ask, therefore, whether some concept of co-ordination involving the activities of different people is not necessary in any social theory.

Austrian theory deals with interrelationships among people, but the emphasis falls on the *consequences* of interrelationships, rather than the nature of the interrelationships themselves. Unfortunately, the problem of 'interdependency' as

conceived by Austrians is the Hayekian and neoclassical one of whether, and how, co-ordination occurs and, also, whether different actions are, or become, compatible. These problems with which Austrians have been preoccupied, as exemplified by Kirzner's theory of entrepreneurship (1973, 1985) which gives prominence to the co-ordinating role of the entrepreneur, reflect the adoption of a third-person perspective.

There is much more to social interaction than the co-ordination of activities, and eliminating equilibrium from economic theory does not constitute a case for ignoring or overlooking the interrelationships between people and between different groups or between businesses themselves. In fact, just the opposite. Freed from the constraints of a 'systems view', there is an opportunity to examine social relationships more fully. One of the important tasks is to understand how people understand, and make use of, institutional arrangements in order to get things done when - as inevitably they do - they require the co-operation, participation, involvement, and assistance of others.

For instance, a function of middlemen in a distribution chain, or of various types of intermediaries such as brokers and agents, is to 'bring together' potential buyers and sellers or lenders and borrowers. The more successful they are at doing this, the more money the intermediaries will make. Often, as in the case of merchants, these enterprises fulfil other functions as well (see Hicks, 1969). But whether one focuses on the role they play in holding reasonable stocks (so that retailers are able to replenish their shelves at short notice), or holding a range of goods from different manufacturers, or in being able to purchase in bulk because they supply a large number of retailers, they facilitate the process of production and distribution among a number of people and businesses.

The specialised businesses and other institutions which organise, manage, and orchestrate the activities of different parties are legion. They range from auctioneers, banks, lawyers, and consultants of all kinds, to advertising and other elements of the marketing function, and even include 'business lunches'. Lobbyists

exist in order to ensure that legislators and others take into account their clients' interests when it comes to formulating, amending, or approving legislation. A conceptual framework that enables the theorist to examine these institutions and arrangements is surely desirable, even though that framework does not include an equilibrating function.

Explaining where and how relationships have to be managed or co-ordinated depends, first, on recognising the *mutual* interests of individuals. All business activities involve mutual, or *common* interests, whether or not these interests converge or diverge (as in the case of competitors).²³ People who have a mutual interest in each other's business are not confined to the same 'industry' or 'market' as these are conventionally defined, nor, in a world of 'global competition' and 'transnational corporations', even to the same country.

So fulfilling these objectives requires an *understanding* of the interrelationships and their implications. Who are the customers, suppliers, subcontractors, partners, subsidiaries, or competitors? Who is the opposition? How important are these relationships? Current as well as former business interests may influence plans, as might the individual's views about possible future relationships with particular parties. Interpretative understanding is the foundation for getting to grips with these issues

7. A different notion of individualism

A first-person perspective is naturally a form of individualism but it is not the individualism of either mainstream or Austrian theories. In arguing that methodological individualism is troublesome, it is the form of individualism

²³ It is precisely the recognition of a mutual interest amongst individuals who regard themselves as competitors that may lead to attempts to try to 'eliminate the competition' in one of two ways: either by forcing the competition out (to which end numerous strategies may be adopted), or by co-operating instead of competing, say by forming a cartel, or by way of a 'gentlemen's agreement'.

associated with economic theory that is at issue, not the idea of 'seeing' things from the individual's perspective.

In spite of Hayek's contention (1948b, p.6) that 'true individualism' is primarily a theory of society, an attempt to understand the forces which determine the social life of man....' (emphasis omitted), there is little in Austrian economics which can be described as relating to the social life of man. Much like neoclassical theory, and for the same reasons, it abstracts from social relations.

For example, the Austrian theory of money, how it evolved and its role (see Menger (1950, Ch.8)), the analysis of speculative markets (Lachmann (1986, pp.10-11 and 125-127) and of other social institutions, expressly recognises the interaction of individuals; but their interaction is indirect and anonymous²⁴ - through (rather than *in*) markets - and their impersonal 'relationships' are based on perceived market opportunities and on price signals.

The individualism of Austrian economics has its roots in two sets of factors. The compositive method has been associated with Austrian economics since Menger (see Hayek (1955a, esp. pp.38-39)). Individuals' actions, or choices, are regarded as the basic building blocks of social phenomena, and explaining these phenomena means showing how actions, plans, expectations, and knowledge give rise to them (see Lachmann (1977c), pp.152-155) for an account of the compositive method). The other factor is the pervasive influence of the implicit third-person perspective which rules out discussion of people's motives (see Chapter 7). Motives belong to the language of interpretative understanding and without them neither friendship, trust, filial duty, nor loyalty to the company, can form part of the

²⁴ In some respects the evolution of the modern market economy has resulted in certain types of transactions becoming increasingly anonymous and impersonal. Compared with a hundred years ago, manufacturing firms, banks, and even certain retailers, do not now have the same relationships with their customers, and perhaps there is no one in the firm who actually knows a particular customer. Yet this is not true of all transactions and, at different levels within a company, individuals' relationships with others - both inside and outside the organisation - are important to 'doing business'.

explanation of conduct. It is motives such as these, however, which identify the social nature of conduct.

The individualism of Austrian economics is also a reaction to, and rejection of, collectivism. This is particularly true of Hayek's contribution (e.g. (1955a, pp.55-59)), which is marked by a tireless crusade against collectivism and also against central planning which was seen as a corollary of collectivism (1948a, Chs.7, 8 & 9). Mises (1936) and (1973) is also a strong opponent of collectivism (see also Lavole (1985)).

Apart from throwing individualism into sharp relief, the rejection of collectivism seems to have two sets of implications. The first, which causes little trouble and is less relevant to the thesis, is a critique of macroeconomics based on the argument that the notion of an aggregate social welfare function, conceived as a basis for policy, makes no sense; one cannot produce an aggregate of individual's preferences (see Kirzner (1976c)).²⁶

The second implication, however, is more problematic, for it seems to us that the rejection of collectivism is linked to the rejection of a role, and especially an explanatory role, for institutions. In Austrian economics, institutions exist as products, and often unintended products, of human action; but, institutions do not shape individuals' activities or their decisions. As Hodgson (1986, p.220) puts it, '[t]he inclusion of social structures and institutions in the moulding of human action, appearing both as partial explanations and things to be explained, would be inconsistent with work of methodological individualists such as Hayek....'

We support the contention that collectives, or 'wholes', as Hayek sometimes refers to them, cannot have motives, and that an explanation of collectives' activities

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The idea of aggregating individuals' preferences would, at any rate, only manifest itself in a scheme where preferences are treated as things that exist in the world, that have a structure (like a shopping list) and, presumably, are durable, so that they can all be scrutinised for compatibility and consistency and then combined. The social welfare function is a child of a third-person epistemology.

means understanding the motives, objectives, or activities, of all the individuals who manage, or are associated with, the institutions. At the same time, it is also possible to subscribe to the view that individuals have an *understanding* of institutions, and the meaning which is ascribed to social institutions records them an existence which is separate from the people who manage them or are associated with them.

Institutions are constituted in social interaction as part of the life world and their very purpose and existence is defined in the context of social interaction. The individual's understanding of institutions is interpretative understanding and individuals attribute characteristics to institutions - such as stability, reliability, honesty, inefficiency, corruption - which are not associated with specific people in the institution. How they view the institutions has a bearing on what they do, or do not do.

It is because institutions are durable beyond the life-span of the average individual, and have an existence which is independent of their present owners, managers, or employees, that their managers can undertake long-term investments '*by*' *the institutions*. Similarly, it is his trust in the banking system, rather than in the directors of a particular financial institution (who in any event are probably not even known) that encourages the individual depositor to place his life savings on long-term deposit.²⁸ Or it is a belief in the inefficiency of the postal service that leads the individual to insure his parcel or to send an important document by special courier, rather than entrusting it to the vagaries of the mails.

Mises argues that 'social entities have real existence' and 'determine the course of human events' (1949, p.42). At one level his view is that it is desirable to highlight the importance of institutions in an analysis of human action.

²⁸ This is not to deny that, on occasion, a manager or employee may make a difference to the way in which, say, the customer perceives his bank. Customers may leave a branch when the manager is transferred because, from their point of view, the personal relationship that exists with the manager is the most important aspect of their relationship with the bank. The point, though, is that individuals do develop business or other relationships with institutions which can outlast their relationships with particular individuals in those institutions.

Methodological individualism, far from contesting the significance of such social wholes, considers it as one of its main tasks to describe and to analyse their becoming and disappearing, their changing structures, and their operation.

This statement, however, makes no reference to integrating an analysis of institutions into an explanation of action, and his epistemology makes such a goal irrelevant.

On a number of occasions Lachmann has made a case for providing a role for social institutions in Austrian theory.²⁷ Austrian individualism confounds this object,²⁸ at least in a manner which would enable the analysis of institutions to be integrated into an explanation of individuals' understanding and, thus, into the explanation of individual conduct.

Understanding people's activities - what they are doing and why - involves an understanding of institutions - from religious to businesses - and of how individuals themselves understand the social nature of institutions.

In different circumstances the individual is a churchgoer and a businessman, though sometimes the two activities, and his motives regarding these, are not entirely separate. As economists we are particularly concerned with individual and his 'business environment', but it will be evident in the analysis of decision-making in the remaining chapters, that the individual's 'business' decisions cannot, and should not, be divorced from his other social relationships.

By taking cognisance of people's understanding of institutions and their changing consensus, at different times, on the desirability of relying upon particular institutional arrangements, the theorist concerned with problems of social

²⁷ See the second essay 'On Institutions' in Lachmann (1970). See also Lachmann (1986) and (1991).

²⁸ In recent years, there has been an increased interest in an 'institutional economics'. One attempt to draw together Austrian theory and a theory of institutions is that of Langlois (1982a) which contains a number of additional, interwoven threads.

interaction adds an important dimension to economic theory. For, as Hodgson argues (1986, p.222),

if we were to believe that action was entirely the result of constrained but otherwise free individual choices, then we may be quickly drawn to the conclusion that a great number of people are stupid, irrational, evil, or insane. In contrast the institutionalist view leads us to emphasise that much of this behaviour is moulded by factors outside the individual concerned, and it leads to a greater respect for that person in his or her predicament, as well as a more fruitful and less simplistic explanation of those actions themselves.

Assisted by the notion of third-person perspective, we can see that Hodgson's view is not compatible with interpretative understanding for if institutions exist 'outside' the individual and, presumably, are not subject to his response. We can, nevertheless, accept the spirit of his argument and have suggested that recognising the role of institutions in shaping conduct is entirely congruent with the individualism of a first-person epistemology.

E. Abandoning prediction

Prediction, as the term is used conventionally to mean forecasts based on the discovery of underlying regularities within a system, is not part of the language of interpretative understanding. Austrians are less likely than economists of other persuasions to be perturbed by these arguments. Although they hold a variety of positions on prediction in economics - some rejecting outright the possibility of prediction and others arguing that a form of prediction is possible - Austrian economists have emphasised explanation, as opposed to prediction, as the main purpose of economic theory²⁹. There is certainly no presumption amongst Austrian theorists of the symmetry of explanation and prediction, which is a feature of the 'covering law' notion of explanation associated with positivism.

²⁹

Perhaps it should be noted that even the notion of explanation is given different interpretations. Hayek (1948d, pp.67-68), for example, though at times a proponent of *Verstehen* (see Hayek (1973, p.8)), argues that explaining conscious action is 'a task for psychology but not for economics or linguistics, jurisprudence or any other social science. What we do is to merely to classify types of individual behaviour which we can understand... provid[ing] an orderly arrangement of the material....' (p.67).

Caldwell (1982, pp.122-123) provides an overview of a general Austrian position on what he identifies as the two most important uses of the term 'prediction' in economics: forecasting and the testing of hypotheses. He explains that Austrians reject forecasts as 'nothing more than summaries (with projections) of certain recent statistical regularities....' (p.122) and he sets out the reasons why Austrians reject both the need for, and ability of, economists to test hypotheses.

Caldwell is probably correct in his identification of the general Austrian position on prediction, though there are differences of opinion on the matter and this is where the lack of a well-defined, commonly-held Austrian methodology and theory is revealed.

Characteristically, Mises (1949) adopts the position that praxeological knowledge - the *a priori* categories of understanding - 'makes it possible to predict with apodictic certainty the outcome of various modes of action' (p.117). 'Prediction' here applies purely to logically necessary relationships which Mises treats as the basis of knowledge. When it comes to practical 'quantitative matters', all that individuals have to go on is understanding, which is the 'only appropriate method of dealing with the uncertainty of future conditions' (p.118).

Lachmann, too, reveals extreme scepticism about the possibilities of prediction (see (1950) and (1986, p.140)), taking the view - one that he shares with Shackle - that the task of economics is fundamentally 'backward-looking' ((1986, p.32) and (1977e, p.89)). Its purpose is to explain what has happened rather than to predict what will happen.

At the other end of the spectrum of views, Hayek has argued for some time (see, for example, Hayek (1967b) and (1975)) that economics permits 'pattern predictions', of 'the kinds of structures that could be formed from the available kinds of elements' (Hayek (1973, p.8)). Pattern prediction finds support from O'Driscoll and Rizzo (1985, see p.27) who introduce 'favourable relevance' as an analogous, but not identical, notion.

A taxonomy of different positions on the issue of prediction is less important than the epistemologies which those positions reflect. Though their reasons for doing so differ, possibly because they subscribe to different philosophies, all these authors repudiate a modernist methodology. Even when they support some form of prediction, this support does not stem from a belief that economics has, can, or should, identify empirical regularities or underlying mechanisms at work.

It is one thing to establish a general position on what Austrians reject, but another to discern a middle ground in terms of what they accept. It would be useful to be able to say that these positions represent differences between those who are more, and those who are less, hermeneutically inclined. On a general reading of their work, one would put Hayek and Lachmann into the former position but, on the question of prediction, the two are fairly far apart.

One has a sense that Austrian theorists are not particularly concerned with prediction and do not wish to be. Somehow, since they espouse a view that the world is not determinate, prediction should not really be part of the picture, but the epistemology associated with the conceptual scheme that they employ always directs thought back to questions about prediction. The point is that they take the view that the world should be conceptualised as a *whole*, and as one that exists out there. From this effectively third-person perspective it is difficult to conceive of 'knowing' without a counterpart 'predicting'.

To the subjectivist, understanding is all and is all there is to understand. Nothing is beyond the open-ended hermeneutic circle of interpretation, an ongoing dialogue of finding out. Prediction defeats understanding and the hermeneutic circle, for it implies that the scheme of things out there can be known in its entirety. We need to know all the possible options in order to be able to predict which will occur. Lachmann (1986, p.152) is correct in saying that 'prediction... would mean that the growth of knowledge has, at least for the time being, reached its end.'

We can, and must, conjecture about what may happen. We are conscious of the future because the things in which we are engaged today, or now, point us ahead

in the *durée*, in the same way that they may take us back in time, thinking about activities and relationships of the past.

In thinking about how someone may respond to a suggestion or request, it is natural to rely on an understanding of that individual's character or habits. The expectation that a person will do something is a belief that he will act 'according to type'. It is a conjecture, which does not replace unknowledge with knowledge. I hope, or think, that he will do something, but I am still uncertain. It is entirely appropriate to fall back on one's experience of other people. If they act according to expectation, well and good; but judgements about what others will do are not 'predictions' as the term is used in positive science. A conjecture is not a belief that I have discovered in his conduct some underlying mechanism or law. If the person does not do what I expect, I may be surprised or disappointed and will certainly put it down to experience, but I will not seek to revise a theory of behaviour, as if my surprise is evidence of the violation of some important rule or postulate concerning the interrelationships and the workings of a system.

Individuals are creatures of habit. We argue in the next chapter that activities are not necessarily guided by well-thought-out plans. Knowing (understanding) people's habits can stand us in good stead, enabling us to embark on courses of action with high hopes, and even a 'fair degree of certainty', that we are doing the right thing. None of this, however, presupposes a third-person epistemology - knowledge of a complete system and its mechanisms. This epistemology means all possible outcomes can be defined and enumerated or the probabilities of all events can be determined and this, quite literally, is beyond understanding.

