

**METHODOLOGY OF ECONOMICS,
POSITIVISM &
LIBERAL EPISTEMOLOGY**

BY

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Introduction

The purpose of this essay is to give a brief summary of the relationship between Philosophy of Science and Economics in the twentieth century, and further, to make a comment on the contemporary status of this relationship in light of attacks of indeterminacy on positive economics¹. Also, this is an appeal to economists and philosophers of science to explore discussions on methodology with substantive discussions in ethical theory. The motivation to undertake this summary derives partially from a desire to make a succinct statement available to economists at large, who by the very constraints imposed by their specialized avocation, have not the resources to undertake a detailed study of epistemology, but who would like to grow more self-conscious of their methodology and thereby locate themselves in a larger framework of philosophy of science

Even though Milton Friedman's article '*The Methodology of Positive Economics*' has done the service of initiating a popular discussion in the area of philosophy of science as it relates to economics, it falls short of one's expectation by presenting only a very narrow and a specialized variation of a larger species of epistemic discussion; furthermore, it does not meet the very standards that positivists have set for themselves. Paul Samuelson's position with respect to methodology, as presented in his theory of 'revealed preference' and his '*Foundations of Economic Analysis*', suffers the same limitation by not providing a sustained and a comprehensive argument in philosophy of science. The necessity to undertake a comprehensive survey of economic methodology is further substantiated by a need to connect the subject matter of methodology of economics with substantive discussions in political and moral philosophy; this is an aspect that I find conspicuously missing from Bruce Caldwell's '*Beyond Positivism: Economic Methodology in the Twentieth Century*', the very book that inspires this summary. You will, therefore, also find here in this essay my own devices that anticipate a little more than a tenuous connection between methodology and moral philosophy

Methodological Monism Vs. Methodological Pluralism

According to me, the dominance of methodological monism², i.e., insistence of any scientist or economist on the correctness of one method, or one purpose of first order scientific investigation, accompanied by an insistence on a single meta-theoretic scheme of justification, is a consequence of a closely corresponding trend in philosophy of

¹ I owe the organization of my ideas to Bruce Caldwell's book, '*Beyond Positivism*'; this essay is meant to do both, review Caldwell's book, as well as carry some of my own perspectives in philosophy of science as it relates to economics.

² Please note that methodological monism does not preclude debate; in point of fact it only exacerbates debates on methodology, as in the case of economists who have their own individual emphases to the exclusion of others.

science. Caldwell's position stands directly in opposition to this insistence³. My own position with respect to this debate is heavily loaded in favor of pluralism, but with the added qualification, that this be so on account of considerations of pragmatism.

Methodological monism in economics, as in the philosophy of sciences, flows out of a tendency exhibited by practitioners, and theorists alike, to give importance to one set of criteria of science at the expense of an alternate criteria of science. One who is scarce acquainted with methodological debates might wonder at this point, how can there be alternate criteria of scientific investigation; are not scientific criteria⁴, a unified and coherent scheme of knowledge acquisition? The content of the following sections of this essay answer this question in greater detail by outlining the continued possibility of competing theories of scientific method, evidenced by the number of them that historians of economic ideas have already encountered to date.

Logical Positivism

Introduction

If modern philosophy began with Descartes in the seventeenth century, especially with the paradigmatic phrase 'Cogito Ergo Sum', Logical Positivism may be seen as the climactic culmination of this tradition. This tradition, while including the likes of Locke, Berkeley, Hume, Kant, and Hegel, may be characterized by two major philosophical distinctions which are of great significance to the way scientific methodology developed. The first of these distinctions is the one between realism and idealism, and the second of these distinctions is the one between empiricism and rationalism⁵. While the disputes revolving around the first distinction raged about ontological questions of existence, the disputes concerning the second distinction were about epistemic questions of knowledge acquisition. Since ontological disputes may have direct consequences on ethical theories, and epistemic disputes may have direct consequences on scientific methodology, notwithstanding the influences that ontological speculation may have on methodology and likewise epistemic on ethical theories, one may describe the considered period of modern philosophy as a continuum of conflict between two divergent tendencies of human thought: on one hand lending credence to the experientially intangible, and on the other, validating conjectures and hypotheses only with that which is concretely available in experience. It is interesting to note that Bertrand Russell makes a definition of liberalism by attributing to it any rational endeavor to escape an historical oscillation between the social consequences of these divergent tendencies⁶

³ Bruce Caldwell: Introduction, pg. 2, "One preconception of mine that is admittedly unoriginal is that there is no single infallible method: there is no best way waiting out there to be discovered, neither in the form of some Platonic ideal, nor by careful objective study of the history of method. Rather, I am a methodological pluralist, by which I mean that, just as there exist many tasks for theories to perform, there are also many method for the evaluation and criticism of theories".

