**Ontology and the Current Economic Crisis**

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**Introduction**

There are, *meta-theoretically* speaking, two main ways to investigate socio-economic phenomena in general and the current economic crisis in particular, each one rooted in its own ontology. The first, which I refer to as `*scientistic-oriented economics* ´ is rooted in an ontology of atomistic, observable events and event regularities. The second, which I refer to as `*political-economics*´, can be rooted in an ontology which I will abbreviate to *structures and mechanisms* that are reproduced and transformed by human agents. This ontology has been advocated by critical realists (CRs). The version of political economy[[2]](#footnote-2) I advocate, therefore, is a critical realist-oriented political economy (CR).[[3]](#footnote-3)

This paper tries to show that scientistic-oriented economics is, quite literally, useless in explaining the current crisis, and locates the source of this uselessness in its underlying ontology. Political economy, by contrast, can be far more useful in explaining the crisis, and the source of this usefulness is the underlying ontology. This does not, of course, mean that there is a direct line from a *correct* ontology to a *correct* explanation, but there may well be a direct line from *incorrect* ontology to *incorrect* explanation.

The paper has 5 parts. Part one sets out two competing ontologies of the economy. Part two introduces scientistic-oriented economics and explains its ontological roots. Part three introduces political economy and uses CR to explain its ontological roots. Part four then turns attention to the current (European) crisis. Part five draws all the strands together to show the uselessness of scientistic-oriented economics in explaining the crisis.

**1. Two competing ontologies of the economy**

All orthodox (mainstream or neoclassical) economic theory, research (and policy) is explicitly based upon the application of what is commonly referred to as the `scientific´ method. Because orthodox economists rarely reflect upon their method (or meta-theory more generally) what they end up with is an ill-conceived jumble of the deductive nomological (D-N), hypothetico-deductive (H-D), inductive-statistical (IS), and/or covering law models of explanation. From this perspective(s) to explain something is to predict a claim about that something, as a deduction from a set of initial conditions, assumptions, axioms and law(s). The prediction, stated as a hypothesis, might for example be: `an increase in the density of trade union membership (event x) is associated with a decrease in macroeconomic performance (event y)´. The hypothesis can (although in the case of `toy´ models, often is not) then be tested using a variety of statistical techniques.

This conception of the `scientific method´ is, however, not genuine science, but spurious or bogus science (Fleetwood & Hesketh 2010). Indeed, it is more accurate and less misleading to refer to it as the `*scientistic method*´´.

What is not always appreciated by heterodox economists is that a great deal of heterodox economics, including some Marxist economics, is also based upon the application of the `scientistic´ method. Simply referring to it as `Marxist political economy´, or using `Marxist´ variables, changes nothing. I will, therefore, use the term `*scientistic-oriented economics* ´ to refer to any school of economics that uses the *scientistic method* – this goes, *inter alia*, for *some* Austrian, Evolutionary, Feminist, Institutionalist, Post-Keynesian, Marxist and Radical economics. I will return to Marxist economics in part three.

**2. Scientistic-oriented economics and its ontological roots**

Ontology is the general inquiry into being, existence, or more simply the study of *the way the world is*. *Social* ontology is the general inquiry into the way the *social* world is and *economic* ontology is the general inquiry of the way the *economy* is.

Like all methods, the scientistic method presupposes an ontology. This ontology is one of atomistic, observable events and event regularities. Observed events are the ultimate phenomena about which *scientistic-oriented economists* (as I will call them) collect data – e.g. unemployment, inflation, growth rates, wage rates, and so on. If these events are observed (or proxied) in terms of quantity or degree they become variables – i.e. *quantified events*. The ontology consists, therefore, of *observed* events that are unique, unconnected or *atomistic*.

The part of the world amenable to ‘scientific’ enquiry is presumed *exhausted by* observable phenomena, and the latter is presumed fused with the events that underlie, and give rise to, observations. This boils down to a commitment to observation of events as a reliable, indeed as the *only*, pathway to knowledge. This ontology (schematised in figure 1) is referred to by CRs as ‘flat’, partly because of the fusion of the empirical and actual domains and partly because it lacks ‘depth’ – discussed below.

|  |  |
| --- | --- |
| **Domain** | **Entity** |
| Empirical | Experiences & observations |
| Actual | Events & Actions |

*Figure 1. Flat ontology*

***Epistemology***

For scientistic-oriented economists, particular knowledge is gained through observing events, but more *general* or (allegedly) ‘scientific’ knowledge is gained only if these events manifest themselves in some sort of pattern. This pattern is one of *event regularities –* i.e. where the occurrence of one event is regularly followed by the occurrence of another event. A typical (alleged) event regularity would be one whereby the occurrence of a wage increase (one event) is regularly followed by the occurrence of a fall in the demand for labour (another event). Event regularities can be conceived of as deterministic or stochastic – i.e. probabilistic.

* *Deterministic* event regularities can be styled*:* `whenever event x then event y’; ‘whenever event x1….xn then event y’; y = *f*(x) or y *=* f(*x1….xn*).
* *Stochastic* event regularities can be styled: ‘whenever the mean value of events x1, x2, x3, x4,…xn then the mean value of event y’.

A (generic) econometric equation reflecting this stochastic inflection would be:

(1) *y* *= α + β1X1 + β2X2, + β3X3 + β4X4…+… βnXn + ε*

The following things are noteworthy here. Deterministic or stochastic *events* and their *regularities* are fundamental to scientism because they are the basis upon which laws or law-like statements are derived. This approach lends itself to mathematical expression. The functional relation is the `workhorse´ of mathematics and statistics. Only that which can be quantified can appear as a term in a functional relation. Indeed if it cannot be quantified it cannot be part of the theory or model and cannot, therefore, be investigated.

