

A CRITIQUE OF THE AUSTRIAN APPROACH TO HOLISTIC CONCEPTS

GUSTAVO MARQUÉS

IN THIS ARTICLE I will revise Mises and Hayek's thesis about the proper categories of economics. In their view, classical economics was successful in identifying the right concepts of economic science, but its aggregative (universalistic) and objective approach was not satisfactory. Keeping the objectivist view of economic science, macroeconomics undertook a stronger form of aggregation, introducing a set of completely arbitrary categories, which I shall call holistic concepts. According to the Austrians, classical categories must be preserved, because they are compatible with methodological individualism and their objective content may be replaced by a subjectivist approach. Holistic concepts, instead, are considered incompatible both with methodological individualism and with subjectivism. Classical aggregation is a weak form of aggregation that may (and deserves to) be reformulated, but macroeconomic aggregation must be rejected.

I find the traditional Austrian position flawed. Mises and Hayek agree that holistic concepts cannot be used neither for explaining economic *decisions* nor for explaining or anticipating the *objective consequences* of individual actions. I think, however, that a limited defense of macroeconomic aggregates is compatible with Austrian approach. Though from an Austrian point of view the description of the objective consequences of actions must be done without any reference to holistic aggregates, for explaining agent's decisions, instead, taking holistic concepts into account may be necessary.

Feeling uneasy with the traditional harsh approach to holistic concepts, nowadays some Austrian economists are beginning to pay more attention to macroeconomics. Mises and Hayek's ideas about that issue

GUSTAVO MARQUÉS is professor of Methodology of Economic Sciences and Epistemology of Economics at the School of Economic Sciences at the University of Buenos Aires and also professor of Philosophy at the School of Economic Sciences at the University Lomas de Zamora.

may hinder this movement toward the adoption of more friendly relations between macroeconomics and the Austrian approach. Criticizing the traditional Austrian view about holistic concepts may be of some help in promoting a more unprejudiced attitude toward macroeconomic aggregations, and clarifying in which sense macroeconomics may have a place in Austrian economic analysis.

INTRODUCTION

The third generation of Austrian economists (particularly, Mises and Hayek) deeply appreciated orthodox economic theory. But they were critical of the type and contents of its categories. They believed that classical economists had identified most of the *relevant* economic concepts, like prices, rent, interest rates, time preference, etc., i.e., the ones considered by agents themselves when making economic decisions. As far as these considerations guide economic actions, economic processes must be elucidated in these terms. In this sense, the classical procedure truly conforms to a *methodological individualistic* approach, and it was judged perfectly admissible. In spite of this, the classical approach was flawed because the relevant concepts were deemed to have an *universal* and *objective* nature. This *aggregative* and *not subjectivist* procedure brought economics to a halt. We therefore can say that, from the Austrian point of view, classical aggregations met the requirements of methodological individualism, but failed to incorporate subjectivism.

Classical aggregation should not be confused with the type of aggregation that predominated in macroeconomic theory, which generated concepts that were only imaginary constructions, like “aggregate velocity of circulation of money” or “aggregate capital,” considered void of contents by the fathers of Austrian economics, and do not form part of the agents’ decision-making process. These concepts were considered irrelevant (and even dangerous) for economic analysis, and mistaken from an epistemological point of view. While classical aggregation provided an inadequate treatment of adequate concepts, macroeconomic aggregations provided an inadequate treatment of *inadequate* concepts. To avoid confusions it will be useful to distinguish between two radically different forms of aggregation, which may be designated as *universalism* and *holism*. According to the Austrians, universalism may be reformulated, but holism has to be rejected.

Following Mises and Hayek, most Austrian economists claimed that modern economic theory must follow (and improve) the work of classical economists, keeping the individualistic approach and categories, but giving up its universalism and incorporating a subjectivist view. Besides, most of them rejected macroeconomics, because they believed that subjectivism and methodological individualism were incompatible with holistic categories.

Today, things are changing, and some Austrians hold a more open-minded approach to macroeconomics and are making substantial efforts to incorporate some holistic concepts into economic analysis.¹ In spite of that, the historical prejudice against this kind of concept is due to their supposed commitment to methodological holism and may hinder this progressive movement. If correct, the arguments provided in this article may help pave the way for a more unbiased view of macroeconomics and for further incorporation of holistic concepts into Austrian economics.