⁴ especially the criteria adopted by the person who asks this question itself!

⁵ In the strict philosophical sense, i.e., *a-priorism*.

⁶ Bertrand Russell, 'A History of Western Philosophy', Introduction.

Experiential Verifiability and Analytic Tautologies

Logical Positivism derives its criterion of cognitive significance by an appeal to the two tendencies mentioned above. The empiricist versus rationalist, and the realist versus idealist debates, which were the preoccupation of philosophers of science until the end of the nineteenth century, filter down along the continuum of history of ideas, to become the Synthetic versus Analytic paradigm of the logical positivists⁷. Analytic propositions, to the logical positivists, are those which gain cognitive significance from the fact that their truth value derive from definition, or convention: they are tautologies reflecting a value which is already contained in the predicates of these propositions. Synthetic propositions are those which are true in virtue of conveying experience. An instance of an awareness of such a distinction may be found in Gardner Ackley's text *Macroeconomic Theory*, in which he subtly hints at an occasional coincidence of analytic relationships and empirical relationships⁸. One will also notice here that emphasis has shifted from analysis of cognition directly by pre-logical positivists, to analysis of the language in which cognitive activities are ensconced by logical positivists.

The significance of drawing such a sharp distinction between the divergent modes of cognitive significance to the logical positivists, lies in schematizing kinds of knowledge. The most popular expression of this dramatic gain in self confidence, especially in terms of the speculative perspicuity that this schematization promises to offer, is to be found in A.J. Ayer's *Logic, Truth and Language*. In this particularly charming exposition of logical positivism, an exposition which ostensibly swept away the cobwebs of British empiricism in the heydays of the Vienna Circle, one finds the strongest statement about the then newly found method of weeding out metaphysical nonsense from anything that makes a claim to cognitive significance. Propositions which are neither analytic nor synthetic are metaphysical; metaphysics is a pejorative term in the works of logical positivists.

The paradigm of logical positivists is thus constituted of a criterion of empirical significance that is based on experiential verifiability. Both physical scientists and social scientists alike, insofar as they continue to be positivists in some sense, exhibit an awareness of how to demarcate what is considered metaphysical from true scientific knowledge on the basis of experiential verifiability. Platonic universals are relegated to poetry, while testable hypotheses find place in compendiums of economics or physics. The spirit of logical positivism, according to Caldwell, permeated economic methodology sometime in the immediate post-depression era, thereby consolidating the scientific strain in studies of political economy, and effecting a transformation of a still metaphysically

⁷ In fact the concepts of Synthetic and Analytic were already given exposition in Spinoza and Kant.

⁸ the relationship between demand and supply as an analytical (i.e., by definition) construct, and the relationship between the same concepts as established by empirical investigation: "The equality which we discovered among total spending, the money value of total output, and (under simplified assumptions) total income was only a definitional identity. It implied nothing whatever as to causation.....Despite the fact these accounting relationships imply nothing as to causation, it is of course possible to postulate causal relationships, direct or indirect, among the same variables. This moves us from the realm of accounting into economics.....[For now.] however, our purpose is merely to indicate that we can simultaneously postulate both definitional and behavioral relationships among the same variables."

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Economists with Methodological Concern:

Subjectivism, methodological individualism, and confidence in self-evident nature of the basic postulates of economic theory⁹, according to Caldwell, dominated methodology before positivism was introduced. Lionel Robbins' *'An Essay on the Nature and Significance of Economic Science'* (published in 1932) is considered the twentieth century precursor to a paradigmatic shift in methodology towards positivism. Robbins views that "the fundamental generalizations of economics are self-evident propositions about reality", and that the "expository devices of rationality (consistency in choice), and perfect foresight are usually invoked as simplifying assumptions which are first approximations to reality"¹⁰, are representative of an uncritical methodology. Juxtaposition of such pre-positivist methodologies with positivist methodologies, unveils a clear difference in terms of a positivist's emphasis on experiential verification as a primary consideration in any scientific investigation.