***Aetiology***

Aetiology (the study of causality) is a sub-species of ontology. Scientism´s notion of causation derives from the18th century philosopher David Hume and is, unsurprisingly, referred to as *Humean regularity*, or the *regularity view of causation* (Psillos 2002)*.* It is inextricably bound up with the *regularity view of law*, whereby a ‘law’ is an event regularity, thus:

1. Law as *event regularity*.

This conception is rooted in the *regularity view of causation.*

The concept of `tendency´ is often (mis)used to refer to an event regularity that is not strictly regular. The most plausible (although in my view incorrect) version of this invokes probability such that ‘whenever event x occurs, there is a high probability it will be followed by event y’. This gives rise to probabilistic (or stochastic) law, thus:

1. Law as *event regularity/tendency*.

This conception is also rooted in the *regularity view of causation*, but this is not obvious because the term `tendency´ *appears* to modify the term `law´, giving the *appearance* that (a) and (b) are different when they are not.[[4]](#footnote-4)

Notice that this aetiology is influenced by ontology. If one has an ontology of observed atomistic events, one´s concept of causality cannot be conceived of in terms of anything other than atomistic events and any regularity they manifest. The cause of event x must be some prior, and regularly occurring, event *y*. And if the epistemology is one whereby knowledge is reliant upon identifying event regularities, then knowing the cause of something requires one to know about event regularities. To know the cause of event x, requires us to know (no more than) that event x, or events x1, x2...xn, is/are regularly conjoined to event y.The cause of a lamp’s illumination is the finger that flicks the light switch; and the cause of unemployment is (according to orthodoxy economic theory) increased wage rates.

***Lessons from the Reinhart & Rogoff controversy***

In 2010 Reinhart & Rogoff published, what became a highly controversial paper, claiming to have found a systemic relationship between high public debt levels and economic growth - the implication being that the former causes the latter. Their stated aim was to `search for a systemic relationship between high public debt levels, growth and inflation´ (573). In my terminology, reference to a systemic relationship between high public debt and economic growth is reference to a law-like relationship. The controversy focused upon the discovery of some relatively simple mistakes which, when corrected, overturned their conclusions. The reason I raise this example is not to discuss their mistakes, but because it serves as an important lesson. It illustrates the fact that, whilst economists might doubt the existence of some *particular* law-like relationship, they do not doubt the existence of law-like relationships in *general*. The point I am making here can be fully grasped by noting how I differ from these economists. The reason I doubt the existence of some *particular* law-like relationship, is because I doubt the existence of law-like relationships in *general*.

Let us consider the most recent article (available as I write) surveying empirical research on the relation between public debt and growth.

[W]e survey the theoretical and empirical literature that studies the relationship between public debt and economic growth in advanced economies. We conclude that the case for a causal effect running from high debt to low growth still needs to be made. Apart from causality issues, we also show that the evidence of a common debt threshold above which growth collapses is far from being robust…

In our view, future research on the links between public debt and economic growth should focus on cross-country heterogeneity and on the mechanisms and transmission channels through which public debt may hinder economic growth. Addressing the latter point would require a unified theory aimed at explaining under what conditions and through which mechanisms debt may reduce economic growth...

The relationship between debt and growth is characterized by large cross country heterogeneity…and may also vary over time within countries. The way in which debt affects growth may depend on institutional quality, on the dimension of the public sector, on how and why debt has been accumulated, and on the structure and composition of public debt (Panizza & Presbitero 2013:18).

The point to note is that neither Panizza & Presbitero (2013) nor the other economists they cite in their survey, doubt the existence of law-like relationships in general. Moreover, in this case, they do not doubt the existence of a law-like relationship between public debt and economic growth – with control variables. Their objection appears to be (a) that no-one has managed to find it yet, perhaps because (b) it is complicated by cross country heterogeneity, time, institutional quality, the dimension of the public sector, how and why debt has been accumulated, and the structure and composition of public debt. Believing a law-like relationship is there to be discovered, economists have tried to estimate alternative versions of the following dynamic growth model:

(2) *GROWTHi,t-(t-n) = αln(GDP)i,t-n + βDEBTi,t-n + γ****X****i,t-n + τt + ηi + εi,t*

per-capita GDP growth (GROWTH) of country i over period t-n and t (with n ranging between 1 and 5) is regressed on the initial level of per capita GDP, the ratio of public debt over GDP (DEBT), and a set of controls **X –** [which] varies across studies, [and] includes population growth, the ratio of investment over GDP, and a measure of the stock of human capital.

Notice that equation (2) expresses the same sentiments as equation (1) above vis-à-vis events, event regularities, causality as regularity and causal law. This is entirely to be expected, because it follows from orthodox economists’ methodology, and therefore, from their ontology, epistemology and aetiology.

***Agency***

The concept of agency used by scientistic-oriented economists is *the rational individual* - i.e. an atomistic bundle of preferences. Some use therational individual because it is considered to be a fair representation of real people, whereas others use it because it provides mathematical tractability. Moreover, as ontological and methodological individualists, scientistic-oriented economists (should) have no conception of anything (e.g. social structures and mechanisms) existing *independently of agents* that enables and constrains their actions. From this perspective, structures and mechanisms are nothing more than the outcome of agents´ actions, meaning structures and mechanisms are collapsed into agency. Instead of an *agency-structure* relation, scientistic-oriented economists have only an *agency-agency* relation.