Particularly, in this paper I will argue in favor of the following thesis:

- (a) A full commitment to subjectivism blurs Hayek's sharp distinction between "constitutive" and "speculative" concepts, allowing holistic categories, and particularly, macroeconomic aggregates, to be "constitutive" in Hayek's sense;
- (b) From an Austrian point of view holistic concepts are unacceptable for explaining the objective consequences of economic actions, but, as long as individual decisions should be explained by constitutive concepts, macroeconomic aggregates could be incorporated for explaining economic decisions and actions;
- (c) Rejecting holistic aggregates imposes severe restrictions on the Austrian's treatment of expectations, forcing them to consider only a subset of those that are really at work in the economic process. The Austrian view of intertemporal coordination may be also in danger.
- (d) On a more methodological level, holism as a type of aggregation should not be confused with holism as a methodological approach. Thus, even if methodological holism were incompatible with methodological individualism, holistic macroeconomic aggregations are perfectly compatible with both methodological individualism and subjectivism.

I. CATEGORIES OF ECONOMIC SCIENCE

Arranging facts or events into classes requires the application of some classificatory criterion. Most of the objects and phenomena referred to by ordinary vocabulary are grouped together according to some shared

¹See, for instance, Garrison (1978).

observable physical properties that are the chosen criterion. The vocabulary of scientific theories, on the contrary, provides a very different classification system: it puts together those entities that, though seemingly different to our senses, react alike in given experimental situations, a behavior which is usually explained positing a common structure or some trans-empirical nature.

One of the central features of modern science (which gives us a clue for understanding its success) has been the replacement of those classifications of external stimulus provided by ordinary concepts for new classifications founded on experimentation. This is the basis of the logical empiricist distinction between observational and theoretical terms. According to the Austrians, both types of concepts fail to provide a comprehensible account of human actions and social phenomena. To carry out this task, a conceptual revolution, even more radical than the one produced by modern science, was needed. It was necessary to adopt an entirely new classification system, which is *subjective*, but as long as it is shared by all those who have a common background or a common human nature, it is also *social*. These concepts were called *teleological* by Hayek (1996, p. 59). The subjectivist approach promoted by the Austrians in social sciences implies the substitution of its teleological concepts for its supposedly objective vocabulary—introduced in social theory under the influence of natural sciences.

Once the subjective nature of economic and social concepts had been established, Hayek introduced a second distinction between those concepts that economic agents take into consideration for deciding and acting, and those designed to explain these actions and their results. The concepts of the first type, which through their influence on actions play a causal role in the conformation of social phenomena, he called “constitutive.” Concepts of the second type are merely mental constructions intended to offer a theory of these phenomena, and were called “speculative” concepts (Hayek 1979, chap. 4). According to Hayek, the theories people form about social phenomena may be completely wrong, and one of the tasks of the social sciences is to revise them and find more adequate representations. But, to understand the agents’ actions and decisions, their own knowledge and concepts are required and, therefore, constitutive concepts can not be avoided.

In *Human Action*, Mises’s position on this issue is close to the one advocated by Hayek. At first, any classification is highly arbitrary.² For

²Mises (1996, p. 123) states “Construction of concepts and classification are mental tools.” In a footnote he adds

Classes are not in the world. It is our mind that classifies the phenomena in order to organize our knowledge. The question of whether a

this reason, Mises found it necessary to distinguish between those concepts that are just “mental tools” from those that are necessarily taken into consideration by agents when deciding and acting. If we disregard Mises’s interest in praxeology, his distinction almost coincides with the referred Hayekian distinction.³ Both authors believed that many concepts scientists and historians need to explain past events have no relevance for the acting man.⁴ To be “realistic,” economic theory should incorporate into its vocabulary those concepts that guide the agents themselves when planning their decisions as consumers or producers.

2. IMPROVING THE BASIC VOCABULARY OF ECONOMICS

From the Austrian point of view, classical economics has provided important stepping stones toward the conformation of an adequate economic science. First, it rightly identified the real subject of economic decisions, the individuals, giving up any reference to agencies of hypostatic nature.⁵ Besides, it has pointed out those (very) factors which individuals consider when making economic decisions. Included in this category are prices, individual incomes, interest rates, wages and salaries. Many other factors, frequently mentioned in sociological explanations, were not considered relevant to understand economic processes. Classic economics, for instance, assumed that agents were

certain mode of classifying phenomena is conducive to this end or not is different from the question of whether it is logically permissible or not. (ibid.)