Decisions are based on experience and judgement, not knowledge of what will happen. They take account of what we think might happen, and do not involve the certainty that only specific things can happen. This is the main idea of the next chapter where the object is to examine planning and decision-making from a first-person perspective and to compare this with the conventional treatment of business decision-making in order to prepare the ground for an analysis of location decisions.

CHAPTER 6

PLANS AND DECISIONS

'Uncertainty', so often completely forgotten, or regarded as a 'trimming', by economists, is something that it would be disastrous not to introduce into administrative theory at the outset. If money revenue is the businessman's sole aim, cost, as well as revenue, is always somebody's uncertain, fallible estimate or projection of future prices and is a 'function' of that particular person's mind. If the first approximation allows us to forget this, it becomes a 'vicious abstraction'.

G.F.Thirlby, 'The Economist's Description of Business Behaviour', p.206.

I. THE NEED TO EXPLAIN DECISION-MAKING

The object of this chapter is to examine the nature of planning and the considerations that bear upon the plans made in both large and small firms, so that we have an idea of what factors influence the decisions of managers of such organisations.

The more general aim is to develop a language, a set of concepts, that is useful in explaining decision-making and, specifically, location decisions. From a first-person perspective, recognising the importance of the double hermeneutic, understanding plans and decisions involves establishing how planners go about planning, and that requires an understanding of the planner's circumstances in order to reveal the considerations that have a bearing on the formulation of plans.

The analysis of planning is accomplished in a number of stages. First we set the scene for the analysis, indicating that in the remaining chapters it is the formulation of investment plans that directs the enquiry. We then examine briefly how business decision-making is portrayed in the literature on business management. Noting the 'viciously abstract' character of that portrayal, as Thirlby (1973) quoted above might put it, we focus on the nature of a plan from a first-person perspective, looking at the individual constituting plans in the *durée*.

Having stressed the social nature of all activities, it is necessary to investigate the social context of planning and, to this end, we distinguish between investment planners in large or small manufacturing concerns. An examination of their social relationships, together with an understanding of the nature of planning, provides a setting for addressing the issue of location. In the course of the enquiry the conventional view, derived from the economics of location, about how locations are chosen, is challenged and overturned.

Our starting point is the premise, to be found in the behavioural approach to location, that location decisions are made, and have to be viewed, in the context of an investment decision. Posing the question, how does a planner or the manager of a business approach the location of production facilities - what he has in mind when he deals with the location - the likely answer is that he does so in the course of planning an investment.

In the behavioural approach to location, some authors place the location decision in the context of investment decisions (see, for example, North (1974, pp.213-214)), though they have little to say regarding the implications of juxtaposing location problems and investment decisions. As discussed in Chapter 3, within the decision structures of the firm 'pressures' build up for action which subsequently may necessitate an investment and this may, or may not, have implications for location. The 'problem' of location is identified, but the behavioural approach does not furnish tools to explore it.

Decisions that have implications for location are matters that have to do with managing production capabilities: whether it is worth acquiring new production facilities, whether to rationalise or reorganise what already exists, whether to reduce the production capacity, or to extend the existing facilities. Understanding why such activities are contemplated means examining how particular individuals - the managers and planners - assess their situation.

Senior management may have decided to diversify in the light of exceptionally strong growth, or to rationalise when faced with declining profitability, or they may have decided to buy out the competition. Each of these decisions will have different implications for the location of production facilities.

Within the organisation, decisions to build a new factory, to purchase one, or to extend existing production facilities, will be viewed as 'strategic'.¹ Strategic plans might revolve around all or some of the following: diversification into new markets, restructuring the management of the enterprise, or developing alternative distribution channels for products. Measured in terms of the financial capacity of the company, the consequences of strategic decisions are usually costly. Because they may result in changes in the way organisation is managed or involve an upheaval as far as the production activities are concerned, strategy formulations are likely to be accompanied by a large-scale planning exercise involving various people or departments in the organisation.

By studying the 'character' of investment plans - the circumstances under which they are made, the nature of the plans themselves, and the sorts of considerations which bear upon the way in which the decision-maker thinks about undertaking an investment - the object is to throw light on how locations come to be identified and the sorts of factors that direct the 'choice' of a location. To this end, questions that are addressed in the chapter include: what is a plan, and what on what do decisions rest; and how do the social circumstances of the people involved influence the planning of investments.

In fact, economic theory does not guide us in answering these questions.² We

¹ See Hamermesh (1983, p.1) who quotes a definition of (corporate) strategy as 'the pattern of objectives, purposes, or goals and major policies and plans for achieving those goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be.'

² An important exception is the contribution of G.L.S. Shackle. No study of investment decision-making is complete without an examination of his work. The problem of finding
(continued...)

want to challenge the view of plans and planning that is commonly associated with economics and is implicit in both the 'map-image' of location theory and the comprehensive preference fields of consumer choice theory. In all cases, in keeping with the epistemology of the third-person perspective, plans are conceived as blueprints.² This conception fails to address the character of the sort of investment plans in which we are interested.

If economics does not provide theory of planning, can theories of decision-making in business management provide the direction that is needed to examine investment plans? The next section is a brief investigation of some contributions in this area and what they have to offer, in order to see whether the frameworks employed are suitable for our purposes.

II. DECISIONS AND PLANS AS BLUEPRINTS

For convenience, different approaches to business decision-making in management theory can be classified into two categories. The first are partial equilibrium models which present techniques for making decisions. These are associated with disciplines such as marketing, managerial finance, and corporate strategy and they purport to specify the logic for making effective, 'rational' decisions. In general, the methodological underpinnings of the conceptual frameworks employed and the frameworks themselves are not made explicit, but they are the same as those of neoclassical theory. The contributions define an 'optimal' solution in the context of different 'business problems', and they identify the conditions associated

²(...continued)

a 'language for expectation' is one with which he has grappled (see, *inter alia*, 1965, 1969, 1970, 1972a), and he makes a serious attempt to develop a formal framework for analysing investments, recognising that while 'expensive tools need much time in which to repay their cost[, t]hat time must needs lie in the future which is out of reach of direct observation, which in strictness is *unknowable*' (1970, p.97, emphasis in original). Of particular interest is Shackle's attempt to reconcile 'unknowledge' with a desire to be able to 'quantify' the prospects of returns from different investments so that the investments can be compared *ex ante*. (See, 1970, pp.97-105; 1972a, Chs.18, 33 and 34.) The account of the hermeneutic circle highlights a formalism in Shackle's description of decision-making that is at odds with the spirit of his thinking on epistemological issues.

optimal decisions. (See, for example, Weston and Brigham (1975) on financial decision-making and compare Kotler (1971) on marketing decisions.)

A second category serves a somewhat similar purpose, that of specifying what constitutes an optimal process of decision-making. The foundation of the behavioural theory of decision-making is behavioural psychology - the same conceptual scheme associated with behavioural location theory - and the foundation is often identified explicitly. These contributions sometimes examine the psychology of decision-making on the premise that, if he understands this, the manager - whose primary role is to manage people - will be more effective in his role. (See, for example Hogarth (1987).)

Neither category approaches decision-making from the point of view of the individuals involved, asking how they understand the problem at hand. The problem is taken to be 'there' (it exists in the world) and decision-makers have to solve it in an optimal way. In both categories the spirit of modernism is very strong and its tenets (as identified in Chapter 2) are plainly visible. Models of financial decision-making, for example, rely extensively on mathematical formulations of the decision problem and they frequently appeal to probability theory as the foundation for determining the outcomes of 'uncertain' events.

Implicit both in the application of mathematical models and in the use of statistical probabilities is the idea that the decision-making problem pertains to a complete, or closed, system as defined in Chapters 1 and 2. The system can be represented in its entirety and all the possible results or outcomes determined, if only on the basis of the probability of their occurrence. Behavioural theorists also use experiments to test how individuals make decisions or form judgements.

A. An example from the theory of managerial finance

For examples of the first category of approaches to business decision-making, one can look to contributions in the area of managerial finance - an assemblage of

partial equilibrium models rather than an integrated theoretical scheme - to see how the process of decision-making is represented and why the models are unsuited to answering the sorts of questions that we have set ourselves.

Like neoclassical theory, the focus of modern corporate or managerial finance is optimisation. In this case the object of each model is to solve a partial equilibrium problem, by determining an optimal asset portfolio, or finding the optimum capital budget - 'the level of investment that maximises the present value of the firm' (Weston and Brigham (1975, p.257)). For each problem, there is a technique which should be applied, say, to identify an optimal investment portfolio, by allocating a sum of money among a portfolio of assets with different streams of expected returns with which are associated varying degrees of risk.

In the definition of the capital budgeting problem, all the elements of the third-person epistemology are present. The nature of the investment decision is determined by the way in which the problem is formulated, typically that of maximising 'risk-adjusted returns'. It is presupposed that there are specific alternative investment opportunities available to the firm. Streams of earnings from each investment are estimated for various dates in the 'future'. The magnitude of the earnings is 'uncertain' but their probability distributions are known. For each investment, the object is to find a suitable risk-adjusted rate of discount, which can be applied to these earnings to estimate a present value. This exercise identifies which investment yields the maximum present value and, by comparing that value with the cost of each investment, which are the profitable investments. (See Beenhakker (1974, 1975) on this standard approach to modelling investment decisions.)

Planning in this context means defining all relevant aspects of the world in order to find the best combination of elements. There is a 'correct' (or even just a 'good') estimate of future earnings, and there is an optimal solution to the investment problem. Optimising involves the assumption of a limited number of 'states of nature' that can occur out there. The modeller is able to identify and

exhaust all, or at least the most probable, of these in determining an investment or decision strategy.

The epistemology of these models identifies the decision-maker as someone whose object is to grasp all aspects of the world in order to find a solution in a particular concatenation of external events that has developed, or one that - calculated on the basis of statistical probabilities - will develop.

The exercise of attaching specific figures to different streams of earnings under various assumptions - such as market growth and levels of interest rates - in order to optimise, is not at all consonant with the perspective of the individual in the *durée*, 'thrown into the world', making plans, thinking about what lies ahead, and considering possibilities in a logical way. With the redefinition of the problem from 'thinking about' to 'optimising', the epistemology has undergone a change. The argument that there is an optimal, determinate solution to allocating a sum of money is based on a different conception of the scheme of things to that of the decision-maker as 'being-in-time'.

To illustrate this, let us consider a few questions concerning investment, in the form in which these models treat the subject. What is the 'outcome' of a proposed investment? Is anyone able to say when the outcome is attained? What is the decision-maker's objective, and how is this specified? Is it 'higher than average profits', 'an acceptable level of profitability', or 'a better than average return'? What do such 'goals' mean? How would we know when, or whether, the decision-maker had achieved his objective?

The answer to the last question is that we would do not, unless he tells us that he thinks he has achieved it. Profits and streams of earnings are not things that we can find out there. They are the result of the day to day activities of people in the firm and their competitors and other related issues. Profits or earnings can only be measured *ex post* and then they are *reported* (i.e., interpreted) using accounting conventions and practices. To a degree, profits are what the reporters want them

to be. Whether reported profits are deemed to be 'high' or 'low' is also an interpretation, over which there will be at least some differences of opinion. Are we taking a short- or long-term view? With what are the profits being compared?

At the planning stage, there is uncertainty about what a proposed investment will yield, which means that 'estimates' of returns are pure conjecture. The idea of an investment having an 'outcome' and of specifying expected earnings in different years into the future is a product of an epistemology which represents the world as comprising concrete and discrete things. Plans and decisions, too, are conceived to be consistent with this view of the scheme of things. The behavioural approach to decision-making considers the nature of the process of decision-making rather than optimising situations. Does the behavioural approach yield more appropriate insights?

B. The behavioural approach to decision-making

Simon (1979, p.66) notes that one of two research programmes associated with the theory of the firms is 'economic behaviouralism', rooted in psychology and 'brought into economics to handle certain problems that appeared not be treated satisfactorily by the [other] situational approach.' Simon was instrumental both in developing the behavioural theory of decision-making and in applying it to problems of economics and of business (see Simon (1952, 1957, 1960)).³

Behavioural decision theorists see decision-making as a process, with a definite structure. Their object is to identify the structure and also the process by which the decision-maker 'grasps' the world out there, in order to show what constitutes an efficient decision-making process and whether the decision-maker uses a process that is 'procedurally rational'.

³ Overviews of the theory are provided by Edwards (1967a and 1967b). See also Hogarth and Reder (1987a); and Kahneman, *et al.* (1982) for the contributions of psychologists to behavioural decision theory.

The decision-making process is identifiable as a self-contained entity, and the process is analogous to the operation of a mechanism.⁴ In addition, the process exists within a system of events and circumstances which also form the closed, self-contained external world the decision-maker.⁵ The decision-maker responds to events in the world, which happen in a mechanical way, by having to calculate the probability of their occurrence.

The behavioural theory of decision-making postulates a scheme of things which is no different from that of neoclassical theory: it is the partial equilibrium models of business decisions.

Simon calls the rationality associated with the optimising agent 'substantive rationality', which 'is viewed in terms of the choices it produces' (1987, p.26). Behavioural theory is concerned with '*procedural rationality*' which refers to processes, while substantive rationality emphasises outcomes or results. 'Behaviour is procedurally rational when it is the outcome of appropriate

⁴ See Katz and Kahn (1966, Ch.2) on the 'system concept' that is the foundation of behavioural theory. Their reference to organisations as 'open systems' does not contradict our argument that the epistemology of a third-person perspective denotes a complete, closed system. Openness, for Katz and Kahn and for other behavioural theorists, signifies that the firm is subject to influences from outside. The important consideration is that the 'outside' is conceived as being complete. The world out there forms a whole entity and is capable of being comprehended in its entirety. Only in this context does optimisation make sense.

⁵ The third-person perception of the economy, or the market as a system, is identified explicitly in the following quotation from Coleman (1987, p.184). He examines the assumptions of models of rational action and argues that

the straightforward model of rational action that satisfies normative theory will, despite all the evidence about its descriptive deficiency, be adequate for most problems in economic theory as a descriptive theory. It is deficiencies in the apparatus for moving from the level of the individual actor to the behaviour of the system that hold the greatest promise of gain. The reasons, I believe, lie in part with evolutionary processes in social and psychological organization.... [T]here is wider variability in social organization through which individuals' actions combine to produce system-level behaviour.

deliberation. Its procedural rationality depends on the process that generated it' (Simon (1979, p.68)).

Taken at face value, the definition of procedural rationality as behaviour that is 'the outcome of appropriate deliberation' (p.69), is liable to mislead because there is no indication of the third-person perspective associated with optimising behaviour. Yet, procedural rationality does involve a third-person perspective and its ontology is identical to that of orthodox economics. Knowledge is 'grounded' and refers to things out there. The scheme of things out there is complete, although the individual's knowledge of what is out there may not be complete. Simon's statement (1987, p.27) about the context in which procedural rationality is relevant identifies the epistemology as the third-person perspective.

If... we accept the proposition that both the knowledge and the computational power of the decision maker are severely limited, then we must distinguish between the real world and the actor's perception of it and reasoning about it. That is to say, we must construct a theory (and test it empirically) of the processes of decision. Our theory must include not only the reasoning processes but also the processes that generate the actor's subjective representation of the decision problem....⁶

The various 'problems' that are used to illustrate procedural rationality all fulfil the ontological requirements of a third-person perspective. Examples cover 'computational efficiency' (Simon (1979, p.69)) related to cognitive processes associated with solving 'problems' such as playing chess, solving puzzles, and betting in games of chance. The nature of these problems is that they lend themselves to determining a solution, in terms of a procedure or course of action, that is demonstrably superior to others.⁷ One of their features is a definite

⁶ Here again is the epistemological dualism that characterises the behavioural approach to location that has the same conceptual foundation as the behavioural theory of decision-making.

⁷ It is small wonder that, according to Zeckhauser (1987, p.255), individuals 'do better' - in terms of making decisions which corroborate the rationality postulate - 'on recurring, everyday choices than on major decisions, such as the selection of a spouse, occupation, or retirement plan'. If it is to have any relevance to decision-making then the domain of the behavioural theory of decision-making, as exemplified by the examples cited, is 'recurring, everyday choices'.

outcome, or outcomes. A puzzle is solved or it is not, a chess game is won, lost, drawn, or abandoned.⁸ The 'states of nature' and the choices that can be made are finite in a game of chess, and at any one time are constrained by clearly defined and agreed rules.