***Digression: some versions of Marxist economics***

Note, in parentheses, that the same kind of econometric equations as (1) and (2) can be found in the work of some Marxist economists.[[5]](#footnote-5) Basu & Manolakos (2012: 11), for example, test Marx´s hypothesis about the long run tendency of the falling rate of profit with the following equation:

*(3) Log (rt) =α + βt + γ1𝓏1t* + *γ2𝓏2t* + *γ3𝓏3t* + *γ4𝓏4t* + *μt*

*r* is the rate of profit

*𝓏1t* is a measure of the intensity of exploitation of labour by capital

𝓏*2t* is a measure of the deviation of the wage rate from the value of labour power

*𝓏3t* is a measure of the overpopulation in the economy

*𝓏4t* is a measure of the relative price of constant capital

*t* is a deterministic time trend

Marxist political economists should be very concerned that the `scientific method´ used here is identical to that of orthodox economists and rests on the same flawed ontology.

***Summary***

Scientistic orientated economists ask: what are the variables and what are the law-like relations between them? With an ontology of events end their regularities, and an associated aetiology of causal law as regularity law, asking this makes perfect sense. But, as we will see blow, it also means *not* asking certain questions, or at least not being able to ask them properly.

**3. Political economy and critical realist-oriented economics**

In the last two or three decades, various CRs, across several social science disciplines, have gradually been assembling a social ontology, a set of statements about how the social world is. There is significant, although not total, agreement between CR´s. The following section offers a sketch of this ontology vis-à-vis the political economy - i.e. a sketch of how the political economy is. Briefly stated, the political economy is constituted by agents who reproduce or transform *structures and mechanisms* (a place-holder for a whole variety of non-agential phenomena including social and cultural structures, rules, norms and conventions) and is also open, multiply caused, complex, stratified, emergent and transformational via human agency.Let me elaborate.

***Multiple causality***

The political economy is *multiply caused*. For example, changes in the quantities of labouring services supplied and demanded are not the only causes of changes in wage rates. Wage rates are also caused by scores of *socio-economic phenomena*. Not only are there a large number of these phenomena, each with differing levels of influence, they interact with one another to create complex causal chains. Orthodox labour economists know full well that wages are *multiply caused* by `economic´ factors such as productivity, education, training and shirking. But why stop there? Wages are also caused by `non-economic´ factors such as gender, race, class, notions of fairness and justice, social and organisational culture, the politics of the workplace, political ideology and so on. The more multiple socio-economic causes are at work in labour markets, the more frictions, or rigidities will impinge upon the relationships between labour supply and demand, and changes in the wage rate (and *vice versa*); the more these relationships will be idiosyncratic or *ad hoc* rather than law-like. Nb. Orthodox economists often respond by simply adding in more variables.

***Complexity***

The political economy is *complex* in the sense that it generates changes which then feedback to alter it. Consider a labour market involving a large local employer offering `family friendly´ working practices such as term-time working for its working mothers. Whatever the merits of this policy, the unintended consequence is to produce, reproduce and re-enforce the discourse or ideology among all those engaged in the hiring-process that women´s primary orientation is towards domestic commitments. And this in turn creates a labour market segregated along gender lines: one segment with full-time jobs reserved for men and another segment with part-time jobs reserved for women. The more complexity generating phenomena like discourses and ideology are at work in labour markets, the more these relationships will be idiosyncratic or ad hoc rather than law-like.

***Stratification***

The political economy is stratified. Stratification is often depicted in the following figure 2.

|  |  |
| --- | --- |
| **Domain** | **Entity** |
| Empirical | Experiences, perceptions & observations |
| Actual | Events & actions |
| ‘Deep’[[6]](#footnote-6) | Structures & mechanisms |

*Figure 2. A stratified ontology*

Structures and mechanisms *causally govern, but do not determine, events and observations*. Gendered structures and mechanisms, for example, causally govern the actual horizontal segmentation of labour markets by gender, which is subsequently observed. Structures and mechanisms are, typically, `out of phase´, with the actions and events they govern. This, for example, explains why some, but not all, women find themselves in `male´ occupations. The more structures and mechanisms are `out of phase´ with the actions and events they govern, the more event *ir*regularity there is. The more event irregularity, the more these relationships will be idiosyncratic or ad hoc rather than law-like.

***Transformation***

The political economy is *transformational* or *morphogenetic/morphostatic* in the following sense. Agents do not create or produce structures and mechanisms *ab initio,* rather they *re*produce (hence *morphostatic*) or *transform (*hence *morphogenetic)* a pre-existing set of structures and mechanisms. Every action performed requires the pre‑existence of structures and mechanisms which agents draw upon in order to initiate that action. By drawing upon these structures and mechanisms, agents reproduce or transform them. For example, speaking requires the structure of grammar and the operation of a labour market requires mechanisms for establishing ownership rights. This ensemble of structures and mechanisms simply ***is*** society or is a sub-section of society, such as a labour market. The transformational principle, then, centers upon the structures and mechanisms that are the *ever-present condition, and the continually reproduced or transformed outcome of, human agency (cf. Archer 1995, 1998)*.