³Mises states

It is important to realize that the period of production as well as the duration of serviceableness are . . . not concepts constructed by philosophers, economists, and historians as mental tools for their interpretation of events. They are essential elements present in every act of reasoning that precedes and directs action. . . . The period of production and the duration of serviceableness are for him categories in planning future action, not concepts of academic retrospection and historical research. (ibid, p. 477)

⁴See Hayek (2008) and Mises (1996, chap. 18, sec. 4).

⁵Mises (2003, p. 162) states

Only the disintegration of the universalistic mentality brought about by the methodological individualism of the seventeenth and eighteenth centuries cleared the way for the development of a scientific catallactics. It was seen than on the market it is not mankind, the state, or the corporative unit that acts, but individual men and groups of men, and that their valuations and their actions are decisive, not those of abstract collectivities.

not constrained by moral considerations: when buying or selling a good, fairness (as well as the nationality or the religion of the seller or buyer) has no influence at all. This classical view, however, is not quite correct: although they rightly identified most of the relevant economic concepts, they wrongly considered them as having an *universal* and *objective* nature.

The classical economists' approach was contaminated by universalism since it depicted individual decisions as influenced by the relevant factors as a whole. They thought, for instance, that total (not marginal) utility was relevant to understand economic reactions. Besides, they saw economic categories as having an objective content, which could be measured in appropriate units. Their universalism and objectivism prevented them from reaching a right grasp of economic processes and confronted them with unsolvable quandaries.⁶ What is required, in their view, is to improve on the classical vision of economic concepts, filling the gaps which undermine them. Two things are needed: a *disaggregated* analysis of factors and economic decisions, and a full incorporation of the *subjective* approach in the consideration of economic concepts.

Disaggregating a concept is a complex task, which involves at least two different procedures. In the first place, as long as concepts can be said to have several degrees of universality, universalism can be reduced. Decomposing a single broad concept into different sub-concepts does not *per se* eliminate universalism, but it does reduce its initial extension. From the Austrian point of view, this attitude should be encouraged and (borrowing Lakatos's words) is considered a progressive change in economic theory. This kind of progress was already initiated by the Classical regarding the orthodox production function.⁷ However, as Mises pointed out, the process of tempering the universalistic approach

⁶See Mises (1996, pp. 62-63 and 121).

⁷Mises (2003, pp. 16-17) states

Conceivably it would be possible to formulate the theory of the appraisal and factors of production . . . in the broadest generality so that, for one thing, we would work only with an unqualified concept, viz., means of production. We could then elaborate the theory in such a way that the three factors of production that are enumerated in the customary presentation would appear as special cases. But we proceed differently. We do not bother to furnish a universal imputation theory of the means of production as such, but proceed immediately to the treatment of the three categories of means of production: land, labor, and capital.

was not systematically pursued by the classical economists.⁸ Much work in this direction is still needed.

In the second place, it is always possible to be more specific about any economic concept, pinpointing the time and locality in which it is operating, and its particular relation with the agents involved. The classical theory of land provides an illustration of this procedure: it “never lost sight of the fact that land is appraised differently according to its quality and location.” In this way universalism may be eliminated, not merely reduced.

When Austrians make a plea for a more disaggregated approach, they have in mind these two different procedures which are mutually complementary: to reduce the concepts’ scope, and to specify the particular time and location in which the category occurs and its particular relation with the relevant agents. For brevity’s sake, we could call the first and second procedures, respectively, “logical dimension” and “historical dimension” of a concept.⁹

Given the set of relevant economic concepts, in addition to its disaggregate analysis, a fully subjectivist approach is also needed.¹⁰ What Menger did with the concepts of good, economic good and value should be done with the remaining concepts (costs, benefits, interest rates, supply of (and demand for) money, etc.). These concepts were already present in the classical theory, but they were given an objectivist content. Costs, for instance, referred to something that somehow could be measured in an impersonal way. The subjectivist view shows that this goal is unattainable, and strives to supply a non-objectivist content for every economic concept. The Austrians agree that the progress of economic theory relies on the successful development of this project.

⁸Ibid. (p. 17)

the theory of wages did overlook the fact that labor too is of different quality and intensity and that on the market there is never a supply of or a demand for “labor” as such, but only a supply of and a demand for labor of a definite kind.