The credit of introducing positivism in to economic theory given to Terence Hutchinson, is amply justified by his 1938 book *'The Significance and Basic Postulates of Economic Theory'*. Testability of scientific propositions, as against psychological methods or intuition, or introspection, or bearing credulity to the so called self-evident truths of economics, is what then, economic methodology, according to Hutchinson, must exhibit in order to make economic theory a scientific enterprise. However, it is interesting to note that Hutchinson insinuates the notion of intersubjectivity¹¹ as a qualifying criterion of empiricism in situations that may not be directly amenable to empirical verification. One is tempted here, to touch upon the debate that the notion of intersubjectivity has generated both, in general philosophy of science, as well as utilitarian philosophy. But on the whole, it is safe to classify Hutchinson as a positivist, as he does dwell upon the positivist criterion of cognitive significance as the central dimension of economic methodology.

Variations within positivist economic methodology become more apparent with the coming of Milton Friedman's *'Essays in Positive Economics'*, notably his famous chapter and essay *'The Methodology of Positive Economics'*. In this essay, which for the very first time caught the imagination of mainstream economists in any significant manner, one finds his attempt to draw a relationship between positive and normative economics, very similar to H.L.A. Hart's jurisprudential analysis¹² of law and morality as distinct and

⁹ Caldwell, 'Robbins versus Hutchinson-The Introduction of Positivism in Economic Methodology' *'Beyond Positivism'*.

¹⁰ Caldwell, *'Beyond Positivism'*

¹¹ "They [propositions]-need not, that is actually be tested or even be practically capable of testing under present or future technical conditions or conditions of statistical investigation, nor is there any sense in talking of some kind of 'absolute' test which will 'finally' decide whether a proposition is 'absolutely' true or false. But it must be possible to indicate intersubjectively what is the case if they are true or false" Terence Hutchinson, *'The Significance and Basic Postulates of Economic Theory'*

¹² H L A Hart, *'A Concept of Law'*.

yet related concepts. While there is sufficient confusion¹³ about the meaning of positive law in jurisprudence, positive economics has largely been recognized as a field of investigation that contrasts with subjective value based policy prescription making. One will recognize at once that the distinction between positive economics and normative economics (i.e., subjective value based speculation) is not analogous to the distinction between synthetic and analytic, but synthetic and the metaphysical. This is because the products of subjective value based speculation are not analytic truths.

Friedman's distinction between positive economics and normative economics is not however, the special aspect of his doctrine of positive economics. He draws this distinction, as have many others prior to him, only to bring to the fore one of the common causes of confusion in economic debates. Theorists engaging in debates in economics, according to him, may be at cross purposes merely because they rely on an idiom that obscures the differences between propositions of positive economics and propositions of normative economics. In order to avoid this confusion and heart-burn, it follows from Friedman's view point, economists should rely on value-free, experientially verifiable tenets and premises.

But the first distinctive aspect of Friedman's theory of positive economics lies in his unifying the synthetic and the analytic in to a common scheme of economic reasoning and prediction. The distinction between the synthetic and the analytic does not prevent him from employing analytic structures at the service of organizing synthetic observations and findings. "viewed as a language, theory has no substantive content, it is a set of tautologies. Its function is to serve as a filing system for organizing empirical material and facilitating our understanding of it." The relationship between the concepts of demand and supply¹⁴ is provided as an illustration to elaborate this point. "viewed as elements [i.e., demand and supply] of the language of economic theory, these are the two major categories into which factors affecting the relative prices of products or factors of production are classified. The usefulness of the dichotomy depends on the empirical generalization that an enumeration of the forces affecting demand in any problem and of the forces affecting supply will yield two lists that contain few items in common."

The second distinctive aspect of Friedman's theory of positive economics lies in his making the predictive capacity of hypotheses (as against say explanatory capacity) the sole criteria of cognitive significance. This criterion continues to be positivistic insofar as it still relies on experience as a basis, and it varies from other possible positivist theories insofar as its end is restricted to prediction of hypotheses. The criterion of cognitive significance, while remaining true to positivism, is distinctive in Friedman's case because of the special end that it needs to meet. The rationale behind the choice of this particular end, i.e., prediction, and not anything else (say explanation), is based on our inability to choose among competing hypotheses that are possible in explaining prior experience, in other words, since it is possible to come up with many hypotheses to fit the same data, it

¹³ Owing to the many uses of the term 'positive law', Hart mentions five distinct uses of the term in his *'Philosophy of Jurisprudence'*, among which the distinction between positive law as 'what is' and law as 'what ought to be' is included.