Let us put this in the context of labour markets. Labour market agents (such as employees[[7]](#footnote-7)) are born into a pre-existing world containing, *inter alia*, the social structures of class, laws, rules and discourses governing the legitimate and acceptable exchange of labour services for wages. These phenomena ensure that labouring activity is a quasi-commodity. And this quasi-commodity is traded in labour markets. In order to act in labour markets, then, employees must draw upon phenomena like the social structures of class, laws, rules and discourses. By drawing upon them, they reproduce or transform them. As they reproduce or transform them, they simultaneously reproduce or transform themselves as sellers of the quasi-commodity labour power. The more social phenomena such as the social structures of class, laws, rules and discourses are at work in the social economy, the more these relationships will be idiosyncratic or ad hoc rather than law-like.

***Agency & structure***

Transformation involves:

* Agency *and* structures and mechanisms
* Conscious deliberation and unconscious, tacit action or habit

Sometimes agents reflect on the structures and mechanisms that enable and constrain them, and engage in conscious deliberation (although not in the sense of *the rational individual*) designed to meet some objective. At other times agents act unconsciously, tacitly, and act on the basis of habit. To do so means they have internalized some kind of rules and norms, via a process of habituation.

[I]t might be possible that our actions are directly and non-consciously determined by our current dispositions, while allowing that those dispositions are themselves the outcome of a series of past events. Those events include (i) very recent reflections that we tend to see as directly causally effective ‘decisions’; (ii) older reflections that shaped our dispositions consciously at the time but which we may now have forgotten; and (iii) experiences that affected our dispositions (for example in the subliminal acquisition of a habit or skill) without us ever consciously deciding how (Elder-Vass 2006: 175).

Just as agents draw upon and reproduce or transform structures and mechanisms, in so doing they reproduce or transform *themselves* as agents of a specific kind – e.g. job-seekers, discouraged workers or whatever. Archer (2000: 258) refers to this as the `double morphogenesis [and morphostasis] of agency´.

Because both agency, and structures and mechanisms, are always in operation, there are two sources of change.

First, agents can, and do, change their minds. This should not be taken to mean that humans are entirely capricious or act whimsically, if for no other reason than they constantly engage with structures and mechanisms. Rather, it means their actions are not entirely predictable because they retain the ability to *always have done otherwise*. To deny this is to deny human subjectivity, creativity, imagination, ingenuity and entrepreneurial activity. Wage rates or working conditions that were accepted as legitimate by workers in one period can become unacceptable in another period and *vice versa*, and it is often difficult to attribute causes to this other than to say workers changed their mind – *sui generis*, or because of information about other possibilities or comparators. Orthodox labour economists know this and refer to it as changes in `preferences´. But unfortunately, they almost never investigate the source of these preferences and they are, as Hodgson (2003: 60) puts it, `immaculately conceived´.

The second source of change comes from changes in the structures and mechanisms themselves. The more labour markets are characterized by agents, that on the one hand operate on the basis of habits, not deliberation, and on the other hand on the basis of the social structures of class, laws, rules and discourses, for the same reasons noted above, the more actions will be idiosyncratic or ad hoc rather than law-like

Many scientistic-oriented economists collapse structure into agency, and in the process structures and mechanisms simply vanish from the analysis. The resulting ontological and methodological individualism leaves them unable to investigate the way non-agential forces influence agents. Rational Economic Man is driven entirely by his preferences in an environment where the constraining or enabling forces of structures and mechanisms do not exist.

***Emergence***

The political economy is emergent. The usual example of emergence is water. Water is emergent from hydrogen and oxygen, but has properties that are not found in either hydrogen or oxygen. This holds for the social world too – although unlike the natural world where emergence does not require human action, the social world does. The political economy is emergent from a set of structures and mechanisms – such as the structures of class; the laws, rules and discourses governing the legitimate and acceptable exchange of goods, services and labour power; and the market mechanism – by which I mean far more than a set of supply and demand functions (Fleetwood 2006 and 2011).

***Event irregularities, epistemology, open and closed systems***

The social world in general, and the political economy in particular, is multiply caused, complex, stratified, transformational, emergent, and subject to the exercise of human agency interacting consciously with structures and mechanisms, and unconsciously or habitually with rules. In this case, any putative relationships between the actions of human agents, quantified and expressed as variables are, therefore, likely to be idiosyncratic and accidental, rather than law-like. In CR terminology, the political economy is an *open system*.

The critical realistconcept ofopen and closed systems is simple, perhaps deceptively so. *Systems that display event regularities are closed; systems that do not display event regularities are open.* This is often styled as: `whenever events *x1, x2, x3….xn*, then event *y´.* They canbe expressed as a mathematical function – deterministically as in (4) or stochastically or probabilistically as in equations (1), (2) and (3) above.

(4) *y* = *f* (*x1, x2, x3….xn*)

To exemplify: if labour supply *regularly* increases following wage rises, then labour markets are *closed* systems; if labour supply *sometimes* decreases, *sometimes* increases and *sometimes* remains unchanged following wage rises, then labour markets are *open* systems. In open systems, relationships such as that between changes in government expenditure and output and employment, or public debt and economic growth, are idiosyncratic and accidental rather than law-like.

With the recognition that events do not manifest as regularities or laws, combined with the further recognition that *something* must govern these events, the emphasis of investigation necessarily switches from the domains of the empirical and actual to the `deep´, and to the structures and mechanisms that govern the flux of events. Investigation switches from the *consequences*, that is, from the *outcomes or results* (i.e. patterns as event regularities) of some action, to the conditions that make that action possible. Knowledge derives from investigating the ‘deep’ structures and mechanisms *not* patterns in the flux of events.