⁹Interested readers may compare the notion here described with Max Weber (1949) and Alfred Schütz’ notion of ideal types. See, for instance, Schütz (1962, chaps: “Choosing among Projects of Action” and “Common-Sense and Scientific Interpretation of Human Actions”).

¹⁰Subjectivism may be plausibly considered as a component of the historical dimension. Here I mention it separately with the purpose of highlighting its importance.

3. TWO DIFFERENT FORMS OF AGGREGATION

Although the third generation of Austrian economists dislike aggregate concepts, they do not deal with any aggregation in the same way. The Classics' universalistic concepts are objected, but must be retained and improved, resorting to some of the procedures mentioned above. Macroeconomic concepts, instead, should be dismissed altogether. They can not be fixed, because they are intrinsically inadequate. They are not the kind of concepts able to give an account of economic processes, and often reflect the authorities' misconceptions. It is therefore better to designate them as *holistic*, and set them apart from aggregations belonging to the other type.

Traditionally, Austrians have leveled two main objections against holistic concepts. First, key economic concepts, such as money, prices or interest rates, designate social phenomena that were unintentionally caused by the separate individual decisions of the many agents that populate the economy. From their point of view, every "correct" category results from a "constitutive" process conformed by the individuals' actions and decisions. Macroeconomic concepts, on the other hand, such as "total volume of trade," "quantity of money in the global economy," "velocity of circulation of money," do not designate (and do not measure) anything at all.¹¹ They are just fabrications. In some cases, the criticism is even stronger: some concepts put together entities that can not be so grouped by any valid aggregative procedure. Capital measured in physical unities is an instance of this case. Such concepts are misconstructions.¹²

A consequence of the previous remarks is that one can't operate with holistic categories as if there were causal connections between them. The factors alluded to by holistic concepts (no matter which) do not interact with each other (something that does happen with physical entities). Only individuals interact one with another. As long as there are no social constants, no regular and systematic relations between holistic categories can be discovered. Loosing sight of this simple fact is one of the main problems of the quantitative theory of money. From the Austrian point of view this criticism is essential, because they considered that it was the belief in the existence of some kind of "social laws" and the goal of prediction which made aggregate concepts so attractive for macroeconomists (Hayek 2008).

¹¹"The 'average period of production' is an empty concept" (Mises 1996, p. 486).

¹²Mises again criticizes "real capital": "this concept of a totality of the produced factors of production is an empty concept" (1996, p. 263).

4. COMMITMENT WITH SUBJECTIVISM DOES NOT IMPLY THE REJECTION OF HOLISTIC CONCEPTS

Austrian arguments rejecting holistic variables are interesting and deserve close examination, but they are far from being decisive for those who (like the Austrians themselves) adhere to methodological individualism and subjectivism. Even admitting that such concepts have no reference at all and no systematic connections with each other, this fact, by itself, does not rule out the possibility that holistic categories may play a role in economic processes and could be usefully incorporated into economic analysis.

The key for this contention is to keep in mind the distinction between the decisions (and actions) of the agents and its consequences. Economics has to deal with both of them. It has, then, two main tasks: (a) To explain and to anticipate the *objective consequences* of the agents' decisions. In this regard an objective economic theory of the sort pointed out by Mises is required,¹³ (b) To explain and to anticipate agents' *decisions and actions*. For this last purpose agent's ideas (even the fanciful ones) have to be taken into account. The fact is that agents *may* believe that holistic concepts are (or may be) causal agencies, and may believe that among them there are some connections posited by macroeconomics. If agents *had* these beliefs, a full commitment to subjectivism means that holistic concepts would have a huge economic significance.¹⁴ The remarks about subjectivism and its implications that are developed in this paper are mainly related to this second task.¹⁵

¹³Mises states

In speaking of the laws of nature we have in mind the fact that there prevails an inexorable interconnectedness of physical and biological phenomena and that acting man must submit to this regularity if he wants to succeed. In speaking of the laws of human action we refer to the fact that such an inexorable interconnectedness of phenomena is present also in the field of human action as such and that acting man must recognize this regularity too if he wants to succeed. (1996, p. 755)