Although they would deny that business decisions are any different - hence the argument that understanding how people play chess provides insights into business decisions (see Simon (1979, p.83)) - the fact is that the problems that behavioural theorists choose to study are deliberately chosen, or defined, to fit their methodology.⁹ This is well illustrated in the application of probability theory to these problems, in order to deal with situations where the decision-maker 'faces uncertainty'.

In recent years especially, the behavioural theory of decision-making has focused a good deal of attention on decision-making under uncertainty (see Kahneman, *et al.* (1982) and Hogarth (1987, Ch.5)). In behavioural theory uncertainty is not, as in ordinary language, a general 'state of mind', but is a feature of the world. Uncertainty exists out there and means that specific things - individual instances or cases - are not clear. There *will be* a particular profit or a particular revenue but *what* it will be is unclear. Thus, Kahneman and Tversky (1982, p.507) state that '[a]t all levels of biological complexity there is uncertainty about the *significance of signs or stimuli* and about the possible consequences of actions' (emphasis added).

⁸ The same arguments apply to the tests used to examine decision-makers' 'judgements' and their responses to uncertainty. See the contributions in Kahneman, *et al.* (1982), especially Bar-Hillel (1982), Kahneman and Tversky (1982), and Tversky and Kahneman (1982b).

⁹ There are circumstances, such as tests of skill or strength, where the parameters on which performance will be judged are so carefully laid down that decisions which have to be made, to all intents and purposes, are made against the background of a complete system. So it is possible to say whether the individual's performance fell short of some optimum, either in terms of what he achieved or how he got there. The position of a business manager - the way he understands - is not analogous to someone judging a gymnastics contest.

Probability theory is seized upon with enthusiasm to show how decision-makers cope with 'uncertainty'. The point to be emphasised is that *it is perfectly legitimate* to use probability theory to solve the puzzles, games, and riddles which comprise the problems of 'decision-making'. In these 'complete worlds', where all possible outcomes can be established, the problems are amenable to the application of statistical probability, but they are not problems characterised by uncertainty and they are not typical business problems. Investment decisions certainly do not fulfil these criteria.

The failure to comprehend that in this scheme there is no uncertainty, only risk - as we distinguished them in Chapter 3 - is a source of confusion, as illustrated by Zeckhauser (1987, p.257). Having actually introduced the distinction between risk and uncertainty, he has no option but to conflate uncertainty with ignorance. His dilemma is that, by his own definition, uncertainty refers to situations where probabilities are unknown. Yet behavioural decision theory permits decision-makers to determine the probability of anything and everything happening, so uncertainty must refer to situations where people are simply *ignorant* and have not taken into account, or have not calculated, the probability of the event. Certain 'states of the world', as they exist out there, have not been considered. In support of this reasoning, Zeckhauser (p.258) provides a marvellous illustration of the third-person perspective: 'even if one thinks for a very long time, one can only identify states of the world that capture, say, 90% of the *possible outcomes*' (emphasis added).

There is an important epistemological distinction between ignorance and uncertainty; between what is not known to some, and what *cannot* be known by anyone. Ignorance means to be unaware or uninformed, and refers to situations where some individuals know, while others do not. In most cases, with time and effort, ignorance can be overcome. Uncertainty, which pertains to plans, applies at a particular moment in the *durée* when we are thinking about doing something and need to commit ourselves. The significance of being uncertain is that at that moment, when we want to do so, we cannot find out what is going to happen.

And, later, when we can find out, the opportunity has passed; it is too late. Uncertainty can neither be removed, nor overcome.

To illustrate the distinction between ignorance and uncertainty, let us suppose that most people in my office do not know how to set the timing on a car but could probably learn to do so fairly quickly; they are ignorant on this matter. One of my colleagues is not mechanically minded and we are uncertain about whether he could acquire the skills. Until he actually undergoes instruction, and demonstrates aptitude, we are all *uncertain* about his ability. The uncertainty represents a state of 'unknowledge', which no one can change (or 'remove') before this person is put to the test. Even then the test may prove to be inconclusive, so that the uncertainty remains.

argue that uncertainty, which is in the nature of all business decisions, can be expressed as so many *degrees* of probability associated with each of a number of outcomes is, in our view, doubly misleading. As Shackle points out, the argument presumes that there is a specific, finite number of outcomes (implying a closed system), which has been determined in advance; but to know of the possible outcomes is to have knowledge of the system as a whole. In addition, the idea of degrees of probability implies at least that the decision belongs to a class of similar identical events, that the decision-maker recognises this decision as belonging to a class, and knows, or can estimate, the frequencies of the outcomes of the events in the class. Again, all this presumes the existence of a complete world, and that business decisions always have a counterpart somewhere else or at some other time. Yet no one has explained whether, or how, decision-makers recognise the class of events in order to establish the probabilities.¹⁰

¹⁰ Notice how Hogarth (1987) glosses over these issues. Having argued that 'formal, statistical models should be used for prediction where possible' (p.57), he notes two objections to this suggestion: quantitative data and 'sufficient numbers of past instances'. The first difficulty can be overcome by using qualitative information, 'scaled and represented in numerical form'. The matter of 'past instances' is almost passed over. Hogarth says that 'to build statistical models... one needs adequate data sources. However, even when data sources are not rich, some means of statistical combination of data... often leads to better predictions.'

Although behavioural theorists recognise that 'the laws of probability theory do not apply to all variants of uncertainty with equal force' (Kahneman and Tversky (1982, p.519)), their attempts to broaden or to change the meaning of the term are hampered by the epistemology of the scheme.

An individual is either uncertain or he is not, because he knows what will happen. He is not more, or less, uncertain. In the course of time, he can *know* about things, about which, formerly, he was uncertain. This an essential aspect of the conception of the individual as being-in-time, understanding in the hermeneutic circle, associated with a first-person perspective.

The treatment of expectations in these orthodox approaches to decision-making is equally unsatisfactory and is a corollary of the notion of 'uncertainty' associated with a third-person epistemology. Expectations are understood as detailed pictures that individuals have about specific events or phenomena that already exist, or will exist, in the world out there. Expectations, as mental images, are the counterparts of the probabilities that people hold about events. Since probabilities refer to specific things happening, so expectations are representations of the things to which the probabilities refer. Consider the following statement about decision-making (Hogarth (1987, p.101)).

[I]n many if not most - realistic situations, people are ambiguous concerning the probabilities of events than can affect outcomes....

In the Einhorn-Hogarth ambiguity model, people are assumed to assess ambiguous probabilities by first anchoring on some value of the probability and then adjusting this figure by mentally simulating or imagining other values the probability could take. The net effect of this simulation process is then aggregated with the anchor to reach an estimate.

This view of expectations, notably in the notion of assessing 'ambiguous probabilities' (which is an oxymoron), provides a good illustration of how plans are depicted from a third-person perspective. In behavioural theory and business management theory, the tendency is to treat plans - things which direct the firm's future activities - as models or blueprints, exact descriptions of what people should

do. In the context of our discussion of methodology, the reasons for this conception are easily appreciated.

C. The received view: plans as blueprints

The following extracts from Le Breton and Henning (1961, p.5) are intended to guide planning in, and the management of, business enterprises.

The attainment of a given goal will be best achieved by first devising a precise plan of action. This will begin with a clear statement of the objectives of the plan. When an enterprise-wide plan is formulated, the objective of the plan may be a near duplicate of the objective established for the enterprise....

The finished plan will contain a recommended course of action and a statement of required resources. Depending on how detailed a plan the marketing manager might wish, this plan could contain reference to hundreds of items.

...Two additional facts should be emphasised. Within each major plan, reference is usually made... to the functions organizing, staffing and controlling....

The second significant fact is that as a plan is prepared, it will often require the creation of new policies or the redefinition of existing policies.

These extracts establish the view of the organisation as a complete system, and the plan encapsulates that system in its entirety. The different approaches to business decision-making share this conception of both the organisation and plans. The plan also constitutes the basis on which the system is optimised. As the plan is formulated so the system must adjust, adding here, removing there, until it fits together 'properly' and matches the plan of which the organisation is a replica.

Lachmann has argued that plans should form the nucleus of subjectivist economic theory, the task of which is to 'make the world... intelligible in terms of human action and the pursuit of plans' (see 1977f, p.261; also 1977g, p.47). '[P]lans and the meaning the planners attach to them are things that matter and must be included in every attempted explanation of [economic] processes' (Lachmann (1970, p.7)). Focusing on individuals' plans provides 'a new starting point, based

on the method of interpretation, for a theory of action... inspired by the Weberian notion that action derives its meaning from the mind of the actor' (p.9).

How are plans conceived? Plans are 'a mental picture of the situation in which [the individual] will have to act' (Lachmann (1977h, p.75)). In the following quotation (1986, p.4), the idea that market activity represents interaction between plans can easily mislead one into regarding plans - 'comprehensive means-ends frameworks' - as *things* that exist, concrete in substance and with definite form.

At any moment the actor's mind takes its orientation from (but does not permit its acts to be dictated by) surrounding facts as seen from its own perspective, and in the light of this assessment decides on action, making and carrying out plans marked by the distinction between means and ends. This perspective applies to the future as imagined, as well as to the past as known. Interaction as reflected in market events is always interaction between individual plans. Each stage of a market process reflects a mode of such interaction.

...[W]hat men adjust their plans to are not observable events as such but their own interpretations of them and their changing expectations about them.

From an epistemological point of view, this conception of planning resembles the treatment of decision-making in behavioural theory.¹¹ The statement that market events are the interaction between plans can be misconstrued, with plans being viewed as a perhaps less permanent form of Paretian indifference curves. Thus, 'economic agents meet in markets, each with his own plan that constitutes a coordinated means-ends scheme, and find that these plans are not consistent with each other' (Lachmann (1986, p.56)).

One of the difficulties in overcoming the misconception of planning as a process of formulating models of the world is that the term 'plan' has different meanings

¹¹

The difference between the approaches is a matter of interpretation. Lachmann's position appears to be that what the individual sees out there *is* the world out there, while the behavioural approach draws a distinction between the circumscribed or limited 'view' of the individual and the complete world 'known' to the theorist. Neither of the approaches, however, is consonant with the idea of the individual constituting his world.

as illustrated by the following dictionary definition (*The American Heritage Dictionary*, 1987).

plan *n.* 1. A detailed scheme, program, or method worked out beforehand for the accomplishment of an object: *a plan of attack*. 2. A proposed or tentative project or goal: *Do you have any plans for the evening?* 4. A drawing or diagram made to scale showing the structure or arrangement of something.

There is a great difference between a plan of action and an architect's drawing, but in the epistemology of the third-person perspective the different meanings are conflated; all plans are things in the world, that mirror precisely other things in the world. Plans are about things that are yet to happen, but both the plans and the things they describe are as real as anything else out there. Because events are determinate, we can tell what is going to happen or can estimate the probability of events. Knowledge has its counterpart in pieces of the world, so plans represent pictures of the world as it will materialise in the 'future'. In the same way that knowledge is either complete or incomplete, so plans are either more, or less, accurate; or good or bad representations of reality. And, as knowledge changes, bits can be removed from plans and new bits added.

The idea of *the* plan, as a single, comprehensive, unequivocal description of things to be done, continues to dominate thinking as a product of a scheme that is negligent towards interpretation or understanding.

We hope to substantiate that in the case of investment decisions, but possibly also in respect of other decisions, the business decision-maker typically does not have at his disposal a list of options from which to choose ('substantive rationality'), nor does he have a programme for getting to his goal in the best possible way ('procedural rationality'). Both are figments of the third-person imagination and would only be of value if the individual's understanding corresponded with that epistemology and ontology, and if the goals and the means of getting there existed as parts of a fully self-contained set of objectives and programmes.

Leaving the troublesome epistemology of the third-person perspective behind, the present object is to investigate the nature of plans and decision-making from a first-person perspective. This means asking questions about how plans are constituted, questions that deal with how individuals understand and what they know when formulating their plans.

III. PLANNING: THE HERMENEUTIC CIRCLE AND *DUHÉE*

What does it mean to say that 'the attainment of a *given* goal will be best achieved by... devising a *precise* plan...'? (Le Breton and Henning (1961, p.5, emphasis added)). What is a given goal? To whom and how are goals given? What is 'precise'? If the term means either 'detailed' or 'accurate', then what detail and how is the accuracy to be determined? What level of accuracy is required for a plan to be 'accurate'?

These questions serve to illuminate the difference between plans as part of knowledge that is grounded in the brute facts of reality and is held with apodeictic certainty, on the one hand, and plans as understanding and as part of the process of constituting, or giving meaning, on the other. Understanding involves interests and experience, one's *attitude* to others and to the matter at hand; it is subjective and cannot be divorced from the individual as being-in-time. The statement that goals are 'given' suggests that they can be established and can exist independently of meaning and understanding, as concrete facts that are independent of what people know, think, or believe.

A. Plans are thoughts

Reflecting on the nature of plans, we recognise that they start as *thoughts* and sometimes, indeed most of the time, go no further than this. Planning means thinking about objectives - what we would like to do, are required to do, or are instructed to do. It also involves thinking about how to do what we want to do. Planning is not a discrete process in the sense that now an idea develops, next it

is translated into a plan of action, then at a specific time which is determined in the plan, it has an outcome. Schütz (1972, p.45) refers to Bergson's notion of the *durée* as 'a continuous coming-to-be and passing-away of heterogeneous qualities'. Later (p.51), he says that 'the "Now" is a phase rather than a point, and... the different phases melt into one another....'

Both these phrases have a somewhat metaphysical ring to them, but capture the idea of an evolving and changing understanding (*Verstehen*); of being conscious of different things, or of thoughts having a different focus. It is the shifting focus that marks the passing of time. The changes are not identified in the *durée* as such, but only, as Schütz (p.19) describes it, by self-reflectively 'isolating [action]... from the flux of experience and consider[ing it]... attentively'.

This procedure of considering our plans self-reflectively also reveals the passage of time in the *durée* as an ever-evolving awareness or consciousness that is associated not so much with sudden realisation, or with new ideas continuously brimming up, as with a 'firming up' or 'crystallising' of ideas; of becoming aware that this is, or is not, the thing to do. Also possibilities or options are turned over, not necessarily as clear-cut alternatives but as rather vague ideas about what to, and why something is worthwhile. Gradually a plan emerges, never as a fully-fledged 'structure for action', but as ideas about what to do and how to do it. Ideas never really solidify; they do not amount to a coherent entity which contains detailed interconnections. Instead, different concerns are given attention. So nothing now is of interest, then attention is turned to something else as perspectives unfold.

This is the nature of understanding and of constituting meaning in the hermeneutic circle. The process is characterised by a 'dialogue'; 'testing' prejudices in the light of what happens, and also through discourse with associates and colleagues. The interests of others have to be considered by the planner. Interaction plants the seeds of ideas, and views are shaped and reshaped.

Whether it is getting up for work, going to work, setting up a meeting, ordering parts, or taking a lunch break - other people are involved in our activities. They may be more or less directly involved, in that their requirements, interests, habits, and attitudes are more or less clearly in mind as we go from one activity to another.

The social nature of activities is one reason why, at times, it is desirable to formulate formal plans. Formal plans are drawn up by people who meet and later meet again to discuss the progress of their plans. The more that hinges on the outcome of the plan, the more complex the tasks - in terms of the number of people involved, the number and nature of activities (whether routine or out of the ordinary), and the more costly the operation - the more likely it is that the activities will be designated in a formal plan. But formal plans are never complete. People write down procedures to be adopted, so the plan reflects the ideas, at the time, of those who devise it. It is misleading, however, to characterise a plan as something with an objective and serviceable form which various people can administer to produce effective actions. A plan is more than the notes, memos, and reports that are the written 'evidence' of meetings, discussions, and deliberations. In use, the plan is ideas and thoughts about procedures that should be followed and things that need to be done. Decisions are taken on the basis of these ideas. What matters, in understanding decisions and also what people do, is the *meaning* that they ascribe to the plans.

How the meaning is constituted depends on people's interests which need not be consistent. Documents are interpreted in the light of many different factors. Even after the 'go-ahead' has been given because someone thinks that this is a worthwhile venture, any plan will be reshaped in the interests of various managers. Plans actually evolve, perhaps long after the basic procedures are established, not *growing* but *changing*.

It is very difficult to say that a plan began here or ended there, as there are no clear-cut beginnings or well-defined endings in the *durée*. New projects emerge

from what people are already doing. The company might have been successful and grown rapidly or its sales might have dwindled necessitating remedial action. Whether actions appear to be feasible, attractive, or impractical depends on the decision-maker's interests, his appraisal of the firm's circumstances, and his assessment of its prospects.