***Aetiology***

For CRs `law´ means `tendency´. A tendency is a force that, metaphorically speaking, drives, propels, pushes, thrusts, asserts pressure and so on. The tendency is *the force itself* which is very different to the way tendency is often used by scientistic-oriented economists to refer to a stochastically expressed law, or some loosely operating event regularity. Stating this carefully:

(c) Law as (*genuine*) tendency*.* This conception is *not* rooted in events, event regularities, or the *regularity view of causation*, but in the concept of causal power. Tendency is the (transfactual) way of acting of a thing with properties.

To write that a phenomenon has a tendency to β does not mean that it does β. In an open system, causal mechanisms do not exist in isolation from one another. There are, typically, a multiplicity of mechanisms each generating their own tendencies. These tendencies converge in some space-time location. Any particular causal mechanism that has a tendency does not always bring about certain effects, but it always *tends* to – i.e. it acts *transfactually*. The actual outcome of this confluence of tendencies is impossible to predict *a priori*.

***Summary***

CR orientated economists ask: who are the agents, what are the structures and mechanisms they reproduce or transform and what tendencies are generated? With an ontology of agents and structures and mechanisms, and an associated aetiology of causality as tendency, asking this makes perfect sense. It is worth pointing out that the above arguments are intended to illustrate the usefulness of deploying CR meta-theory to substantive concerns of political economy. The arguments developed in the following sections cannot be deduced or `read-off´ from this meta-theory. It is, therefore, entirely possible for a reader to agree with the meta-theory, but disagree entirely on substantial matters vis-à-vis the crisis. CR meta-theory is no more than the ground upon which reasonable arguments about substantive matters may take place.

**4. The current (European) crisis**

The aim of this section is to (no more than) sketch the main causes of the current European *sovereign debt crisis* (SDC) – i.e. the inability by the government of a sovereign state to re-pay, or re-finance, its loans, especially the peripheral states of Portugal, Ireland, Greece and Spain (PIGS). Let me, at the outset, make four points.

First, the SDC was *triggered* by the banking crisis, which triggered a global recession. The SDC was not, therefore, triggered by public sector deficits in peripheral states. Public finances in states worsened *after* the crisis, not before, meaning public sector deficits could not have been the *cause* of the crisis.

Second, I reject superficial `explanations´ of the cause of the crisis that blame, *inter alia*: `lazy, profligate southern Europeans´, `short-sighted people borrowing in order to live beyond their means´, `incompetent and inefficient states´ (although this is not entirely without foundation) or `greedy bankers´ (which does not mean bankers are not greedy).

Third, the causes can be conceived of in three senses: *distal, medial* and *proximal*. This is an analytical device used to deal with the fact that there are not just different causes, they have what we might (metaphorically) call different `*causal distances*´ from the crisis – and there is some over-lap. Allow ,e to insert a small note for clarification. Distal causes are necessary causes in the sense that they are rooted firmly in the nature of market-based economies and not, therefore, peculiar to time and place. Proximal causes are not so firmly rooted, are contingent, and peculiar to time and place. Medial causes can be thought of as `in between ´, as it were. Locating these causes is a (debatable) empirical matter, as is any attempt to establish a connection between them. That said, distal causes act tendentially on medial and distal causes, but the actualization of any distal cause is always contingent.

Fourth, in the CR lexicon, the concept of causality at work is *tendency*. Take for example a phrase I will use below:

* `the shift in the balance of political power, de-regulation and flexiblization of labour markets led to wage restraint´.

This should be read as:

* `the shift in the balance of political power, de-regulation and flexiblization of labour markets *tends* to restrain wages.

To say there is a tendency for wage restraint does not mean that wage restraint regularly follows a shift in the balance of political power, de-regulation and flexiblization of labour markets. In an open system, there is, typically, a multiplicity of mechanisms each generating their own tendencies and counter-tendencies – e.g. unions and political movements could regain the balance of power and overturn the de-regulation and flexiblization of labour markets. The actual outcome of this confluence of tendencies is impossible to predict *a priori*.

***i) Distal causes***

These are ever-present causes that are woven into the fabric of the political economy and, as such, are necessary and non-contingent. They cannot be removed via reforms – at least not without *fundamentally* altering the nature of the system. Three of the key distal causes are as follows. First, the tendency of the rate of profit to fall (TRPF). The TRPF is built into the process of capital accumulation and both causes, and is caused by, owners and controllers of capital constantly seeking to increase the ratio of (physical) capital to labour in order to raise productivity. Second, whilst many do not accept the TRPF, and the exact nature of decline is debatable (i.e. is it cyclical or linear downwards?) no-one doubts that capitalism is beset with periodic crises caused by low rates of profit. Third is the class struggle between owners and/or controllers of capital and owners of labour power only – i.e. workers.

***ii) Medial causes***

These are causes that operate `between´ the distal causes and the actual crisis. They pre-date the current crisis and pave the way for it. I will sketch them under three headings.

*Globalization*

The 1990s witnessed the emergence of, and integration into, the global capitalist system of large, low wage economies - especially China. One of the effects was to give the owners and/or controllers of capital the power to either re-locate production, or at least to *threaten* re-location – whilst this threat may be exaggerated, it has often been causally efficacious. This had significant implications for class struggle in Europe – of which more below.

