

How Can We Avoid Closed-ended and Single Exit Theories in Economics and Political Economy: Reflections on Richard Wagner's *Mind, Society and Human Action*

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Economics basically begins with two empirical observations. First, individuals pursue their interests. Second, Paris gets fed. And the task of the economist is to reconcile those two observations. In one version, the profit maximizing behavior of individuals results in a general competitive equilibrium; in another version, individuals will be alert to those opportunities that are in their interest to be alert to, discovering opportunities for mutually beneficial exchange; and in still another version, the reconciliation fails to result because of any number of human imperfections. The main versions that get played out in public debate over the virtues of not only the market economy but also the discipline of economics itself are the first and third. And both of those are built on closed-ended models of choice and single-exit theories of equilibrium. The first version results in an optimal outcome; the third results in a suboptimal outcome. This scientific vision of economics reached its pinnacle in the 1960s and 1970s with the Arrow-Hahn-Debreu model of general competitive equilibrium and the proof of the first and second fundamental theorems of welfare economics, and its flip-side the pure theory of market failure (as developed by Samuelson, Bator, Arrow, Akerlof, and Stiglitz) focusing on the various implications of imperfect information and imperfect market structure. Ironically, both the model of general competitive equilibrium, and the model of market failure, scarcely paid attention to the institutional environment within which market processes are played out.

The first and third versions of the intellectual efforts to square self-interest with social order while clearly simply being flip-sides of one another,

ignore completely the second version of the reconciliation. But as Mark Blaug (2001: 153) has pointed out, this general equilibrium vision of Adam Smith's 'invisible hand' thesis is a "historical travesty." Smith and his contemporaries presented neither a closed-ended theory of choice, nor a single exit theory of equilibrium. The pursuit of self-interest can be reconciled with a social order that promotes the public good, but it can also --- as Smith's discussion of the sophistry of mercantile interests as well as his discussion of the "bad" educational habits of Oxford professors shows --- result in detriments to the public good. But a close reading of Smith and other classical political economists reveals that their version of how the market process reconciles self-interest with social order depends on a specified set of institutions.

It is this need for institutional analysis that led to the New Institutional revolution in economics in the 1950s, 1960s, and 1970s. The development of public choice theory by Buchanan and Tullock, the property rights economics of Alchian and Demsetz, Coase's law and economics, North's new economic history, Williamson's and Ostrom's development of the economics of governance, and the Mises-Hayek-Kirzner theory of the entrepreneurial market process, all evolved against the intellectual backdrop of the model of general competitive equilibrium on the one hand, and market failure theory on the other hand. The New Institutional analysis shifts attention from assumptions of behavior perfection/imperfection, to an attention on institutions that emerge to ameliorate the tensions and difficulties associated with the imperfections of man. Rather than full and complete information, imperfections of information, and rather than lightening calculators of pleasure and pain, man is viewed as a being forever caught between alluring hopes and haunting fears. The reconciliation of self-interest and social order isn't accomplished through behavioral assumptions, but through an identification of specific institutional conditions that are able to channel the individual pursuit of private interest in a direction that realizes the social gains from cooperation under the division of labor. This, of course, is what Adam Smith laid out in *The Wealth of Nations*, focusing from the very beginning of the book on the great productivity gains due to the division of labor and the wealth creating capacity of specialization and exchange. When it comes to the "men who sit in the seat of Adam Smith", those who forged the New Institutional counter-revolution in economics and political economy have a more legitimate claim than those who engaged in the "historical travesty" of interpreting the 'invisible hand' along the lines of general competitive equilibrium or the flip-side of that in the theory of market failure. (see, e.g., Buchanan 1979)

During the early days of a self-conscious New Institutional counter-revolution, the German sociologist and philosopher Hans Albert (1979) put a challenge to his compatriots --- neoclassical economics will never repair its

institutional deficiency, he argued, until it repairs its behavioral deficiency. Albert's point is that the closed-ended model of choice that the maximizing model of man represents will be unable to adequately deal with how the institutional environment structures incentives and impacts the flow and quality of information that decision-makers face. In T. Eggertsson's survey of New Institutionalism (1991), he distinguishes between Neo-Institutionalism (built on the maximizing model) and New Institutionalism (built on the Simon model of satisficing). 'The secret is to deal with capable but fallible human actors, and not robot 'agents'.

Richard Wagner's *Mind, Society and Human Action* is a brilliant exposition of the implications of pursuing the "open" as opposed to "closed" perspective (what he terms neo-Mengerian orientation in contrast with a neo-Walrasian orientation). The closed model brings tractability, but only by rendering the social ordering *process* trivial. Reconciliation of the pursuit of individual interest and social order is not so much explained but collapsed one into the other. "Within this closed framework, people do not truly make choices. They face a list of enumerated options in the presence of a well-defined utility function, and the outcome is inexorable, similar to involuntary reflexes." (2010: 21) Closed-ended theories of choice fit neatly with single-exit theories of the market. In contrast:

With open concepts, however, people face genuine choice, in which case they could make different choices if it would have been possible to relive the scene multiple times. With everyone in the same position, multiple histories could have emerged. There are thus several tomorrows that could emerge out of today, depending on the particular choices people make and the resultant interactions that are set in motion. The social world can be rendered intelligible without being genuinely predictable ... Prediction is a reasonable standard for any closed system to which equilibrium pertains. If someone makes a particular choice in the presence of a particular set of prices, the closed model of utility maximization requires that person always to make the same choice, for the requirement of transitivity brings closure to the model of choice. Alternatively, once we recognize that people can act creatively and experimentally, there is no necessity that they always make the same choice. They may very well want to explore and experiment. That exploration and experimentation can still be rendered intelligible even if it isn't genuinely predictable. (2010: 21)

Once time and knowledge are taken seriously, Wagner contends, the neo-Mengerian orientation reconciles the individual pursuit of interests and the regularity of social order through the network of institutions that govern social intercourse. Absent this neo-Mengerian reorientation, the economic model following the neo-Walrasian orientation assimilates the social regularity to the maximizing model of man.