This description is supported by the findings of Williams and Scott (1965) concerning the nature of investment decisions. Their findings relate to research that they undertook in order to 'examine... particular decisions in the... general context of the firm's policies and procedures' (p.11), but they were not easily able to find suitable projects to study because '[m]any projects were so closely related to previous and subsequent investments that it would have been impossible to study them in isolation'.

B. Plans, decisions, and actions

A threefold classification of plans, decisions, and actions is a feature of a third-person perspective where plans and decisions are a response to some 'pressure'. A problem arises out there and the individual has to respond to it, so he makes a decision, following a logical 'path' if he is 'procedurally rational', and then does something.

The classification may be useful from the point of view of conceptualising what 'decision-making' is about. It is unhelpful when the object is to explore how the individual constitutes his world. Treating the classification as a rigid sequence that *exists* in people's minds - with the implication that they are conscious of doing something called planning, then of deciding, and finally of acting - is misleading.

Planning and deciding are two different types of activities, as Le Breton and Henning correctly hold (1961, p.7). They see decisions as resolving 'conflicting alternative choices'. Making a decision involves reaching a conclusion, settling something, or making up one's mind. A plan, in the view of these authors, has

three characteristics: the future, action, and the idea that the course of action will be taken by the planner or by someone designated by him. They also point out that decisions are taken throughout a planning process and are 'inextricably interrelated to planning'. There is no conscious distinction between the two.

Schütz (1972) provides valuable insights into the nature of decision-making and his analysis is a landmark in the development of a subjectivist paradigm. Yet his conception of plans is also apt to mislead because it implies that these are formulated as definite and coherent images, 'pictures' of a future state of affairs, as the following passage reveals.

'[T]he analysis of action shows that it is always carried out in accordance with a plan more or less implicitly preconceived' (p.59). It is a characteristic of conscious action that (p.63)

before we carry it out, we have a picture in our mind of what we are going to do. This is the "projected act." Then, as we do proceed to action we are either continuously holding the picture before our inner eye (retention), or we are from time to time recalling it to mind (reproduction). This "map-consulting" is what we are referring to when we call the action conscious.

Schütz explains (p.63) that 'actions are conscious if we have previously mapped them out "in the future perfect tense"' and his exposition suggests that projection amounts to mentally rehearsing (our term) the action. While not denying the idea of 'projection' - it is the sort of notion associated with thinking about the 'quality' of an investment that we are about to undertake - we want to avoid the impression that the project amounts to a complete mental picture, or a blueprint, of the 'completed action'. Such implications are at odds with the spirit of Schütz's phenomenology and are in conflict with modern hermeneutics. At times, however, there is no conflict at all (see Schütz on the 'Act of attention', p.6E).

C. Much activity is routine

Again, reflecting on our activities we recognise that most plans we make are of the type associated with the following statement: 'I plan to be at the office by eight-

thirty and to see my first appointment at nine'. Getting to the office is simply a matter of routine. Much of the time, if plans are made at all, we are hardly conscious this. A considerable part of daily life consists of routine activities that are more or less habitual.¹² The 'projected act' does not presume that activities - mine and other people's associated with my getting to the office - are mapped out; that the individual is conscious of checking the clock, picking up and putting on his hat, walking through the front door, going down the path to the car, opening the gates, and so on. Nor does the notion of projection presume that he thinks about what other people will be doing that may delay, or facilitate, his departure. Planning to be at the office by eight-thirty means little more than making a mental note to leave in time to get there by eight-thirty.

Busy with our activities, immersed in the *durée*, thoughts evolve, we have ideas and problems are identified. Planning is part of this process of 'being conscious' and plans may evolve slowly or, as suggested, the need to do something is merely noted, or perhaps we are struck by a thought about a way of overcoming a snag that has arisen. The line between planning and deciding is difficult to draw and is certainly not at the forefront of consciousness in our daily activities. Planning, generally, is without a time dimension. The activities in which the individual engages merely continue. It is only by 'stepping out' of the *durée*, through the act of self-reflection, of turning consciousness in on itself, that there is a sense of having 'planned' or of having decided.

¹² Because it is central to interpretative sociology, Max Weber (1964) begins *Wirtschaft und Gesellschaft* ([1922] (1964)) with a definition of action, which emphasises that action, as distinct from other forms of behaviour, consists of those activities to which 'the acting individual attaches a subjective meaning...' (p.88). In expanding upon this definition, Weber explains action in terms of the concepts 'ends' and 'means'. With good reason, Schütz (1972, p.19) criticises Weber's distinction between action and behaviour, pointing out that '[e]ven... traditional [habitual]... behaviour has some kind of meaning.' This is the argument that is relevant to the points made here. Much of the individual's daily activity (routine) is habitual, to the extent that it does not involve the process of 'projection' which Schütz associates with planning, but this does not make it any less 'meaningful' in the Weberian sense. I can go into the kitchen and do all sorts of things associated with preparing a meal, and may even cook the entire meal, without being conscious of planning anything, but my activities are still purposeful and directed at the attainment of some end.

Of course, we do not *observe* other people planning, deciding, and acting. We *understand* what they are doing in the context in which we encounter them. The context, too, is shaped by our relationships with others - as friends, or colleagues, or family. Unless they tell us that they have decided to do something, or are working on a plan for some purpose, or we are sitting down together to draw up a plan, the fact they may be planning or deciding is unknown and is mostly irrelevant.

What matters is our interaction in the *durée*. Either we are doing things together - such as having a game of golf, taking a tea break, resolving a crisis, planning a luncheon - or my activities are directed towards meeting your demands, taking cognisance of your request, and so on. This 'social existence', the intersubjectively constituted life world, continuously influences our activities. While it is important to convey the extent to which the conventional notion of decision-making in economics is misleading, the real interest as far as the thesis is concerned is in the implications of the social relationships associated with plans or decisions.

IV. SOCIAL RELATIONSHIPS AND PLANNING

Planning, whether it is done by one or many people, is a social activity, and plans are constituted intersubjectively. There are the people for whom a plan is intended, those who will use it, and also those who, one way or another, are going to be involved in the planned activities. They may be consulted or instructed about what they will do.

The planner and decision-maker rely on advice, assistance, and information. Sometimes it is consciously sought but it may be acquired serendipitously. What goes under the heading of 'the provision of information' is to a large degree

institutionalised, in that the planner has both formal and informal contacts.¹³ These may range from business associates to family members to fellow golfers. Institutions such as estate agencies, banks, or computerised online databases provide specific information and, sometimes, specialists are called upon to undertake 'feasibility studies'.

Economists have neglected social relationships,¹⁴ but the question of the decision-maker's associations, the nature of these relationships, and how they influence him, are important in understanding the process of planning and decision-making. They serve to illuminate factors that bear upon decisions, and they are the sorts of issues that we must address. What is needed, first, is a means of conceptualising social relations, a framework in terms of which the decision-maker's relationships with others can be examined. Then it is necessary to establish which relationships are important to the investment planner. In his 'social world', which associations have a bearing on his decisions and why?

¹³ Industrial geographers have pointed to these issues, as illustrated by the model of the structure of location decision-making proposed by North (1974) and in the analysis of Townroe (1971, Ch.5). The sources of information depicted in North's model include estate agents, local newspapers, industrialists, personal contacts (see Figures 8.3 and 8.4, pp.232 and 233). While these authors identify various sources of information on which location decisions may be based, McNee (1974) is one of the few contributors in the field of industrial geography who alludes to the importance of social relationships. His article begins with the statement 'decisions and choices are always in the context of society' (p.47), but the analysis does not live up to this introduction. In sketching the history of the hypothetical Gismo company, McNee glosses over social relations which might shape the changes taking place.

¹⁴ Thus, when speaking of the 'complementarity' of investment plans, Lachmann (1978a, p.3) makes no reference to relationships among people that complementarity implies. He states that,

the heterogeneous capital resources do not lend themselves to combination in any arbitrary fashion. For any given number of them only certain modes of complementarity are technically possible, and only a few of these are economically significant.

Although he views the capital structure as being endlessly variable as people's plans change and capital has to be redeployed, he treats the capital stock as a complete, interlocking, but changing system, a conception that masks the importance of relationships between people.

A. Schütz on social relationships

In order to conceptualise the social interaction associated with business decisions, the categories provided by Schütz (1972) are fruitful. His analysis of social relationships is well suited to the requirements of the thesis, as his object is to examine social interaction from the point of view of *how people constitute social relationships; i.e.* how they understand these relationships.¹⁵

Discussing the individual's awareness of other people, Schütz states that

I not only consciously experience you, but I live with you and grow old with you. I can attend to your stream of consciousness, just as I can attend to my own, and I can, therefore, become aware of what is going on in your mind.... You and your subjective experiences are not only "accessible" to me... but are taken for granted by me... (p.140).

He adds that there is a 'complicated substructure' in our interpretation of other individuals of which, for most of the time, we are unconscious; but the 'deeper layers' are brought to light as soon as we contemplate others' motives or directly question them about their intentions or aspirations.

¹⁵ It is important to clear up a possible misconception about the concept of the social world, a notion which Schütz himself wishes to avoid. Elsewhere in the thesis, with reference to the third-person perspective, the term 'world' is used to refer to a conception of the scheme of things as complete and self-contained. The term 'social world' simply conforms with Schütz's usage. The latter argues that 'world' means only 'that different people are consociates, contemporaries, predecessors, or successors to one another...' (1972, p.143). He is careful to stress that the term is not to be interpreted to mean 'given and complete' - the meaning that we have associated with the third-person perspective. Schütz argues (p.142, emphasis added) that

the world of my actual perception is only a fragment of the whole world of my experience, and this... is but a fragment of the world of my possible experience, so likewise the social world (itself a portion of this "whole world") is only *directly experienced by me in fragments as I live from moment to moment*. This directly experienced social world is again, on its side, segmented according to conceptual perspectives. Beyond this domain of directly experienced social reality to which I am anchored by spatiotemporal community, there are still other realms.

Even in the shared 'Here and Now', the '*domain (or realm) of directly experienced social reality*' (p.142, italics in original), we have different relationships with our contemporaries who share this '*Mitwelt*'. There is a group of people with whom each of us is most intimate, which we might think of as an inner-circle of associates, and which may include family and friends and work associates. Others, consociates, are part of our *Mitwelt* but are hardly known to us at all. We may have little understanding of their interests and habits and little insight into their motives and, indeed, may have no need to understand them.

Schütz also distinguishes between the individual's '*Umwelt*' and his '*Mitwelt*'. The former is the 'world of directly experienced social reality' (p.30), the latter consists of contemporaries who surround my world; who live in the world '*with*' me but who do not live '*through*' it as a matter of direct experience' (p.142). These people are referred to simply as 'contemporaries' ('*Nebemmenschen*'). They are people whom I do not have occasion to meet, or with whom I do not come into contact, although at some or other time I may do so.

[L]iving with my fellow men, I directly experience them and their subjective experiences. But of my contemporaries we will say that, while living among them, I do not directly and immediately grasp their subjective experiences but instead infer, on the basis of indirect evidence, the typical subjective experiences they must be having. Inferences of this kind, of course, can be well founded. (pp.142-143).

Schütz identifies a '*Vorwelt*', a world of predecessors which is separate from old, or past, relationships with people who were, or still are, contemporaries (p.207). A predecessor is someone 'in the past not one whose experiences overlap in time with one of mine' (p.208). The significance of the *Vorwelt* is that, in interpreting the activities of predecessors, 'there is no open horizon towards the future... there is nothing as yet undecided, uncertain, or awaiting fulfilment'. Finally, there is also a social world of successors ('*Folgewelt*').

As Schütz points out, there is a fundamental epistemological distinction between the individual's insight into the circumstances of the *Umwelt* on the one hand and the *Mitwelt*, *Vorwelt*, or *Folgewelt* on the other. Knowledge of the former, based

on experience, is our interpretation of lived-through events. Using terms coined by Max Weber, Schütz refers to this as '*observational*' understanding, while our ability to understand and to explain the actions of our contemporaries, or for that matter our predecessors or successors, is based on '*motivational*' understanding (1972, p.30).

In examining investment and location plans, motivational understanding, which is 'not tied to the world of directly experienced social reality' (p.30), is important. The theorist is interested in the lived experiences of the actor, and in how the decision-maker's lived experiences bear upon the things that he does. This motivational understanding Schütz calls '*genuine understanding of the other person*' (p.111). It is this understanding how the individual understands that is at the heart of modern hermeneutics.

Our object is to examine the planner's *Umwelt*. This involves identifying the social relationships that are important to him in his role as manager and establishing why, and how, particular relationships are important.

In analysing the social relationships of managers, it is desirable to divide decision-makers into two broad groups on the basis that the daily lives - the social business worlds - of managers who work in large and typically bureaucratic firms are generally very different from those of the managers of small firms. The experiences, activities, and relationships of the two categories of decision-makers are so diverse that to treat them alike would be to obscure factors which are important in understanding their conduct.¹⁶

¹⁶

The need to divide firms into large and small companies in part depends on whose activities are of interest and on what these people do. If the focus was on workers on the factory floor or lower-rung administrative staff, whose work activities are fairly routine - including their business dealings with people outside the firm itself - and whose authority is limited, the distinction would probably be unnecessary.

B. Firm 'size' and decision-making¹⁷

The social circumstances of managers, as planners or decision-makers, in large and small firms are completely different. This is one amongst a number of factors which justifies drawing a distinction between the two types of firms in analysing decision-making. The categories 'large' and 'small' do not refer to conventional measures of size (*e.g.*, employment or turnover), to whether managers operate in a hierarchical, bureaucratic environment (see Torrington and Weightman (1985, p.32-34) associated with bigger industrial undertakings, or whether they experience the autonomy and flexibility of managing a smaller concern. The defining characteristic of the smaller organisation (also noted by Torrington and Weightman (1985, pp.31-32)) is that, in contrast to its bureaucratic counterpart, it has an 'entrepreneurial culture'.¹⁸

It is not the size of the firm *per se* that is of interest, but the relationships between people in the firm, and between them and other individuals with whom they associate. To the extent that there is a rough and ready link between the structure and the 'culture' of the firm on the one hand, and its size on the other, and that the

¹⁷ It was only when the ideas for this chapter were already quite far advanced and the need to distinguish between small and large firms had been recognised that I 'rediscovered' Penrose's (1959) excellent contribution on the theory of the firm. It is difficult to say how much influence this work had on the ideas in the thesis, having originally read it more than a decade ago. For different reasons - her interest is in the growth of the firm - Penrose does distinguish between small and large enterprises along similar lines to those in the thesis and the insights that she provides are invaluable. Penrose is well aware that her contribution is not part of the orthodox theory of the firm, although she does not recognise quite what differentiates it from 'standard' neoclassical theory. The important consideration is that Penrose's is not an *equilibrium* analysis. Not being constrained by the epistemology of a determinate scheme, she is able to ask questions which illuminate the circumstances of managers and the factors that bear upon their decisions. The result is a more satisfying explanation of firm's activities than neoclassical theory is able to provide.

¹⁸ 'Entrepreneurial' should not be understood to mean that the management of *all* small firms is innovative and willing to take risks.

structure affects social relations, size is a means of categorising firms so as to highlight the social relationships that are of real interest.¹⁹

In this context it is not easy to define a 'small' or a 'large' firm in practice. We cannot say on the basis of the number of employees or asset value that this firm clearly belongs in one or other category. In order to classify firms, or more particularly the individuals who work in them, it is necessary to understand the social structures in different organisations.

Williams and Scott (1965) describe investment decisions by large companies (see especially pp.21-23). Their position is that where, and with whom, the idea originates determines who becomes involved in assessing an investment proposal. Certainly individuals at the highest levels within the company will become involved, sometimes to ensure that the idea has adequate patronage before the proposal is formalised. Wright (1964) does not add much to the picture, other than to say (p.36) that 'we are dealing with an individual who is occupying a position at the upper management level'. Without some knowledge of the management structures of organisations and the recognition that there are both formal and informal channels of authority, communication, and decision-making, it will be difficult to determine who these people are and what positions they hold. At the stage of approving or endorsing the commitment of resources to a particular project, they will certainly be senior managers.

Identifying the planners and decision-makers in small companies may prove easier because there are few senior managers and the whole activity may rest upon the shoulders of one person - the owner or chief executive. In larger companies, however, planning may be carried out in different departments and between the head office and a divisions of the company.