*Developments in class struggle since the 1980s*

The defeat by capital, of workers and unions in several key industrial conflicts, resulted in a shift (or maybe just a perceived shift) in the balance of power away from previously, relatively well-organized unions, to the owners/controllers of capital. Partly as a cause and partly as a consequence, social democratic parties (e.g. the UK Labour Party, the German SPD) abandoned any previous claim (or pretense) to be anti-capitalist parties and embraced neoliberalism. Markets, especially financial and labour markets were de-regulated and made more flexible. The shift in the balance of political power, aided by globalization and the rise of finance capital, along with de-regulation and flexiblization of labour markets led to wage restraint. Wage restraint hit workers in core European states, especially Germany, harder than workers in peripheral states, with wages in Germany rising slower than productivity. Wage restraint led to low aggregate demand, poor macroeconomic performance and set the stage for an increase in personal debt – cheap credit became an unofficial policy for dealing with years of wage restraint.

*Shift from industrial to financial capital*

A combination of low profit rates in the manufacturing sector, coupled with de-regulation of financial markets, led to a significant rise in the influence of finance capital, and to increased financialization – i.e. a process whereby an increasing portion of socio-economic life becomes shaped by the (needs of the) financial system. This affects private individuals (pensions, mortgages and insurances), private firms and the public sector.

An important symbiotic relation emerged between banks and households - especially households in peripheral states. Banks *must* lend, and in the 1990s they turned their attention to lending to individual households. Households needed to borrow for two main reasons: (i) to meet rising house prices - caused by neoliberal policies that de-regulated housing markets; and (ii) to maintain acceptable levels of household consumption (this was, of course, the promise of the EU project) in the face of wage restraint.

Rising personal debt was used by governments as an (unofficial) economic policy to offset low wages and stimulate aggregate demand – whilst government ministers ranted, in public, about the indebtedness of irresponsible individuals. This was a period where interest rates were low; banks were happy to lend; households were happy to borrow; and the owners/controllers of capital were happy to join the party.

***iii) Proximal causes***

These are causes peculiar to time and place. I will sketch them under five headings.

*Financial system*

The de-regulation of financial markets led to a significant rise in all kinds of speculation – i.e. the `Casino Economy´. There was an increase in the use of derivatives and undervaluation of complex, risky and ultimately toxic, financial products. An increase in speculative mortgage lending (sub-prime market) by U.S. financial institutions led to the emergence of toxic mortgages. This led, in turn, to the collapse of Lehman Brothers, a global financial crisis, and then to a global recession.

*Eurosystem - European Central Bank (ECB) and central banks of Eurozone states*

The Euro was designed and implemented to be a world currency to rival the dollar. To carry out this role it had, and still has, to meet certain criteria – without which, international currency markets will not treat it as a world currency. These criteria help to give the Eurosystem its characteristics, which can be summarized as follows:

* The Eurosystem´s monetary policy has one over-riding objective: maintaining low inflation and, of course, doing this solely by monetary policy.
* The Eurosystem has no explicit fiscal policy. The Stability & Growth (S&G) Pact, however, acts as a kind of implicit fiscal policy. Eurozone states must meet two arbitrary limits:
  + National debt must not exceed 60% of GDP.
  + Budget deficits must not exceed 3% of GDP.[[8]](#footnote-8)
* In theory these limits should prevent sovereign states becoming indebted. In practice, some states have been allowed to transgress these limits.
* The S&G Pact has no mechanisms for fiscal transfer between Eurozone states.
* The ECB does not behave like the Central Bank (of a sovereign state). It has no obligation, or mechanism, for managing the debt of a Eurozone state.

Being part of the Eurozone conferred a degree of (illicit) credibility on the bonds issued by peripheral states. International financial markets initially believed that the strong core states would support weaker peripheral states. They `implicitly assumed that members of the EMU simply would not go bankrupt´ (Lapavitsas *et al* 2012: 91). Core Eurozone banks initially kept lending to peripheral states, apparently believing they were safe. As the recession deepened, and peripheral states started to accumulate public debt, core banks started to worry about the creditworthiness of some peripheral states and eventually stopped buying their bonds. This quickly turned into fear of a banking collapse in the core states, should a peripheral state actually default on its loans.

*Global recession, public sector deficits and the Eurosystem*

As the global recession hit the peripheral states, two major problems emerged: the tax intake declined; and expenditure on social security increased. As a consequence, the public sector finances in peripheral states worsened and, furthermore, they were hit by a chain of negative, unintended consequences. The credit ratings of peripheral states were downgraded, pushing up interest rates and increasing their public sector deficits. Some peripheral states now faced insolvency and, importantly, threatened the existence of core banks who had lent heavily to peripheral states. Banks (deemed `too big to fail´) were rescued by individual peripheral states, thereby increasing their fiscal deficits.

The Eurosystem developed various measures to fund fiscal deficits of peripheral states - in order to ensure the survival of the core banks. But Eurosystem funding to peripheral states came with strings – *austerity*. Austerity further exacerbated the two major problems noted above: the tax intake declined even further; expenditure on social security increased even more. Public sector deficits in peripheral states increased.

*Inherent core-periphery division: Germany Vs. PIGS*

For various reasons, the Euro was established (1999) on the basis of unsustainably high exchange rates for peripheral states, vis-à-vis the D-Mark. Since then, the German economy has been characterized by high unemployment, mediocre growth, low inflation, balance of payments surpluses, and wage rises below productivity. Indeed, the German ruling class has been the best in Europe at restraining the pay and conditions of its working class. The Greek and Portuguese economies, for example, have been characterized by high household consumption based upon household debt, and wage rises above productivity. The Greek and Portuguese ruling class has not been as good at restraining the pay and conditions of their own working class.