If our scientific goal is tractability and predictability, then closed-ended theories are going to be the theories selected. But, if, on the other hand, the scientific goal is intelligibility and understanding, then the open-ended theories of choice, pursuit, experimentation, exploration, and processes will emerge as the theories of scientific choice. Wagner's point is very simple --- the logic of the Walrasian system is not in question, but its relevance for understanding a world that is situated in time and place and populated by real human beings is. Of course, all theoretical endeavors require abstraction --- the question is one of *adequate* abstraction. We don't have a map in the glove compartment of our car that is a 1-1 correspondence with the terrain we are traveling, but neither do we have just a napkin with arrows reflecting East-West and North-South as our serviceable map for our travels. Somewhere between free floating abstraction, and momentary concreteness, the theorist will find the *adequate level of abstraction*.

In the affairs of men, this theoretical endeavor forces us to explore beliefs and expectations, the striving for ends and the adjustments to failure to achieve those ends, the relationships entered and exited, and the playing of the game of life within various institutional contexts, including but not limited to commerce and politics. In the process of highlighting the logic of human action as opposed to the flawless precision of robots operating in a toy economy, Wagner resurrects an important Mengerian theoretical region of inquiry that lies between exact theory and historical scholarship -- that is the realm of *applied theory* or *institutionally contingent theory*. The means-ends logic of human action is affirmed, but the manifestations of individual rationality are context dependent. A good way to think about this point is to use a sports analogy, when and where to bunt a ball in a baseball game as a component of a winning strategy is going to depend critically on the score, the inning being played, the skill of the batter and the speed of the base-runners, and whether and where the base-runners are in position. Sometimes the situation will call for the ball to be bunted along the first base line, other times down the third base line, and still others to eschew the bunt altogether and swing away. In each instance, *homobaseballonomicus* is striving to achieve the objective of winning the baseball game in the least-cost manner possible, but the manifestation of that pursuit is not some abstract engagement: it is contingent on context. What makes the game of baseball so exciting in these pivotal moments is that there is not only the element of skill execution, but there is the surprise of what strategy

will be chosen, especially given that the defensive team knows the menu of strategic choices and will also adjust to try to counter. The very unpredictability of the outcome is *why* we have to play the game to find out the result. And failure is *always* an option, and it is how we live and learn to play the game better next time.

Note that in the example just provided we have avoided both close ended choice by the actor, and single exit theory of the outcome, while retaining a theory of baseball interaction that is based on logic and a history of the playing of the game of baseball grounded in experiential evidence. But it is a theory that is quite comfortable with indeterminacy as opposed to determinant outcomes --- “that is why we play the game.” Wagner’s *Mind, Society and Human Action* strives to put the game of life as played out in the field of economics, politics, and society in the same light as my discussion of baseball: a theory of society that eschews close ended choice and single exit theories. In doing so, Wagner emphasizes specific institutional contexts and the strategic interdependence of the various actors and enterprises. Whereas the “timeless logic of equilibrium patterns of resource allocation must take prices and markets as data” (Wagner 2010: 94), the neo-Mengerian market theory “treats the continual change in the social organization of economic activity that emerges within a society, and presumably emerges differently under alternative institutional configurations.” (Wagner 2010: 101) The game of life is one of ceaseless change and it is coming to an understanding of this continual transformation that is the object of a theory of the market process. The passage of time, and the discovery, acquisition, and use of knowledge is ever present. “So far as men are concerned,” G. L. S. Shackle wrote, “being consists in continual and endless fresh knowing.” (1972: 156)

This constant change and requisite adjustments are guided within the market economy by the signals, feedback, and disciplining through property, prices, and profit/loss. But outside of that environment, the signals, feedback, and disciplining don’t cease but take on a different form and channel activities in a different direction. Politics, for example, constitutes a different arena than the market, yet there is still striving, there is still action guided by signals, feedback, and disciplining. Enterprise and exchange relations remain in politics just as in commercial life. But what there isn’t is the guidance provided by clearly defined and enforced private property, relative prices, and profit/loss accounting. As Wagner describes at length, the political pricing system must by necessity live parasitically in relation to the market pricing system. But the absence of clear ownership shares in politics means that “the competing claims about managerial competence cannot be reduced to a common dimension through monetary calculation.” (Wagner 2010: 173) Thus, there is an ambiguity in politics and in political exchange relationship that is not there within the

market process. In Wagner's hands, political economy is not one of strict dichotomization, let alone the implicit economic experts as benevolent despot stance of neoclassical welfare economics. We have instead a political economy of entanglement, and a grappling with the social maladies that can be an emergent outcome of parasitical relationship between political and commercial life.

I cannot do full justice to Wagner's brilliant work in this essay. *Mind, Society and Human Action* is perhaps the most powerful theoretical work in contemporary Austrian economics since *The Economics of Time and Ignorance* by Gerald O'Driscoll and Mario Rizzo (1985). Combined with *Fiscal Sociology and The Theory of Public Finance* (2007), Richard Wagner's work on economics, politics, and society has the ability to transform the social sciences and to reorient our theoretical endeavors in a way that avoids the closed-ended and single exit theories that have dominated since the mid-20th century. The theories that have inhibited our abilities to understand the creativity of human actors, the dynamic entrepreneurial market process, and the institutional contingencies that either unleash or impede those creative energies of men to realize the gains from trade, the gains from innovation, and the gains from social cooperation under the division of labor that enable us to live more peaceful and prosperous lives by being able to live better together.

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