¹⁹

Chandler's (1962) seminal contribution on corporate strategy postulates and investigates relationships between the way in which large firms are structured and managed, and the strategies of these firms. Later contributions have pursued the same theme, also examining the structure and 'culture' of organisations in terms of whether particular combinations of structure and culture are conducive to better performance by large enterprises.

The distinction between managers of small and large firms may be a useful one for many purposes, but it carries with it the *caveat* that the idea of a 'typical' individual in typical circumstances is problematical, and that the 'ideal type' is a concept that has to be handled carefully. The issue is that the concept should serve to illuminate those aspects of individuals' conduct that we wish to examine.²⁰ The particular classification should not conceal that there may be important differences amongst individuals within each group, which it is necessary to identify and to emphasize in order to explain decisions, including those decisions which affect the location of enterprises.

If our contention is that the constitution of a large firm, as opposed to a small one, influences the *nature* of associations between people as well as the *types of people* involved, we should identify the contributing factors and show their significance for the outlook of planners in the two types of organisations. To do this, we examine the position of the manager in a large organisation and then that of his counterpart in a small firm.

V. THE MANAGER OF A LARGE ENTERPRISE

A. A formally-structured work environment

In the large organisation, the senior manager is conscious of his formally structured work environment. He is part of a 'team' (see Penrose (1959, pp.45-49)) and is required to participate in meetings and planning groups. Indeed, a considerable

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Freund (1968, pp.59-70) provides a useful definition and explanation of Weber's concept of the ideal type, including some of the pitfalls involved in its application. Lachmann (1970, pp.26-30), examines the concept, considers its application as a 'fundamental concept' for explaining economic phenomena, and rejects its use in this context. His argument is that 'Weber's ideal type lacks any specific reference to human action and seems to be as readily applicable to the animal kingdom or to the plant world as to the human sphere' (p.29). His proposal is to 'start from something at once simpler and more comprehensive.... *the plan*' (p.29). The arguments set out here suggest, however, that in attempting to understand plans (and decisions) from a first-person perspective, the ideal types of small and large firms provide a useful starting point. At the same time, these types are framed from the point of view of how they bear upon the circumstances of individuals, and are tied directly to understanding those circumstances, so they refer specifically to 'human action'.

part of day-to-day activities are spent fulfilling this function, in association with colleagues who represent the rest of the team. As a 'team player', his independence and the scope for pursuing personal goals is limited. His superiors and other colleagues expect that the decisions that he takes will fit in with the organisation's goals and requirements, and he knows that this is expected of him.

A corollary of the structured environment is that planning and making important decisions is usually a collaborative effort. In all aspects of his job, including the planning function, the individual typically can, and does, rely on various people, including support staff, to assist him. By virtue of the structure of the organisation and the specialisation of functions within it, our individual's jurisdiction in respect of decision-making is relatively limited, and confined to those matters that fall within his designated area of authority in the organisation.

One of the consequences of being in a niche within a well-established large organisation is a sense of security, and perhaps even complacency, about one's position. There is a popular conception that conditions of employment in large corporate organisations are secure. Torrington and Weightman (1985, p.34) state that the predictability of the institutional setting 'provides a secure environment for the employee and a clear line of safe career progression.' The career prospects of a senior manager within a large enterprise depend almost entirely on review and assessment by his superiors and peers within the firm, based on performance-related criteria, such as profits, sales, or turnover. This encourages 'corporate loyalty'. The senior manager's views regarding the organisation's requirements and goals will be shaped by the attitudes of his superiors (perhaps the managing director or chairman) and others to whom he owes allegiance.

An additional reason for the apparent greater security of individuals within this form of organisation, and perhaps the most important one, is that, compared with the small firms described below, large firms are perceived to be on a sounder financial footing.²¹ The converse of this security is a lack of autonomy characterised by

²¹ The reason why the financial standing of the company is probably the most important factor contributing to the individual's feeling of job security, is because it is poor financial performance more than anything else that leads to 'restructuring' which may be associated (continued...)

having to fit into a particular structure: being assessed on one's role as a 'team player'; being constrained by the structure; and feeling what is described as a 'lack of creativity'. It is frequently asserted that this type of organisation stifles resourcefulness and does not reward ingenuity.

B A strong financial base

The value of assets itself normally secures access to credit but, in addition, the large company probably has many options for meeting financing requirements. Besides the banks, a listed (public) company may make use of the stock exchange, issuing its own shares and debentures. All these factors contribute to the firm's ability to raise money on demand.

Its financial position also derives from its position in the market place. With a diversified product line and a wide distribution network - perhaps including foreign markets - the firm is somewhat insulated against both business cycle fluctuations and changes in local market conditions. Losses or declining sales sustained in one area or product line represent only a percentage of turnover and profits, and can be absorbed by the company's performance elsewhere.

In terms of its relationships with suppliers, the large firm does not necessarily suffer the vicissitudes of a single supplier failing to deliver or going bankrupt. In all probability, because of the volume of business, it has a network of suppliers, with whom it has well-established business relationships, who can be called upon if circumstances require this.

C. Conservatism

These arguments do not mean that the managers of large businesses are insensible to the uncertainties of the 'environment' and the vagaries of the market. What

²¹(...continued)

with a loss of jobs. An employee is more likely to lose his job when the company does badly than as a consequence of how he performs.

they do mean is that the large business organisation has the resources to weather a volatile business environment, or even to withstand temporary set-backs such as the effects of a failed investment, better than the smaller manufacturer.

For various reasons, managers within the large organisation are likely to be conservative in their attitudes towards the 'risks' (used in its colloquial sense) of doing business. Conservatism is reinforced by the consideration that, in most cases, there is little opportunity to give expression to personal motives and only limited opportunity for personal gain from taking risks if the venture is successful. Conservatism is also created by the existing base of fixed assets to be managed, and the well-established business relationships which have to be maintained. These constrain the individual's freedom of action. If the large firm also has a substantial amount of long-term debt, the manager's main responsibility is to maintain *continuity* of the firm's activities and operations and to ensure the continued use of these assets in the future. In his appreciation of these conditions, the manager recognises that he does not have much scope for departing from established practices within the organisation.

In view of a broad financial base, decision-makers are not pressured into seizing opportunities. The penalties associated with having made the wrong decision, especially for senior people, are probably greater than the rewards of success. Managers are secure in their positions and at senior levels will probably receive a substantial remuneration package without having to take risks. The individual manager's autonomy is circumscribed by the emphasis on corporate norms, which is a feature of such organisations. Major decisions probably have to be ratified by a board, and in order to give its approval, people with different outlooks and interests need to be convinced of the acceptability of a project. This in itself suggests a bias towards conservatism and restraint, partly as a result of the need to compromise when there are conflicts of interest and differences in outlook.

The shareholding of a large company will favour financial conservatism. The main shareholders are likely to be other large companies, whose investment advisors will

be content with good but sustained earnings, preferring this to the sort of volatility of earnings that may accompany high-risk ventures.²² Larger companies, especially public (listed) ones, operate in the public domain and are subject to scrutiny by the financial press.

All these arguments support the somewhat paradoxical idea that the large industrial organisation, which is generally financially secure, typically leans towards conservatism in decision-making. People are designated to undertake feasibility studies, and the decision-makers - those who have the final say over whether or not the investment goes ahead - will want a detailed assessment of the 'risks' and uncertainties associated with any proposed investment.²³

D. Implications for planning

If we ask what implications these arguments have for decisions taken in the large organisation, it is conservatism and its consequences which have the most impact on investment and location decisions.

In the large organisation, almost all those involved in the decision-making process will be from within the organisation. Planning is a 'team effort', but since the team consists of insiders, perhaps with diverse interests there may be conflicts of interest

²² Various arguments related to shareholding support the view that public companies, listed on a stock exchange, will adopt investment policies aimed at opportunities with prospects of good, secure returns, rather than ones where not only the return, but also the risk, may be high. Poor earnings associated with a failed investment, even if they do little to influence the long term profitability of the company, can lead to a sudden fall in the share price, and may make the company vulnerable to takeover. Similarly, a failed investment, if it impinges on the company's cash flow and affects its ability to service its debt, may either lead to a reassessment, and downgrading, of the firm's credit rating, or it may necessitate a rights issue, diluting the shareholding.

²³ Williams and Scott (1965) establish that investment decisions are often not made by the people who undertake feasibility studies and who gather information. This means that the planners and decision-makers may well place different interpretations on the information that has been gathered and feasibility studies may be a vehicle for the planners to 'sell' their views to decision-makers.

that have to be resolved in formulating the plans. Because of the size and diversity of the organisation, there is a potential for conflicts of interest whenever there are policy changes, so Nelson and Winter (1982) set considerable store by 'routines' for managing large organisations. They hold that an aim of managers is to maintain, as routines, policies that people accept. The large firm is a coalition of people and the need to sustain routines - to avoid departures from the tried, trusted, and accepted - imparts a further element of conservatism to the culture of the organisation.

[A] contemplated action otherwise sensible both for the organisation and for the member taking it may have to be rejected if it is likely to be interpreted as "provocative".... The result may be that the routines of the organisation as a whole are confined to extremely narrow channels by the dikes of vested interest. Adaptations that appear "obvious" and "easy" to an external observer may be foreclosed because they involve a perceived threat to internal political equilibrium (p.111).

All this suggests that financial or profit considerations will not be a primary motivating factor in investment decisions.²⁴ Rather, the 'internal' implications of strategic investments on a diversified company will preoccupy decision-makers: the effects on divisions, management and power structures, shareholders, and on the perceptions of these people. We can propose that the circumstances of the 'environment', including the traditional economic determinants of investment such as the cost of capital, wage rates, and exchange rate variability, will be less important to the decision-makers.

If risks appear to be high, an investment proposal will simply not be ratified; large firms do not have to grab at chances. Wherever possible, decision-makers will try to adopt courses of action which give them flexibility, so that there is a better chance of rectifying problems that might arise. The substantial financial resources of the large enterprise may even encourage planners, prompted by the conservative environment in which they work, to plan for 'worst cases' or at least to adopt a moderately pessimistic, rather than an optimistic, outlook.

²⁴

By virtue of their financial strength, according to Kay and Thompson (1986), large companies are somewhat isolated from the competitive pressures of the capital market.

'Building in' flexibility to plans is liable to increase the cost of an investment by requiring more - or more expensive - resources, allowing for longer lead-times, or perhaps acquiring more capacity than people expect to utilise. These are costs which a large organisation will be better able to afford. The basis on which it can do so is considered in the next chapter. The location of the firm is one of the factors that may contribute to greater flexibility.

VI. THE MANAGER OF A SMALL FIRM

With the object of understanding the decisions taken by individuals in small firms and the factors that influence them, the aim now is to examine those factors that bear upon the *Mitwelt* the planner in a small business.

In contrast to the picture regarding managers of large firms, two sets of factors will typically set apart the individual and his life within the smaller manufacturing operation. One is the extent to which the individual's *Mitwelt* consists of people outside the organisation for which he works, and for this reason, his associates are less likely to be employees of the same organisation. The other is the relative lack of security of individuals in a small organisation, perhaps especially felt by people in management positions.

A. Reliance on 'outsiders'

Apart from the skills of those directly involved in the manufacturing process, from supervisory positions upwards, there is not a great deal of management expertise in the small firm. This means that each manager is also a good deal less specialised and has less administrative support than his counterpart in the large industrial organisation.

As a consequence, in their business relationships, managers of small organisations place relatively more reliance on people outside the organisation compared with their counterparts in larger organisations. This reliance extends from obtaining

specialised services (functions such as book-keeping, machine maintenance, and catering may be contracted out) to generating 'core' business.

Because senior people in a small organisation carry wide-ranging responsibilities with little opportunity to delegate within the organisation, the reliance on outsiders, and the trust placed in some of these people, may be particularly strong. Out of necessity perhaps, the business relationships of managers of small operations are likely to extend to a wider spectrum of people than the managers of larger enterprises. For the former, too, the distinction between business and social relationships is likely to be less clear-cut.

With a small asset base and a high risk profile, the manager of the small firm will not have access to credit from financial institutions as readily as his large company counterpart. Not only is the cost of credit likely to be lower for the latter, but the large company has a wider range of financing options open to it. The small manufacturer may have to look to unconventional sources of credit, possibly paying higher rates of interest. One possibility is to turn to friends and family to provide him with the capital that he requires.

B. The importance of 'networks'

In a thesis on the subject, Godsell (1990, p.35) defines a 'network' as a business relationship

with more than one strand to it. Not just a straight supply and demand relationship, but something based on friendship or kinship, on religious affiliation or geographic location or simply affinities dating back to childhood.

If such relationships are the basis on which a small firm does business, the definition gives tangible meaning to the concept of '*Mitwelt*'. Godsell also notes that networks can be 'organic' and inherited, because the associates are family or belong to the same ethnic or religious group, or they can be 'functional' because they are 'consciously developed'. The reasons why such networks exist and are forged are entirely understandable. Not only do they assist individuals or groups

who feel marginalised by, or are subjected to discrimination within, a broader community, but they provide skills, capital, and business contacts for small businesses which are struggling (see various contributions in Greenfield, *et al.* (1979)).²⁵

Investigation will probably reveal that the distribution channels of a small business are a social network. The relationship with buyers is not a strictly business-like one. Credit terms are flexible, the customers are people whom the manager meets regularly and with whom he socialises. He may even live among them in the same community. In addition to keeping the business going, this also serves to keep him informed of customers' requirements, which is important when operating in a niche market.

For a small-business manager, the people who form part of his network play a bigger role, and have a relatively greater influence on his decisions. The reasons are twofold. People who are not employees of the company simply play a bigger part in his life. In addition, since the manager of the small business has to spend much of his time keeping the business going, he will rely on word of mouth and the opinions of other people to keep him informed about matters that affect his business. Indeed, it is likely that in many cases the investment opportunities are identified by outsiders, friends, family, or business associates.

C. The more tenuous existence of the small business

The last point brings us to another important aspect of the life of the manager of a small manufacturing firm: his concern with, and efforts towards, ensuring that the business remains liquid and survives. The high 'mortality' rate among small

²⁵

Although the literature on networks tends to focus on their contribution to very small-scale businesses and to informal businesses such as co-operatives, the concept is a useful one when understood as the *Mitwelt* of decision-makers, and the notion is relevant to all businesses. Managers in large industrial undertakings no doubt also make use of networks, though probably to a lesser degree than their counterparts in small firms. At any rate, the existence of networks in both contexts is worth investigating.

business is well documented (see, *inter alia*, Kennedy (1985), Larson and Clute (1979), Meredith (1977), Storey, *et al.*, (1987)) and is hardly surprising. These firms face a variety of problems compared with larger businesses. Ensuring the survival of the small firm is not only a matter of self-esteem; in many cases, the manager's personal assets are tied up in the equity of the business because of limited access to external funds.

The small product range of small manufacturers means that they do not have the ability to offset losses in one market against a satisfactory performance elsewhere. They probably face stiffer competition because entry into the market niches occupied by smaller concerns is relatively easy, there being few barriers to entry such as high start-up costs and technological superiority. They do not possess the capital easily to withstand changing market conditions associated with the business cycle and macroeconomic policy, changes such as a reduction in aggregate spending and rising interest rates.

Because of its tenuous market position, the small business also has difficulty in coping with a deterioration in its relationships either with its suppliers or its customers. Limited inventories, and being one of a number of suppliers to a larger concern, make it difficult to retain business in the face of unexpected problems such as a machine breaking down or a strike by the work force. Small-scale manufacturers that supply large firms may find it difficult to secure long-term contracts, the large firm using this as a lever to ensure that the small supplier accepts the pricing structure which the former demands.

The manager of a small, independent manufacturer thus spends a considerable part of his time coping with problems that arise, worrying about finding new business opportunities, and maintaining existing contracts. The corollary of this aspect of business life is that the decision-maker does not have much occasion to evaluate alternatives nor does he have the luxury of waiting to see whether something better will turn up. He has to seize those opportunities which do arise, seeing himself and his company as being at the mercy of 'the market' and 'economic

forces', with little ability to influence the conditions under which he trades. In order to compete, he has to find opportunities to reduce costs, perhaps by paying lower than average wages, or by eliminating some, or all, of the stages in a distribution chain.²⁶

The picture presented here provides some insight into the position of a manager faced with expanding his production capacity. The firm's present capacity is a consequence of decisions circumscribed by limited finances as well as other factors such as a small niche market. In view of the need to generate business in order to remain solvent, the small firm will have difficulty in controlling its expansion. If it is doing well and capacity limits are reached, the manager of a small firm considering a new investment will again have little cause to deliberate and to choose. Even if, in the circumstances, the management decides to move the entire operation from one place to another, the decision is most likely to be taken in the light of the assessment that 'there are no options available to us'.