The German balance of payments surplus has been caused by pressure on German workers pay and conditions, and exports to Eurozone based on high exchange rates for peripheral states. The German balance of payments surpluses have been recycled and lent to peripheral states.

The balance of payments deficits in peripheral states have been caused by recession; bailing out core and peripheral banks; austerity which led to declining tax take and increasing social security expenditure; high interest rates for government borrowing; and in the case of Greece, weak tax raising powers - supported by the rich.

*European ruling class agenda*

Class struggle can take direct and indirect forms. Direct class struggle in core states takes the form, primarily, of labour market reforms to drive down pay and conditions. Direct class struggle in peripheral states takes the form of the (same) labour market reforms combined with harsh austerity measures, like slashing pay rates and freezing recruitment for public sector workers and altering pension conditions and rates. Indirect class struggle in core and peripheral states takes the form of privatization and commodification of public sector services. This leads to downward pressure on pay and conditions, and lucrative profit opportunities, often at very low risk - the state cannot allow many of these (now privatized) services to fail.

It would be wrong to suggest that the European ruling class have a conscious, fully worked-out strategy for re-structuring European capitalism to their advantage. But, given that the recession and ensuing crisis happened, the European ruling class appear to be taking advantage of a very favourable (for them) political-economic climate. This is why neo-liberalism is a kind of `smash and grab´ raid by capital to `loot´ as much as it can whilst the political climate favours them.

***Summary***

The causes of the current crisis, then, are not the result of the invisible hand of market forces alone, but the result of the market forces operating alongside the very visible hand of political forces.

This pattern is not the outcome of the blind interplay of pure economic forces. Every step of this decent into the depths has been mediated by the entire set of EU institutions (Lapavitsas *et al* 2012: xviii).

The crisis…is as much political as economic (*The Economist* 2011: 4-5).

**5. The uselessness of scientistic-oriented economics**

At this point, we can connect the earlier section of the paper, featuring scientistic-oriented economics, to the current crisis, and show that this approach to economics is useless in explaining the current economic crisis. And the reasons are, ultimately, ontological.

First, scientistic-oriented economics is unwilling and unable to attempt to understand the very visible hand of political forces behind the current crisis because it is preoccupied with seeking law-like effects between key macroeconomic variables. This is driven, ultimately, by the ontology of atomistic, observed events and the (alleged) event regularities that (allegedly) make these law-like effects causal.

Second, to the extent that scientistic-oriented economics attempts to understand these law-like relations, it does so via economic theory based upon fictional individual rational maximizing agents, with fictional preferences, engaging in fictional activities, inhabiting fictional households, seeking fictionalized jobs in fictionalized firms, and interacting with fictional institutions, structures, organisations and mechanisms. The net result of this is theories lacking any kind of explanatory power.

Let us consider three examples of the inability of scientistic-oriented economics to offer any insight.

***5.1 Exchange rates upon which the Euro was established***

Consider the unsustainably high exchange rates at which peripheral states entered the Eurozone. In 1979 the European Currency Unit (ECU) was established by the *Ecofin Council* – finance ministers and central bankers of the participating states. The ECU was, in theory, a weighted average of national currencies based upon a grid of bi-lateral exchange rates. The participating states agreed to keep their exchange rates within +/- 2.25% - 6% for the Italian Lire. This was not, however, a one-off set-up. National currencies were repeatedly re-alligned between 1979 and 1995. In reality, however, the ECU never was, and the Euro is not, a weighted average of national currencies based upon a grid of bi-lateral exchange rates. Individual nation states based their currencies (and their policies) on the D-Mark. For example, there were 6 instances of re-alignment of the French Franc against the D-Mark – in each case, a devaluation with a cumulative devaluation of 45.2%.

*Economics cannot establish what the `correct´ exchange rate is/was*

Exchange rates are determined by several factors such as differentials in inflation, interest rates, balance of payments, public debt, terms of trade and political stability and economic performance. Interest rates, a key factor, are set by the ECB. Whilst they are informed by economic variables, they are not determined by them but are, ultimately, political decisions. Understanding the determinants of exchange rates is at best extremely difficult, and at worst impossible. Indeed, many orthodox economists believe that changes in exchange rates are best conceptualized as random walks – i.e. inherently unpredictable. There is, then, no law-like relationship between exchange rates and some set of macroeconomic variables. Economic theory and research cannot explain what the `correct´ exchange rate is for two given currencies. And it could not explain what the `correct´ exchange rates were between the D-Mark and the Drachma and Escudo in the 1980s and 1990s. It took several years to eventually realize that the exchange rates were incorrect. The decision to set unsustainably high exchange rates for the currencies of peripheral states had a degree of `accident´ about it.

*Exchange rate as a political strategy*

When the Euro eventually emerged, the exchange rate between it and the national currencies that it emerged from, were determined as much by political considerations as economic ones. Moreover, remember that by the late 1980s and early 1990s, Monetarism (fore-runner of neoliberalism) had become the `Conventional Wisdom´ amongst economists, finance ministers (and their advisors) and central bankers of the participating states. Monetarism provided a shared discourse, a shared economic world-view. Setting high exchange rates for the currencies of peripheral states meant that improvements in their economic competitiveness would have to come largely via the labour market – i.e. imposing market discipline to worsen the terms and conditions of their workers. Setting high exchange rates for the currencies of peripheral states, was not only a political strategy, it was a strategy that suited the European ruling class.