¹⁴Hayek says

What is relevant in the study of society is not whether these laws of nature are true in any objective sense, but solely whether they are believed and acted upon by the people. If the current 'scientific' knowledge of the society which we study included the belief that the soil will bear not fruit till certain rites or incantations are performed, this would be quite as important for us as any law of nature which we

To rule out the possibility that holistic concepts could be included into economic analysis, the bare distinction between constitutive and speculative concepts is not enough. Hayek is implicitly assuming an additional thesis, claiming that agents *do not and can not* use speculative (holistic) concepts when forming their expectations and deciding.¹⁶ Constitutive concepts, instead, may be used both ways. This creates a fundamental asymmetry at the conceptual level pointing to intrinsic properties of the categories involved. The two kinds of concepts are supposed to be completely different in nature. Such thesis is too strong, indeed, and deserves more elaboration.

Other analytical distinctions concerning language are far more flexible than the one mentioned above. For instance, the usual logical distinction between premises and conclusions of an argument is conceptually clear and sharp, but it is not founded in any reference to intrinsic properties of the sentences involved. Any sentence may work either as a premise or as a conclusion of any argument. Nothing in the nature of the sentences themselves forces them to perform one role rather than the other. The Hayekian distinction between constitutional and speculative concepts is quite more rigid: they do not allow that speculative concepts could be taken into account when agents are planning their economic actions. This impossibility seems to arise from the very nature of the concepts themselves.

Coming from Hayek it is an odd claim. He considers speculative concepts in an objectivist manner, as if their “essence” forced them to perform a role only within “popular theories.” But, as Hayek himself

now believe to be correct. And all the ‘physical laws of production’ which we meet, for example, in economics, are not physical laws in the sense of the physical sciences, but people’s beliefs about what they can do (1979, pp. 51-52)

¹⁵The referee of an earlier version of this article has expressed his concern with the fact that “the author’s view” about subjectivism “seems to make economic analysis a species of fiction writing.” In one sense, he is perfectly right. For Austrians, economic theory, in the strict sense of the term, does not include an idea (i.e., category) just because people believe in it. However, my contention is that economic analysis intended to explain peoples’ economic behavior should incorporate these (even fantastic) concepts.

¹⁶I couldn’t find in Hayek’s texts an explicit defense of this claim. But I think that no such recognition is needed. Hayek should adopt this position. Otherwise agents may transform “just (mental) fabrications” in mental tools for decision making (something that Hayek wanted to prevent). In my view, without the incorporation of an additional thesis of the sort I attribute to Hayek, subjectivism cannot bar this sort of transmutation of speculative concepts into constitutive ones.

has pointed out, though it is possible that “god” or “Holy Trinity” lack reference and conform merely popular theories, beliefs associated with them do influence a good portion of people’s behavior. In fact, many actions would be completely unintelligible to us if these kind of beliefs were not taken into consideration. Analogously, even if “the velocity of circulation of money” is just an artificial construction (as the Austrians think, on a par with terms like “proletarian” or “bourgeois”), if people think it will change and these changes will have some definite effects on their revenues, they will pay close attention to this factor, and their actions may be deeply influenced by it. One would expect a Subjectivist to put far more emphasis on this possibility. It is hard to reconcile Subjectivism and Essentialism.

Besides, Hayeks’ asymmetry seems to be the result of an empirical observation of the way people make decisions, which is provisional by its own nature, and restricted to some particular situations that might change completely. Ultimately, whether agents take into account only some restricted group of variables or not—the constitutive ones—when taking economic decisions, is an empirical issue that has to be solved collecting appropriate information concerning the concrete processes of decision making. Clearly, a bit of Essentialism, that assigns a fixed role to some concepts, does not throw light on the issue.

5. OBJECTIONS TO HAYEK’S VIEW

It has been argued that no argument advanced by the Austrians against holism rules out the possibility that economic agents could take decisions paying attention to speculative concepts. In order to dismiss this possibility we would need empirical information. Because a significant amount of relevant evidence about how agents make decisions is unavailable, I will give some reasons supporting the *feasibility* for collective concepts *to play* a role in making economic decisions.