The motives of managers of small firms are examined in the next chapter, as are the implications for the firm's location. Taking cognisance of his dependence on 'outsiders' coupled with the need, constantly, to ensure that new business is available, the small businessman exercises little choice regarding the location of his production facilities.

VII. DECISIONS, JUDGEMENT, AND EXPERIENCE

In coming to understand the individual's 'situation', our analysis of the 'context' of business decisions, has stressed both the importance of being-in-time and the social nature of business activity. In this final section of the chapter we ask what the analysis implies with regard to the nature of decision-making.

²⁶

Compared with the large manufacturer, the small firm will often suffer a cost and price disadvantage. Instead of competing head on, the latter develops niche markets but these are narrow and market conditions are easily upset.

The conception of decision-making associated with a third-person perspective is ingrained. Businessmen have a list of well-defined alternatives - of *things* - from which they select the one that will be best for the firm, and the criteria that they use are economic ones. Following Thirlby's views in the opening quotation of this chapter, we have attempted to dispel this misleading view of decision-making.

Making their decisions in the *durée*, investment planners evidently have no recourse to 'facts of the situation' as a basis for their decisions. So what ensures the success of an investment? Ultimately, the people who buy the products. Whether they do so depends on what the business does to produce and to market an 'attractive' product; but it depends on many other things beside. These things cannot be enumerated, defined, or established, today, except in the vaguest of terms which are of no value to a decision-maker. For example, the success of the venture will depend on what the firm and its competitors do, on people's preferences and their attitudes towards environmental issues, on technological developments, and on weather conditions. 'Defining' the problem like this, however, does nothing to resolve whether or not to undertake an investment, and no amount of searching will yield *information* on these matters that will settle the question. It will only be possible to find out about any them in the course of time.

We are back to the implications of the hermeneutic circle. When it comes to deciding whether something ought to be done, whether a project may succeed or whether it is beyond the point of rescue, the decision is a matter of *judgement*. Judgement is not grounded, except in personal experience. Even when the 'measuring rod' of profits and losses enters the picture, personal judgement is always the final factor in determining whether to continue to 'roll over' a loan, support a new rights issue, commit money to an expansion of a subsidiary, or to cut inventory levels.

The statement that decisions rest upon subjective criteria is not to be mistaken for a view that decisions are *arbitrary*. On the contrary, despite that fact they rely on their feelings, the individuals making these types of decisions probably give

considerable thought to the matters at hand, in order to do what they consider to be worthwhile or appropriate, and they will try to judge consistently when dealing with other matters at different times.

It is of the essence of judgement that it reflects one's prejudices, also in respect of what is important, or how the matter appears, at that *moment* in the *durée*. The manager who has a background in personnel may well give weight to factors which the production specialist does not consider. In considering a likely location, the person who has personal knowledge of a place will judge it differently from a stranger without such knowledge, but who is given a list of pros and cons that someone else drew up. The stranger's assessment, too, may be different when he has had an opportunity to speak to 'an expert'.

Orthodox economists appear to have accepted that the uncertainty associated with decisions could be encompassed by a theory of search, and that by searching the decision-maker could eliminate, or overcome, the judgemental aspect of reaching a decision. In economics there is a fairly well-developed theory of search, and of optimal search behaviour that started with the (1961) contribution of Stigler (see also Alchian (1971), Rothschild (1973)). The idea behind search theory is that agents confront a (random) distribution of prices and have to find the particular parts of the distribution that are relevant to them. In later formulations they estimate an unknown, but unchanging, distribution of prices using Bayesian analysis (see Lippman and McCall (1976)).

All this, supposedly, provides for more realistic models of decision-making because it does away with perfect knowledge, and makes explicit the costs of acquiring information. Search theory, and the economics of information, however, does not dispense with the third-person perspective, as is clearly indicated by the conditions under which Bayesian analysis applies (*i.e.*, that things in the world out there - in this case prices - form an unchanging distribution). Because the world of search

theory is a closed, complete system, it is possible for individuals eventually²⁷ to find out what all the conditions are like and to optimise.

From the point of view of the individual constituting a plan of action in the *durée*, it is inconceivable to search for *any* solution, let alone an optimal one. He may certainly gather information, or may ask others to do it for him, but does he have enough? Is it worth trying to obtain more information? There are no hard and fast answers to the questions. The information that he obtains does not, in itself, direct him towards the 'right' answer. It may help him to form an opinion, *suggesting* that circumstances are not yet opportune for a particular course of action. But, except in a determinate scheme where there is a fixed 'amount of knowledge', all he can 'acquire' are suggestions, clues, or possibilities.

These arguments justify the value that is attached to *experience*. A third-person perspective cannot accommodate experience except as 'acquired knowledge' which any one can acquire. The quality that is valued by peers and associates and that gives the possessor authority, or makes him an 'expert', and is considered a *sine qua non* for appointment to positions responsibility, however, is not something that is available to all.

Experience belongs with Polanyi's concept of personal knowledge.²⁸ Experience

²⁷ The idea of imperfect information has aroused much debate about whether, and why - since the dispersed prices are equilibrium prices - an equilibrium theory is compatible with the existence of a distribution of prices. Would an initial distribution of prices not collapse into a single price in each market so that the need to search disappears (see Rothschild (1973))? This apparent conundrum illustrates that the difficulty of sustaining 'realistic' assumptions about what people know - the idea that there is a distribution of prices, rather than a single one - in the face of the desire to work within an equilibrium framework is irresolvable. The knowledge that individual prices represent elements in a fixed distribution, which epitomises the third-person perspective, also removes uncertainty (unknowledge); the world out there can be known in its entirety.

²⁸ Discussing an epistemology of personal knowledge, Polanyi (1973, p.256) states his position in terms which match and support our arguments about decisions resting on judgement. He says that 'in the last resort my statements affirm my personal beliefs.... Nothing that I say should claim the kind of objectivity to which in my belief no reasoning should ever aspire; namely that it proceeds by a strict process... [and] include[s] no
(continued...)

is about the transformation of the individual in the *durée*; the 'dialogue' of the hermeneutic circle of interpretative understanding. The individual *gains* experience when, in the course of his activities, he 'tests' his prejudices and preconceptions and these are shaped (or revised). When, as they inevitably must, decisions rest on judgement, there is no substitute for experience - for having had exposure to, and 'internalised', similar situations.

The problem for managers who have to make investment or location decisions is that they rarely have the necessary experience to identify where investment opportunities exist and what is likely to prove worthwhile, or to identify where would be a good place to invest, or about what needs to be done in co-ordinating activities associated with the investment. This is why decision-makers rely on the advice of experts - not because the latter have the knowledge to optimise or to be able to determine what will happen, but because of their experience.

Large organisations are conservative and, with funds at their disposal, hiring experts is a practical way for managers to try to satisfy themselves that they are doing the right thing. Watts (1987, p.174) cites Townroe as noting that this practice is less common, for example, in the United Kingdom than in the United States.²⁹ The expertise may be found among specialists within the firm, or among independent consultants and other advisors who are contracted for a particular project. They bring different *perspectives* on the matters at hand. When consultants make their recommendations, it is their experience with other companies that they draw on, including what they have learned from other people

²⁸(...continued)
passionate impulse of... [the expositor's] own.'

²⁹ Townroe states that firms in the United Kingdom rarely use location consultants, and that the practice is found only among larger firms in the United States. Two comments on this statement are in order. The arguments in the thesis explain why one would only expect large firms to hire consultants. In addition, in terms of the contention in Chapter 7 that ideas for locations generally 'emerge' out of other considerations, one would not necessarily expect firms to hire *location* consultants; but they may hire consultants in connection with the investment or consultants in the area of strategy, whose advice settles the matter of location.

about why and where companies have been successful. Their advice reflects a current view of what has been successful both locally and abroad and, for this reason, it often has an element of faddishness about it.³⁰

The received view of planning leads to the conclusion that allowing personal prejudices to 'get in the way', or relying on the advice of others without 'finding out the (real) facts for oneself', is irrational and undesirable. The decision-maker is supposed to look for the right answers and calculate the best solution: as if the future course of events could effectively be reduced to numbers today.

The consideration that knowledge is understanding helps to clarify the importance of the personal element in decision-making, which modern hermeneutics takes to be the essence of decision-making: the individual's feelings, or his faith in a colleague which means that he relies on that person's advice but disregards the 'information' provided by someone else.

The decision-maker relies on well-established contacts and trusted sources because he has only his own and others' experience to guide him. These arguments put an end to the idea that managers seek to optimise shareholders' returns or to minimise costs; *i.e.*, that they pursue things that exist 'out there'. The somewhat disconcerting implication is that 'economic factors' - the values of variables such as prices and costs which dominate 'decision-making' in orthodox theory - may not be important at all. This conclusion is examined in the next chapter.

³⁰

Naturally rhetoric plays an important role in helping people to make up their minds. Managers need to *feel* that they are doing the right thing. Advice from an 'acknowledged expert' with a reputation for solving business problems, may go some way to allaying fears. In this context it is appropriate for the advisor to point out how particular strategies have been responsible for the success of other firms, and to highlight how successful they have been. Some general recipes for success are well known: 'adopt the Japanese approach of sub-contracting'; 'reduce inventory and other costs by implementing a "just-in-time" manufacturing system'; 'reduce manufacturing costs by licensing the product to low cost manufacturers of original equipment, or enter into a joint venture with an O.E.M. company.'

CHAPTER 7

INVESTMENT OPPORTUNITIES AND LOCATION

To fail to bring the planning stage to the surface... allows, by default, the emergence of the view that the large organisation operates under a single planning mind, and, by not looking into the nature of the organisation's authority relationships, allows to persist, if it does not propagate, authoritarian views of a very naïve order. The persistent '*he* will adjust his output...', *he* will do this and *he* will do that, coming from teachers and students alike, is extremely irritating and provoking to anybody who has made a disciplined inquiry into these matters.

G.F.Thirby, 'The Economist's Description of Business Behaviour', p.206

Businessmen do not always "calculate" before they make decisions, and they do not always "decide" before they act. For they think that they know their business well enough without having to make repeated calculations; and their actions are frequently routine.

Fritz Machlup, 'Marginal Analysis and Empirical Research', pp.524-25

I. THE SCOPE OF THE CHAPTER

Equipped with an understanding of the purpose of a subjectivist approach and insight into the social circumstances of managers of small and large firms, we are in a position to answer the question: what does it mean to 'choose a location'? Managers of manufacturing businesses deal with location problems in the course of planning investments. In order to understand what role location plays in their deliberations and how it enters the picture, it is necessary to answer two questions about the planning of an investment: how do investment opportunities originate, or how are they identified; and what are the motives for undertaking the investment.

These questions need to be examined from the point of view of managers of both large and small firms. The issues are discussed in the first two sections of the chapter and, on the basis of that discussion, in section III we adduce how large enterprises and small firms come to identify their locations. We infer that traditional economic factors may have little bearing on decisions to invest and

hence on location. As this view presents an obvious challenge to conventional approaches to decision-making, it is necessary to analyse the role of economic factors in decision-making which we do in section IV. Examining investment decisions in the context the double hermeneutic of social science helps to expose the fallacy of the emphasis on economic factors by orthodox economic theory.

The penultimate section of the chapter is a case study. Inferences drawn from the preceding analysis are applied to industrial relocation policy. Industrial relocation policies were implemented in many countries with most of these implicitly adopting the approach of orthodox location theory that economic considerations are the main determinants of location. In almost every case, however, the policies have failed to reshape the geographic, or spatial, pattern of industry. Our object is to use the inferences from earlier sections to illuminate the shortcomings of the policies.

The thesis began with a thematic overview of the problems and questions. It concludes on a similar note with a thematic survey of the contribution that we have made in terms of resolving and clarifying issues pertaining to methodological discourse in economics. In the final section we also look at the prospects for subjectivism. Hermeneutical subjectivism is of value in explaining the role of institutions in social life, and we offer another brief case study on competition in support of the contention that a subjectivist approach is needed to understand institutions.

II. THE IDENTIFICATION OF INVESTMENT OPPORTUNITIES

We have established that the questions, how are investment opportunities are identified and what are the motives for undertaking an investment, are inescapably hermeneutical, and the object of posing them is to investigate how a manager 'sees' the matter of location. The quotations which introduce this chapter demonstrate the consequences of not being able to understand the nature of decision-making within the firm. Though first raised many years ago, such

arguments have not made much impact on orthodox economics. The reason is that the epistemology of orthodox theory does not recognise hermeneutical problems. According to these quotations and our examination of location decisions, however, the view of the world that economic orthodoxy prescribes is misleading. In examining investment decisions, besides exploring how locations come to be identified, the task of the chapter is to indicate just how misleading the orthodox explanation is.

It is worthwhile briefly recapitulating the story told by traditional location theory of how firms' locations are chosen.¹ This serves both as a reminder of the content of the theory and as a foil for our explanation. The theory includes the following implications.

Decision-makers search for ideal locations. Their searches are directed largely by the values of economic variables at different points in Euclidean space. Such searches are portrayed as being directed towards things out there, which attract firms. Decision-makers possess knowledge in the form of a map of an area reflecting the values of economic variables at different points.

Decisions are made to achieve clearly determined interests of the firm which, as a thing in the world, is a distinct entity, always treated as a whole.² Each firm has definite linkages to other firms and with these linkages constitutes a complete system. Each firm has a ready-made scheme, with definite objectives, for solving location (and other) problems. The 'data' on which choices rest exists in the world and is potentially available to everyone and anyone. The choices - whether to

¹ See McCloskey's views (1991) on the idea of economic explanation as storytelling, and on the types of stories that economists tell.

² By this we mean that although the firm has no form, there is also no conception of sectarian interests within an organisation, or of vested interests that a decision-maker may have in certain activities within an organisation, which he treats as the interests of 'the firm'.

minimise costs or to maximise revenue - are independent of the firm and its activities, though the firm has to take advantage of 'opportunities'.

An optimal location is an end in itself and is determined by comparing the characteristics of alternative locations against predetermined criteria. The best location for the firm is that one which scores more highly than alternatives in terms of criteria such as costs or sales. Decision-makers do not and should not have personal attachments to, or preferences for, places.

These are not capricious aspects of a theory of decision-making but are congruent with the epistemology that delineates the location problem; they define the third-person perspective. The neoclassical firm has been described as 'a strange bloodless creature without a balance sheet, without any visible capital structure, without debts' (Boulding, cited in Penrose (1959, p.11 fn.2)). The absence of these characteristics of a firm indicates that the third-person perspective admits no *history* to account for agents' circumstances and to explain their activities. An explanation of decision-making or location requires an understanding of the importance of the decision-maker's 'history' and his understanding of the firm's past and present, so this is where we start, and examine how investment opportunities are linked to planners' circumstances.

A. Opportunities are born in the *durée*

When the theorist begins his investigation into location decisions, the people and firms in whose activities he is interested are not randomly scattered over the landscape. Nor are managers wandering around with maps that depict spatial economic relationships, looking for investments and places to locate their factories. Their circumstances play a principal role in the identification of investment opportunities and the location of the business. Understanding how the manager understands, or constitutes, those circumstances is the appropriate place to begin an analysis of industrial location. This means, in part, examining his relationships with other people, and how he interprets them.

Investment opportunities are born in thought. These ideas belong in the *durée*. They are the process of interpretative understanding, of taking stock of the current situation, as part of the individual's ongoing 'dialogue' that involves other people and constitutes the hermeneutic circle of understanding. Being consciousness of *others* also means recognising one's current obligations and commitments to people and to institutions. The seeds of a plan, while they 'look forward' in a sense, also refer to a past: to how things have been going, to ongoing responsibilities, and to contractual obligations. In 'looking at' these commitments plans are formed initially, perhaps, as no more than a fleeting thought about some possibility, but later crystallising into a more definite idea of what should be done.

Of course, the *durée* is of no consequence from a third-person perspective. The agent of neoclassical theory faces a complete world out there constrained only by his 'budget' that requires him to tailor his 'choices' in the face of the prices imposed by the activities of others. Whatever he does, there is always a huge range of options open to him.³ By implication, with each 'decision' the agent begins with a clean slate and, in the context of location decisions, with a new firm. All this is completely misleading as far as our understanding of decisions is concerned.