***5.2 Changes in balance of political power***

Consider the shift in the balance of power (noted above), away from previously well-organised labour unions to capital, resulting in de-regulation and flexiblization of labour markets, which in turn led to wage restraint – most notably in core European countries. There is no (meaningful) way of quantifying this power, or quantifying this shift in the balance of power. There is no way of quantifying the effects of this shift in the balance of power on this specific round of de-regulation and flexiblization of labour markets. Even if we could quantify power, and its effects, there is unlikely to be a law-like relation between shifts in the balance of power and de-regulation and flexiblization of labour markets. There is no way of quantifying the effects of this specific round of de-regulation and flexiblization of labour markets on this specific round of wage restraint. Even if we could quantify these effects, there is unlikely to be a law-like relation between de-regulation and flexiblization of labour markets and wage restraint. The shifts in the balance of power are as important in explaining the crisis, as they are impossible to quantify. They cannot, therefore, become part of scientistic-oriented economics explanation of the crisis.

***5.3 De-regulated financial markets***

Consider the case of the `Casino Economy´ and the systematic undervaluation of complex, risky and ultimately toxic, financial products. Paul Tucker, Deputy Governor of the Bank of England, put his finger on the dilemma facing investors:

[T]there is a potent collective action problem in getting off the dance floor. Not a few senior market participants felt from at least 2006 that financial risk was underpriced, and that conditions in, for example, the leveraged loan market were silly. But they also had the no conviction about when, or indeed whether for sure the music had to stop, and so feared that stepping away from the dance `too early´ would crystallize business risk, as the dance would simply go on without them and their franchise would be undermined as customers migrated to their competitors (cited in Leijonhufvud 2009).

Scientistic-orientated economists can only explain this in terms of rational agents, pursuing maximization strategies with less than perfect information. Whilst I cannot elaborate here, suffice it to say that this is a very poor explanation. A serious explanation would have to delve into the political, cultural, social and ideological shifts that encouraged (initially) the UK government to de-regulate financial markets in the 1980s.

There is, then, an explanation for: the unsustainably high exchange rates at which peripheral states entered the Eurozone; how changes in the balance of political power resulted in de-regulation and flexiblization of labour markets, which in turn led to wage restraint; and the `Casino Economy´ and the systematic undervaluation of complex and ultimately toxic financial products. The problem is that scientistic-oriented economics cannot explain any of these things.

**Conclusion**

Scientistic-oriented economists ask: what are the variables and what are the law-like relations between them? With an ontology of events and their regularities, and an associated aetiology of causal law as regularity law, asking this makes perfect sense. But it also means not asking certain questions, not being able to ask them properly and, therefore, not being able to explain them.

CR-oriented economists ask: who are the agents, what are the structures and mechanisms they reproduce or transform and what tendencies are generated? With an ontology of agents, and structures and mechanisms, and an associated aetiology of causality as tendency, asking this makes perfect sense. The ontological commitments of CR implore us to focus attention on a political economy that is open, multiply caused, complex, stratified, emergent and transformational, and the specific groups of agents who reproduce or transform specific structures and mechanisms.

More sophisticated explanations of the current crisis than I have sketched above are, of course, possible. Moreover, such explanations would not necessarily require that they be constructed by researchers explicitly committed to CR. Indeed, political economists like Lapavistas *et al* (2011) offer extremely important insights into the current crisis without mentioning CR – indeed, without mentioning meta-theory. The same could be said for many heterodox economists and others working outside disciplines related to economics, such as political scientists. In many cases where sophisticated explanations of the current crisis are offered, however, they (implicitly or perhaps explicitly) presuppose concepts that are compatible with the main tenets of CR. If CR has anything to offer these other researchers, then, it is not in terms of substance, but in terms of CRs insistence on the need to be conscious of the fact that the social world that is open, multiply caused, complex, stratified, emergent and transformational.

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1. I would like to thank Dimitri Mader for several excellent suggestion that have, I believe, improved this chapter. [↑](#footnote-ref-1)
2. Political economy is the discipline that investigates *the* political economy. I do not like the term `political economy´ (a) because it is often (mis)understood as a kind of 19th century version of economics; and (b) because in orthodox economics it manifests itself as a kind of `mathematical-politics’ – i.e. Rational Choice Theory. It is, however, the `best of a bad bunch´ including `social economy´, `moral economy´ and `cultural political economy´. I use `political economy´ to include social, moral and cultural political economy. [↑](#footnote-ref-2)
3. For elaboration of CR in economics in general see Lawson (1997 & 2003). [↑](#footnote-ref-3)
4. See Fleetwood (2011) for an elaboration of tendency in Marxist theory. [↑](#footnote-ref-4)
5. This is not restricted to Marxist economics, and can be found in other heterodox camps such as Sraffian, Post-Keynesian and Radical economics. It is found less in (Old) Institutionalist economics and economic-sociology, but it seems that the desire to use econometrics (to establish empirical associations between dependent and independent variables (with or without an underlying mathematical model) is compelling – even where it is inappropriate. [↑](#footnote-ref-5)
6. I prefer the term `deep´ to the more usual term `real´ because the latter carries the unfortunate connotation that the empirical and actual are, somehow, not real. [↑](#footnote-ref-6)
7. I could do the same for employers, but would be repeating the point. [↑](#footnote-ref-7)
8. Nb. The National debt is the total amount owed by government *and* private sector of a nation state. The government of a nation state takes tax revenue from citizens and then spends this revenue on public services. When it spends more than it receives, it runs a budget deficit. [↑](#footnote-ref-8)