1. Hayek as well as Mises should admit that knowledge of the actual or future values of aggregated variables do form part of the *authorities*’ decision-making process. Expensive institutions and a growing number of “professionals” are dedicated to obtain this kind of data for government guidance, a process already started before the Second World War and harshly criticized by Mises. But, if authorities take into account such (maybe arbitrary) “numbers” and adopt decisions based on them, why should agents disregard this information? The mere fact that authorities react to changes in these magnitudes give agents an incentive for getting information about these changes. If economic policies were dictated in a definite manner by an old astral chart, any clever entrepreneur would be eager to get this information. Criticizing government theory and practice is the theorist’s business. Practical men,

instead, profit from any clue that allows them to anticipate future states of the market, no matter whether they are unwarranted, even foolish, “popular” theories.

2. The distinction between the theorists and agents’ mode of thinking had some support in the relatively distant past when it was possible to oppose practical knowledge (embodied in familiar enterprises) to scientific knowledge (only available to those who mastered economic theory). Nowadays, the diffusion and acceptance of macroeconomics has transformed holistic concepts as a “mental tool” for economists, authorities and agents alike. In part, this change is explained by the fact that the typical (amateur) entrepreneur of past centuries does not exist any more as a relevant agent. His place has been increasingly taken over by professional economists or managers with strong (macro) economic foundations, who head large enterprises, and approach markets and real economies in terms of aggregate (holistic) variables. As long as they think, reasonably or arbitrarily, that changes in these variables make a difference, holistic variables will be part of their economic deliberations.

6. DISAGGREGATING ECONOMIC DECISIONS

In spite of what has been said, we must concede that, in some cases, aggregate variables might play no significant role in shaping economic decisions. For instance, it is very plausible that in deciding how much to consume or save, knowledge of the changes in global income or the quantity of money existing in the whole economy may have no influence at all. It is more reasonable to think that agents decide such issues taking into account some of the *traditional* economic variables. A disaggregated analysis of the agents’ decisions could show that entrepreneurs and other types of agents consider different variables in shaping their expectations. What is relevant for one group may be irrelevant for another. Probably, macroeconomic variables are far more useful in helping to explain investment decisions than in explaining consumer actions. As said before, this is an issue that should be solved by gathering empirical evidence.

The different ways in which agents form their expectations is extremely relevant for Austrian economics, because of their consequences for the kind of behavior typically exhibited by market economies. The Austrians’ explanation of intertemporal coordination may be briefly stated as:

- (a) consumers’ decisions determine the value of all the key (“correct”) variables of the economy;

- (b) knowing the meaning of these changes, which reflect preferences, entrepreneurs include them in their economic calculus and take measures in order to satisfy consumers' directives;
- (c) this allows that entrepreneurial decisions be in proportion and harmony with consumer decisions, letting the economy proceed in an orderly way and without disturbances.

This is the simple “logic” of intertemporal coordination. From an Austrian point of view, coordination would be secured if governments abstain from any intervention in the market. But, as I have tried to show, it is plausible that at least some entrepreneurial decisions are also based on data, which are not the result of consumer decisions, and do not reflect their intentions regarding present and future consumption expenditure. So, it is possible that decisions taken for both groups of agents proceed in different (maybe opposite) directions, because each group would be basing their decisions on at least a partially different set of data. Lags in coordination may become deeper and coordination no longer secured. Of course, this conjecture requires further elaboration. If true, this vision jeopardizes the most precious jewel of Austrian economics: the sovereignty of the consumers. The data on which entrepreneurial decisions are based may not only reflect consumers' dictates.

CONCLUSION

The arguments advanced in this article might be contested for theoretical and methodological reasons. Particularly, some people may think they imply a rejection of methodological individualism and a commitment to holism. However, nothing said in this exposition supports this conclusion. Admitting holistic categories as taking part in individual decision-making processes does not imply a full acceptance of methodological holism. One may retain the main idea of methodological individualism, which asserts that only individuals decide and act, and at the same time question the narrow view that loses sight of the possibility that in making decisions agents could pay attention to holistic concepts. In this article I have not questioned methodological individualism. I rather claim that if one is both individualist and subjectivist (as the Austrians are), one should also accept that “speculative” concepts could form part of the decision process. But this is all that is needed for those concepts to be admitted into economic explanations.

The argument may be helpful as well to those economists who, having incorporated holistic variables in their theories and models, think they are compelled to reject methodological individualism. Though, as traditionally conceived, methodological individualism and methodological holism are mutually incompatible, methodological individualism and the application of holistic variables are not. Macroeconomics should not be deprived of intentional mechanisms when their use is needed or advisable.

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