³ Neoclassical theory recognises that the firm has 'commitments' as a consequence of decisions made in the past, commitments which are revealed in the form of fixed costs, or a particular capital combination. Yet these do not have any significance for agents other than that it takes 'time' (defined as so many 'periods') before the commitments are discharged. But given a set of comprehensive 'plans' which direct the agent's decisions through 'future' time periods whatever set of prices emerges, these 'commitments' do not really mean anything. A corollary of a complete (deterministic) scheme is that there must always be a way 'out', a means of transforming the current situation into that of the next period. In this sense firms and agents always remain infinitely flexible. Whatever someone else does, they have an optimal response. Clearly, such a scheme is not capable of representing uncertainty. In practice, a commitment means having to do something even though you would prefer to do something else. The decision-maker knows that, having made a commitment, he will not have an easy way out; he will not be free to do other things. That is why, if he is unsure of the consequences, he would rather not commit himself in the first place.

In practice, investment opportunities emerge from something in a way that makes them a product of the moment, as the situation is 'grasped', or 'read'.⁴ In identifying opportunities, what matters are the planner's history and current circumstances, including relationships with other people. Each planner has his own *Mitwelt*, consisting of friends and associates, from whom he comes to hear about business opportunities. Each has his own experience of different places in which he grew up, lived, or worked. He has opinions about people in these places; they are regarded, say, as unfriendly or industrious as the case may be. Experience is the source of *prejudice* - in the sense of previously established judgements, as discussed in Chapter 4 - that shapes the individual's understanding that, in turn, shapes his experience.

As the 'foundation' of investment opportunities is experience, these considerations play a part in how, why, and where such opportunities are identified. At a more practical level, North's (1974) findings about the locations of the 'new firms' in a sample of companies that he investigated have a bearing on these arguments. North states that most of these 'new' firms were

subsidiaries of existing companies and either started their lives in a vacant building belonging to the group or shared one of their parents' factories. A fresh location decision, therefore was not concomitant with the birth of a new company... (pp.238-9).⁵

As a rule, only a few small-scale endeavours can be considered as new business ventures which literally start from scratch, and even then the people involved have a history which shapes the project. The capital costs alone of a large-scale venture necessitate that any proposed 'new' firm has established antecedents. Banks,

⁴ This is the idea behind Keynes's analysis of the effects of short-term expectations on investment opportunities and the 'marginal efficiency of capital'. Those opportunities, however, are interpreted as surviving in a scaled-down form even when the outlook of the business community becomes pessimistic. In our view, under these circumstances, investment 'opportunities' actually 'disappear' and may never come round again.

⁵ We would be inclined to reverse the logic of this argument, with the contention that the birth of these 'new' firms (they are not really new) did not need a location decision.

prospective shareholders, or investors need a record of doing business as an indication of the likely success of the venture.

In examining the circumstances of managers as they pertain to the identification of investment opportunities, it is expedient to use the distinction between the circumstances of planners in large and in small companies. The two groups, as classified in the previous chapter, constitute their 'worlds' differently. How investment opportunities are identified, and the types of opportunities that each identifies, are likely to differ.

B. Evolutionary growth of large enterprises

In the large enterprise, it is the circumstances of the organisation, and managers' perceptions of relationships among people in the organisation, that are relevant to the identification of investment opportunities. These will have a bearing on how the investment opportunities come about and, subsequently, on the decisions that are taken about implementing a course of action.

The factors deduced in the previous chapter, such as financial security, the fact that success in managing a large enterprise is measured by sustained progress and performance, and that decisions taken by a committee or a board require consensus and compromise, and the conservative attitudes of managers, may all come into play. They support the claim that 'routines' are important in large organisations (Nelson and Winter (1982)). We may thus infer that new projects that will be considered, including ones based on new products formulated in the research and development department, are viewed as providing 'natural', or evolutionary, growth for the organisation.

The proposals will be for projects which are believed to complement existing activities and, therefore, to fit into the firm's already extensive sphere of operations. They may include products which extend the existing range and which build upon the same technical and marketing expertise, for example, or investments

which extend or consolidate the firm's existing markets. Similarly in the case of mergers and acquisitions, a major consideration will be whether the demands placed on people can readily be dealt with by drawing on the experience of the present management.

In a large firm, managers do not 'search' for investment opportunities. These are 'created', in that they emerge from deliberations about the firm's current position and future prospects: its financial position and market share, its competitive position in a global market, its management or regional structure, the impact of technological developments, or labour relations. The consideration that investment opportunities are identified and defined in the deliberations of people about the performance, structure, or future of the enterprise, is reinforced by the role of experts in the planning process. Investment decisions will usually only be taken after discussions with a range of people both inside and outside the firm. These include specialists in a variety of fields, from structural engineers to merchant bankers, and associates and acquaintances with knowledge of, or an interest in, particular products, markets, or countries.

Specialists are hired for their experience. An investment plan defies being treated as a self-contained problem and, when faced with many imponderables, a sensible approach for planners is to look for 'recipes' to follow. These help to transform a novel situation into something of a routine one. One way of accomplishing this is to adopt methods and practices that, apparently, have proved successful in other cases and where consultants can provide the recipes. With wide experience, they should be well placed to identify 'strategies for success', so it is understandable that even firms in different countries pursue the same general business strategies.

A consequence of using specialists is to narrow the approach and options which are considered in planning an investment. These considerations provide two sets of pointers that are relevant to the issue of location. First, they establish that investment opportunities are firmly rooted in the *experience* of managers, rather than existing somewhere out there. Also, the nature of the planning process in the

organisation indicates the identification of *specific*, rather than *general*, investment opportunities, and the adoption of specific procedures in implementing the investment.

From this we infer that either in the identification of the opportunity or in deliberations about how to proceed, the location will usually have been 'decided' without much thought having been given to the matter of where that location should be. Searches, and comparisons based on spatial considerations, are superfluous.

C. Investment opportunities and small firms

In many cases the manager of a small company, who is considering undertaking an investment, will be going into *this* business for the first time, though he may have been involved in other businesses before. On the face of it, he has considerable latitude in what he does, how he does it, and where he does it, being constrained neither by decision-making and power structures within an organisation, nor by a history of commitments to particular products, markets, and even to employment practices and social programmes.

The circumstances of these individuals appear to resemble more closely the description of the agent in orthodox theory and, especially, the entrepreneur associated with Kirzner's work (see (1973 and 1985)). Does the small manufacturer search for 'profit opportunities' and perhaps locations? The answer is no; his *own history* matters - the skills he has, where he worked, where or grew up, who he knows, his knowledge of financial matters - in identifying and pursuing opportunities.

The culture, structure, and practices of a large business place their managers under certain obligations. The things that the small businessman considers to be obstacles to his plans, and even the opportunities that he identifies, are perceived as *personal* opportunities or problems. His plans reflect his circumstances: how

can / deal with this matter; is it worth *my* while to do this; who do / know who can help me; will they have sufficient confidence in *my* ability, or honesty. Other people, whom he goes to for advice or for financial assistance, base their dealings with him on an assessment of his competence, honesty, or enthusiasm.

When examining the investment opportunities of the small firm, these considerations have to be seen in conjunction with the fact that the *Mitwelt* of the small-business manager consists of a social network - people who are not employees of the firm. Given this context, how do investment opportunities arise? Investment opportunities emerge from the current activities of the business and its existing contractual obligations. As noted in the previous chapter, in view of his limited means and other considerations, the small businessman has difficulty in managing an expansion of capacity. His approach will be to seize opportunities where he finds them.

Few investments in small manufacturing firms represent absolutely new starts, when the individual has an idea, designs the product, builds or rents factory space, and purchases new machinery to manufacture it. Much stands in the way of carrying ideas through to fruition, and his lack of experience in running a successful business will be an impediment to obtaining funding from financial institutions (see Meredith (1977, p.22)). He might find people - including friends and family - who will finance the business on unconventional terms. Such financiers, who may insist on a share in the business, are not business associates in the conventional sense and really represent part of a social network.

We can postulate that many investments in small businesses involve the purchase of existing operations, even when the manager is going into business for the first time. The factors that lead to such investments fall into two categories, and each category has many permutations. In one case the individual himself identifies the opportunity, which probably comes to mind as a result of his employment at the time. As a salesman, for example, he realises that one of his major customers requires a specialised finish to the product that he supplies. In the other category,

someone in his social network - an associate, friend, or family member - alerts him to a business opportunity.

In each case, whether it is a new or existing business that is the individual's starting point, we understand that the investment opportunities that he considers are narrowly circumscribed. There is limited scope for choice, except with regard to whether he should proceed with the idea. The same considerations apply to the issue of location.

It may already be apparent that for the person starting a small manufacturing concern, or for the manager of a large industrial undertaking, the issue of location is hardly relevant. In each case the location is settled when an investment opportunity is identified, defined by the nature of the investment and the circumstances associated with carrying out the decision to invest.

A major flaw in neoclassical theory is its failure to account for the intersubjective, social nature of business decisions, including the identification of investment opportunities. This failure leads to an erroneous view of the sorts of choices and decisions that people make. The implications for industrial location of the arguments set out here are examined after we have had an opportunity to complete the picture of how investment decisions are made. Doing that means exploring the motives behind the decisions.

III. MOTIVES AND INVESTMENT DECISIONS

'Motive' means 'an emotion, desire... or similar impulse acting as an incitement to action' (*The American Heritage Dictionary*, 1987). What factors induce people to act, specifically to undertake investment decisions? What are their motives? Asked these questions, and assuming that their responses are frank, managers might furnish a variety of answers to both. Motives include personal gain ('this looks like the opportunity that will make me a millionaire'), opportunism ('if this plan succeeds I will be able to gain control of the company'), or animosity

associated with company politics ('this will give me the leverage to force the chairman of the other division to resign'). The desire to own his own business, or to be his own boss, may be paramount, so when an opportunity presents itself - almost irrespective of what it appears to offer by way of financial returns - the individual may seize it. Similarly, some may see a business opportunity as a means of escaping from poverty or of getting out of a family business. Or, with an eye to retirement in a few years, the town and its setting may be regarded as especially suitable. A desire to overcome the problems of an unruly work force or to avoid the effects of a change in government policy - from stricter pollution control measures to higher corporate tax rates - are plausible motives behind particular investments. Some decisions, no doubt, are a consequence of attempts to stave off bankruptcy, and others are based on the desire to become the dominant force in the industry or to have a foothold in a growing market.

These and all the other possible motives are missing from the usual story told by economists because the epistemology of neoclassical theory does not need them. That theory consists of a variety of logical puzzles involving the relationships that exist between 'states of knowledge' and 'preferences' on the one hand, and resources and products on the other. These do not represent business decisions. Optimising behaviour is a key to the solution of the puzzles, not of business decisions.

In the absence of motives, orthodox theory subverts our understanding of the organisation and operation of the institutions of a market economy in a subtle but pernicious way. The implication that the 'motive' of firms is to optimise profits is an erroneous view of what managers do and why they do it. Optimisation is impossible except for someone who has a grasp of the complete scheme, or who believes he does. The pursuit of profits, *per se*, is illogical unless one knows what profits exist out there, or believes that one does. The manager concerned with investment decisions knows and believes neither.

A. Motives reflect the social nature of conduct

Dealing with motives means recognising the social nature of conduct, as demonstrated by our examples. With rare exceptions, such as Penrose (1959), there is little discussion of the 'social nature' of the firm, of the relationships between people who work for the organisation and their relationships with other people.⁶ Neoclassical theory not only isolates the agent from his fellows, but it is also reluctant to consider personal or subjective factors in the investment decision. This accounts for its diffidence in dealing with motives. Modernism offers the excuse that motives do not matter in a scientific theory.⁷ If necessary, empirical studies prove that markets work, and people behave, as if they are profit or utility maximisers.⁸

An interest in understanding and realisation drives one to the hermeneutical approach. If the analysis is to prove useful it is desirable to be able generalise about decision-makers' motives and this is anything but straightforward. Motives are personal and *particular* and the question is how to reconcile this with the requirement that theory is *general*, for a first-person approach must feature motives

⁶ The language of Penrose's theory remains an obstacle. While Penrose points out the importance to the theorist of looking at things from a manager's point of view, this is somewhat incidental to the analysis. Hers is a third-person perspective and this lends itself to referring to *firms'* goals, and firms pursuing profits.

⁷ Motives, to modernist theory matter only if they are expressed in a neutral referential language and identified as things that exist in the world; hence the attempt to ground decisions in a psychology of behaviour. The result is illustrated by Wright (1964). In examining the motives of decision-makers considering investments, he initially argues that the individual is induced to do things by a set of 'desires' and that 'at any moment of time... [he] is only aware of a rather small subset of his own desires' (p.41). Later, Wright's arguments are more sensible. He refers to the existence of different groups with possibly conflicting motives and suggests that 'conflicting interests may have to be satisfied by a single policy' (p.53).

⁸ The nature of this proof is puzzling to say the least. Since no one, including the theorist, has the sort of knowledge that would allow him to try to optimise, and no one knows what the consequences would be if he did, it is difficult to understand how empirical studies can support a finding that people behave as if they are trying to maximise.

in explanations of decisions. The answer to the question lies in the double hermeneutic itself. The theorist, as a decision-maker, has an understanding of how others constitute problems and of their motives.

The people who comprise a person's *Umwelt* and *Mitwelt*, and also to an extent his *Vorwelt* and *Folgewelt*, are those with whom his interests overlap. Their requirements, habits, motives, or attitudes matter in some way, either in terms of what he is doing or what he plans to do. Some individuals set criteria that he must meet, while others are associates or people with whom he does business. Some he can count on for support, others are viewed as rivals. He will respond to them accordingly.

Our approach is to view motives as interwoven with the individual's social circumstances. Whose interests the planner or decision-maker considers, and his feelings about how important it is to take cognisance of other people's motives, are influenced by the type of social relations that he forms. The distinction between large and small manufacturing firms serves to characterise the social circumstances of a 'typical' decision-maker.

B. Large enterprises and diverse interests

Conventional wisdom suggests that planning and decision-making in the large organisation reflect the 'interests of the organisation'. The recognition that conduct is circumscribed by an emphasis on corporate norms supports the idea of corporate loyalty and a commitment to 'the company's interest' as important motives behind investment decisions. Yet various considerations suggest otherwise.

The formal and impersonal nature of relationships is a feature of large bureaucratic organisations. To most people, the senior manager remains an impersonal name and title. When he meets with people outside the firm to do business, a corporate manager is there as the representative of the firm. His presence as an individual

is almost incidental; on another occasion someone else may represent the company. People do business with the *institution*, and it is the reputation of the institution that matters when financing and similar considerations are at stake.

Lately, the literature on strategic management recognises the multiplicity of interests within a large organisation (see Child (1972); Connolly, *et al.* (1980)⁹). According to Connolly, *et al.* (p.216) because groups within the organisation have different interests, they assess its performance in various ways using different criteria.

In a multiple-constituency view, no surprise is engendered by the discovery that stockholders, senior managers, employee unions, and customers espouse divergent views of what the organisation's goals should be. Nor is there any requirement that these groups and others should, in any particular setting, have reached a negotiated agreement or formed a dominant coalition generating operative goals.

The institutionalisation of planning in the large organisation brings different groups into an investment planning exercise. Individuals are seldom party to the whole planning process and no one has a view of a single, unified, coherent plan. These points, and the consideration that different groups may have different ideas about the purpose of the planning exercise, are conveyed by Williams and Scott (1965, see Chs.4 and 7).

Planners know little about what the others in the organisation think. They cannot identify a 'corporate objective' and do not try to do so. Those who put together a proposal intend the document to meet with the approval of whoever has to make the decisions. Their views on what is required will be shaped by directives, usually

⁹ In arguing for their 'multiple-constituency approach' to the concept of organisation effectiveness, Connolly, *et al.* (1980) still tend to reflect the idea that the individuals who comprise the different constituencies view the organisation as an organic whole. These authors' underlying commitment to what, more appropriately, might be termed multiple '*perspectives*' is promising, because it is consistent with the consideration that different decision-makers constitute their 'worlds' differently. They cite various studies (p.212) which conclude that 'strong goal consensus among senior managers of a single organisation cannot be assumed'. This means that different individuals are likely to have different motives and priorities which may be manifested in disagreement over what course of action to pursue and how 'best' to do so.

from senior management. So the 'interests of senior management' - members of the board of directors, or possibly the chairman or managing director - as *interpreted* by the planners, has a major influence on the formulation of an investment proposal. The planners will seek advice and make recommendations incorporating views that they think top level managers will find appropriate or conducive to their own (*i.e.*, the senior managers') thinking.

Various interests are supposed to be represented by the people on the committee charged with making a decision on whether or not to proceed with the proposed investment. What criteria will they use? Probably with different considerations in mind, they will try to reach agreement on whether the investment is 'the right thing at this time'. This, of course, gives them considerable scope to do as they please. Does 'the right thing' mean the project is expected to be especially profitable, or will it enhance the company's image? Will it give the company a leading position in the industry, or improve its competitive position? These rather vague and ambiguous notions mean that there is neither an unequivocal sense of purpose nor a well-defined corporate goal behind the acceptance of an investment plan.¹⁰ If the plan has to be debated, or if there is behind-the-scenes lobbying because differences of opinion or divergent interests make it difficult to arrive at a decision, then rhetoric and political alliances, rather than economic or financial considerations, will play an important part in the decision. It is at this point that particular individuals, by virtue of their positions of authority or their powers of rhetoric, may be in a position to serve their interests by convincing others that the course of action which they want to pursue is the 'right thing for the company'.

¹⁰ These arguments pose problems for the researcher who is interested in studying the investment decision. It may prove difficult for him to unravel the process leading up to the investment decision, and to uncover the 'original' motives for taking it. For by the time he gets to make his enquiries, even those directly involved in the discussions and negotiations are likely to have lost sight of the motives, if they were ever articulated. Over time, the issues which were once reasonably fresh in the minds of the individuals concerned are going to become even less distinct. Furthermore, many decisions are at least implicitly the result of various compromises which have to be struck when the interests of certain individuals or groups prevail over those of other people.

'Strategic' investment and location decisions are guided by people's convictions. They can reflect the interests of particular individuals rather than those of 'the company'. Given that individuals' motives matter and that interpersonal relationships influence their outlook and decisions, what remains of traditional business goals such as profitability? Even if people do not consider these, won't the 'invisible hand' of the competitive market ensure that firms are 'weeded out' if they do not give high priority to economic factors?

To preserve a coherent argument, it is necessary to defer discussion of these issues until we have completed the analysis of decision-makers' motives and have been able to draw inferences about firms' locations. Clearly, economic factors are not irrelevant when it comes to making investment decisions, but we will argue that there are serious flaws in the key components of the received view: namely that profits or costs are what really matter in making decisions; that the market, when it works properly, ensures that only the firms which choose the most profitable investment opportunities survive; that pursuing maximum profit is the 'right' or 'natural' thing to do; and that anyone who does not try to maximise profits is irrational.

C. Personal circumstances of the small manufacturer

What about the position, and motives, of the manager of a small manufacturing firm? It is a commonly-held view that the motives of managers of small firms reflect personal ambitions and goals. Although personal motives may be the main factor behind the initial decision to go into business, having done so the small businessman is largely at the mercy of his social and business milieu. From identifying investment opportunities to obtaining distribution for his product, he will not have much opportunity to weigh up options.

The manager of a small firm almost always has difficulty in securing adequate financing. This individual may well find that financial constraints necessitate certain course of action, and preclude others, in order to satisfy his bank manager

or creditors. A further curb on his 'freedom of choice' is the constant need to attract business, to retain customers, and to gain new ones. Such considerations certainly circumscribe his activities.

The relationships which have the most important consequences for him are those forged with people outside the firm itself. In considering how they bear on his activities, the *personal* nature of the relationships is important. In a small manufacturing concern, the senior managers *are* the firm, and their ability to make their way depends on their own reputations and how they, as individuals, are perceived by others. Given the competitive market niche in which he operates, the inference is that the small business manager's success depends on the network of relationships that he cultivates and how well he maintains it. To do so, he may have to go out of his way to meet the wishes of customers or to satisfy the requirements of suppliers of materials or finance.

This brief account of what lies behind the investment decisions of both of small and large firms gives fairly clear pointers to how the 'location problem' is treated by each type of decision-maker. Broad as they are, the arguments concerning investment opportunities and individuals' motives are meant to show that profits *per se*, and therefore costs and revenues that could be associated with an investment, are not the only consideration in undertaking an investment. Indeed, the arguments suggest that they may be relatively unimportant and that there will be little occasion for anyone to pay specific attention to the problem of 'finding a location'. In neither category do managers have the need to look for investments and, whatever this means for the choice of location, they will not be motivated primarily by a desire to maximise revenues or to minimise costs. What are the implications of this analysis for firms' locations?

IV. IMPLICATIONS FOR LOCATION

We are proposing that far from being a centrepiece in the process of planning an investment, the issue of location, if it is examined at all, is incidental or is

predetermined by other considerations. Either the location is implicit in the identification of an investment opportunity or, by the time the project has been planned, the location has emerged from a consideration of factors such as the markets in which the product will be sold, the main source of supply of raw materials, the location of the major supplier of components, or simply because a consultant feels that it is a good place. In the particular case of small firms, our standpoint is that location and the business opportunity are generally inseparable. The firm is set up or the owner goes into business to take advantage of a niche market that exists in a particular area.

A. 'Spatial knowledge' is immaterial

Even if a specific location is considered, and this likely to be a matter of finding a suitable *site* in an area, there is no reason why planners should have 'spatial information' concerning costs and conditions at different places. In many cases, the particular project takes shape because of the conditions or circumstances at which the production facilities are, or will be, located. Neoclassical theory implies that the firm and its location are two independent entities, but the types of machinery, the technology, the extent to which aspects of the manufacturing process are subcontracted, and which materials are used are influenced by the location. To the decision-maker, a 'location' is not a point on a map, but a community involving social and business relationships and institutions that are important to businesses. What the community can offer affects the nature of the investment.

Planners considering alternative locations will be examining different types of operations, and the 'choice of location' is a matter of choosing one *project* over another. For example, uncertainty about the market potential of a new product may induce management to back a proposal for a smaller scale of plant which, because of lower smoke emission, can be situated adjacent to the company's existing factory close to the city centre. The possibility of adopting some other approach (a smaller plant, perhaps, or a number of decentralised plants rather than

one integrated operation) leads planners to think about alternative 'locations'. It is the operations, not the location *per se*, that is important.¹¹

The nature of 'an investment opportunity' provides a further reason why the spatial considerations of orthodox location theory are unimportant to planners. In orthodox theory every 'choice' means selecting something that has an existence in the world, so examining alternatives, and the distances and costs associated with them, is a *sine qua non* of making a reasoned decision. But an investment opportunity is a possible course of action that planners are thinking about. It is not 'proximity to other firms' or 'the size of the market' that determines whether the project succeeds, but how the project is managed. When the investment opportunity is identified - 'this seems like a good business prospect' - proximity to other firms is hardly ever a factor. Similarly, 'the market' will only exist *if* the investment is undertaken and *if* the managers do the appropriate things to find customers.

Initially costs certainly have to be considered, but later on inventory management, advertising, and industrial relations policies - most of which are independent of where the firm is situated - are going to be at least as important as the costs of raw materials or the distance from the market.

B. Large firms

Regarding the investments made by large firms, if an expansion of capacity is being considered and if it is practical to do so, the inclination of management will be to develop an existing site. Townroe (1971, p.35) says, '[t]he normal pattern of growth is by building extensions... or by increasing the productivity of the existing floorspace' (see also North, 1974, p.242). The conservative outlook of large

¹¹ It is not necessarily the plant itself (*i.e.* the physical manufacturing capability embodied in buildings and equipment), but factors and circumstances associated with the production facility, that may lead the decision-makers to prefer one type of operation and its associated location over another.

companies, together with the general desire to do those things that are least disruptive and create the least uncertainty, suggests that an extension of the existing plant will be most attractive.

This satisfies the need for continuity, for example of relationships with existing suppliers and of a workforce whose capabilities are known, since supervisors, foremen, and other managers will be 'transferred' to the new facilities as they come on stream. Unlike a plant located some distance away, the senior management team can exercise more control over the setting-up, commissioning, and phasing-in of the extended facility; the last being the time when problems most likely to affect the company's performance will occur.

An alternative to developing existing sites for the large enterprise with adequate financial resources and a conservative outlook, which is able to pick and choose investment opportunities, is acquisition or merger. This presents a distinctly favourable strategy for growth. (See Penrose (1959, Ch.8) on reasons why firms grow by acquisition and merger.)¹² With access to enough capital, there is no need to 'start small' or to embark on new ventures on a piecemeal basis. Buying up an existing, established firm has obvious advantages. The most important is that the business and its potential have been tested. If it is a successful firm that is acquired, the uncertainty of the venture is much reduced.

Compared with its smaller counterpart, the large firm has the resources to weather cyclical downturns and to wait out unfavourable market trends. In this context, the acquisition of a firm which has failed may be preferable to starting out with an entirely new operation. Using the experience of the new management to put things right, such an investment may still be 'safer' than a greenfield investment, because teething problems will have been overcome and the firm will have established suppliers and customers. Once a large enterprise owns a number of plants much

¹²

Without the insights afforded by a subjectivist approach, Penrose's analysis is limited to examining financial and economic determinants of mergers.

of the investment activity is associated with extending or re-organising production at these plants.

In none of these cases does the investment involve looking for, or even thinking about, a location. In an industrialised country with a large manufacturing infrastructure, most of the activities of the bigger firms as they expand or decline and have to rationalise their structures and production capacity, will involve investing in new plant and equipment, and even new buildings, on existing manufacturing sites. The reasons why the firms come to be there tend not to be found in a search for suitable sites, but in the decisions which lead to the acquisition or the sale of an existing businesses.

C. Small firms

In the case of small firms, investigating the choice of location appears to hold more interest when the investment involves the establishment of a new firm as opposed to modifications or additions to existing plant. Such an assumption is misplaced. More so than large manufacturing concerns, the small manufacturer's investment is tied to a particular 'opening' in the market; to the ability to identify and to seize an opportunity which is specific to particular, place and which - in the case of fads, gimmicks, or fashions - may have a very limited life-span. He locates wherever he, or an informant, 'finds' the opportunity.

Small manufacturing firms do not provide interesting case studies in location decisions, as the individuals concerned are unlikely to do more than find premises to suit their purposes. Where the issue of location is incidental to the investment decisions made by managers of large companies, the managers of small firms hardly have occasion to think about the location at all. Indeed, it may not be inappropriate to treat the location of the small manufacturing operation as 'given', shaped by factors that are beyond the manager's control.

In the case of an established small business with large firms as customers, any investment decisions taken by the manager will reflect the opportunities created by these customers. A small manufacturer who services a number of small customers, either distributors or manufacturers, also operates under significant constraints. Variability in the size and frequency of orders and erratic payments by his debtors place him at a disadvantage in terms of planning the growth of his capacity. In addition, he may have to contend with business failures among his small customers.

Investment opportunities for existing small firms will involve incremental changes to the operation, mainly changes in capacity. When new products are added, they are likely to be variants of those already being produced, which can be made without expensive retooling and without having to add entirely new production facilities.

When he needs to find new premises, the manager's aim will be to find something convenient, as close as possible to his present location, from where he can service his existing customers. If a large customer moves, he too may have to move. In general though, financial constraints together with modest space requirements will almost certainly mean the purchase or rental of *existing* premises, rather than a desire to build new ones, a point that applies equally to the individual embarking on a new venture by starting his own manufacturing concern.

These views confirm the conclusion of industrial geographers that small manufacturing businesses offer little to interest the location theorist, but this does not mean - as geographers seem to imply - that there is no reason to study the plans and activities of their owners or managers.

V. THE ROLE OF ECONOMIC FACTORS IN DECISION-MAKING

This inquiry presents a fundamental challenge to the conventional approach to decision-making in economics by subverting the traditional story of how locations

are chosen. It denies the search for business opportunities and also the primacy of economic considerations - costs, revenues, and profits - in the identification, or selection, of investment opportunities. Little was said about the actual motives of managers except for the short treatment above, but the view that motives are likely to be diverse runs counter to the customary notion that a high return on investment and the desire to maximise profits are the main priorities of the businessman. The analysis also contradicts the idea that decision-makers 'shop around', comparing alternatives.

The challenge presented by the analysis demands that various questions be addressed. The most important one is the role of economic considerations in investment decisions: how are they relevant to the decision-maker. In order to answer this, we must first look to the source of the contradictory interpretation of decision-making. Understanding why there is the dissent over the role that economic factors play in investment decisions involves comparing the ontology of the 'investment problem' in orthodox theory with that presented here.

Orthodox economic theory provides a recipe for effective decision-making and it defines the ingredients; the variables that are relevant to the selection of a best course of action are invariably economic. The pursuit of profits is necessary for the firm to function effectively in all spheres. In the pursuit of profits, costs and revenues matter. Location theory simply extends the logic of the argument.

We have seen that in the context of the epistemology of the third-person perspective, this recipe for making decisions is incontrovertible. In that context 'the' problem of the decision-maker is analogous to baking a cake. But the ontology of the third-person perspective undermines our understanding of decision-making. Decisions are about things, and investment opportunities exist out there. The investment problem is an entity, a complete system that exists. All the components of the investment problem - the interests of shareholders, streams of future earnings, 'the competition' - are known, 'given' to all as unambiguous entities. 'Considering the interests of shareholders in the light of opportunities for

long term growth', for example, means measuring and evaluating things as one would the ingredients of a cake.

A. The double hermeneutic

On a hermeneutical reading, by contrast, an injunction to the decision-maker to evaluate all possible options in terms of their economic implications does not make sense. There is an essential difference, of an ontological nature, between deciding whether a cake has the right ingredients and deciding whether a decision has the right 'ingredients'. To illustrate this, we begin by examining the hermeneutics of the 'cake problem', which - in the terminology used in the thesis - is a 'self-contained' problem, one that can be grasped in its entirety. The cake problem is then compared with the problem of defining a market or an investment opportunity.

Solving the cake problem is substantially a hermeneutical activity. Whether something is a cake as opposed to a quiche, is established by understanding - an intersubjective dialogue in which language and culture play a fundamental role. That understanding is prejudiced. But having agreed (for the time being) that we have a cake, it is practical, using conventional techniques that are understood (and agreed) to be appropriate in the light of the current 'state of knowledge', to analyse whether the right things have gone into making a good cake. An understanding (*i.e.*, 'knowledge') of the composition of a cake is based on conventions of analysis and on an understanding of chemistry. We can measure its carbohydrate and moisture content and probably also its lightness, fluffiness, and sweetness. To this end, it might be appropriate to call on experts to taste the cake, to report their findings and, perhaps, to compare that cake with others.

Up to a point, the subject-matter of economics and the nature of the 'cake decision-problem' is no different. What constitutes 'a decision', or 'the market', or a cake is a matter of understanding. The cake problem, however, only involves a single hermeneutic, that of the person or people adjudicating whether something is a cake and whether it has the right ingredients.

Baking a cake is analogous to a 'system' with an 'outcome'. The adjudicators establish through discourse whether the outcome is to their liking and they can analyze the procedure adopted by the person who baked it. The thing in which they are interested has no understanding of whether it is a good cake, so even though in Gadamer's sense they interact with the cake, it is the discourse among the adjudicators, including the baker and any experts, which determines whether the cake is satisfactory.

But as we stressed in earlier chapters, in economics in general and in analysing decision-making in particular, the problems have a *double hermeneutic* because they are about how 'individuals' understand, or constitute, their 'worlds'. Both 'deciding on an investment' and defining 'the market', for example, involve intersubjective understanding, but not just my understanding of how other economists understand *something*. The problem *is* one of *understanding*. The market - not as a place, but as buyers or sellers - is a matter of what and how people understand. Defining a market for fruitcake means not only settling the matter with other economists, but knowing who the buyers and sellers are and how they understand the market.

'The market' for a product consists of those people who, over a period of time, think *at a moment in the durée* that it is worthwhile buying a particular product. Implicit in this notion are various conventions about a geographic area, the product itself, and possibly even about substitutes and competitors. Having resolved any controversies over these conventions, it may be feasible to ascertain what the market was yesterday. But no one knows what the market will be in six months time, *not even those who will then constitute the market*, unless they have all already made up their minds.

Unlike baking and evaluating a cake, defining a market is not the type of problem where one can say: if you do this and take account of this and this, you will have determined the market; therefore, these are what should go into a good estimate