¹⁴ Gardner Ackley uses the same concepts to illustrate the same point in his *'Macroeconomic Theory'*.

becomes necessary to rely on a criterion which makes one of these hypotheses the chosen one. Capacity to predict, then, is the additional basis on which to formulate synthetic generalizations

While Friedman's ability to recognize one of the basic problems of positivism, i.e., an inherent difficulty in making a choice of an hypothesis from a multiple number of them, all with an equal degree of correspondence with observed facts, is admirable, one still wonders how he seeks to avoid the other problem of positivism: i.e., existence of an equal degree of difficulty in assessing the capacity of a hypothesis to predict a-priori, i.e., without resorting to inducting which hypotheses have predicted better in the past

The answer to the above question lies in the last distinctive aspect of Friedman's positivism, i.e., his view that realism is not a consideration in the acceptance or rejection of hypotheses: "we have seen that a theory cannot be tested by the realism of its assumptions and that the very concept of the assumptions of a theory is surrounded with ambiguity" According to Caldwell, and Lawrence Boland¹⁵, Friedman's emphasis on prediction, as against explanation, of a synthetic proposition, makes him an instrumentalist, where, an instrumentalist may be seen as someone who is unconcerned with the truth or falsity of a proposition, but is concerned merely with its ability to serve a certain end - here, the capacity to predict. Since realism of propositions makes 'unjustified' assumptions and references to the truth or falsity of hypotheses, it cannot become a basis of choosing a hypothesis from among competing hypotheses. Therefore, Friedman brings in his strain of pragmatism in the form of instrumentalism to bolster his positivism. However, the question still remains as to how a hypothesis' capacity to predict is assessed; because the rejection of realism does not still give instrumentalism an a-priori certitude; and should Friedman not be concerned about a-priori certitude of synthetic propositions and inductivism, how does he continue to be a positivist¹⁶?

Samuelson's operationalism contrasts with the 'primacy of prediction' theory of Friedman, both in terms of importance given to theoretical terms as well as purpose of theory. Samuelson's operationalism is inspired by a tradition which demands the reduction of theoretical structures, either explanatory or predictive, into strongly empirical or observational terms. Ernst Mach's phenomenalism is good example of this kind of a thinking. Strong empiricism undermines validity of theory in comparison to object words, which refer to objects without any intermediate scope for interpretative relativism or confusion. Caldwell characterizes Samuelson's operationalism as a confused mix between the methodological invocations of falsifiability theory¹⁷, a position which addresses positivism by reversing empirical verification to falsification, and a desire to reduce economic theory to operational terms.

¹⁵ The first to label Friedman's position as one of an instrumentalists position

¹⁶ And should a-priori certitude not be possible for synthetic propositions, positivism itself collapses

¹⁷ Caldwell thinks it compares favorably with Hutchinson's leaning toward falsifiability

Post-Positivism (Attacks on Positivism)

Introduction

It is interesting to note that positivism began to run out of steam on its own accord. The first critique of positivism involves the employment of a kind of a skepticism that the precursor to positivism himself used - i.e., David Hume in his *Essays Concerning Human Understanding*. While radical empiricism began with Hume, an adoption of a moderated form of his skepticism led in to positivism, which in the end began to be questioned on the basis of the unmoderated version of his skepticism. In other words, there are two distinct aspects to Hume's epistemology: on one hand there is to be found extreme exercise of skepticism¹⁸, which destroys a-priori notions of causation and which when pursued to its logical end may result in phenomenalism; and on the other hand, there is to be found a moderated exercise of skepticism¹⁹, which is both, inconsistent with the first form, as well as leading to diverse philosophical traditions, notable among which are utilitarianism in moral philosophy (Bentham, etc) and positivism in twentieth century epistemology (as exemplified by Russell, Moore, etc) A revival of the former in a certain form becomes the basis on which the latter is questioned.

Should one note that the cognitive criterion of significance of the positivists, i.e., the principle by which synthetic propositions are held to be true on account of experiential verification, is really a translation of post renaissance empiricism filtered through Hume by relaxing his skepticism, it will become evident how the stricter version of Hume's skepticism may be brought to bear negatively on it. The very same can be said about the status of utilitarian philosophy should one question how a utilitarian version of causation can survive an irrefutable attack on determinacy in whatever form. This is precisely the moot point where attacks on positivism have taken root. Given this backdrop, one may easily imagine where a Karl Popper, or a Thomas Kuhn, or an Imre Lakatos derive their discontentment with positivism.

Popper and Kuhn

The Popperian discontentment with the main tenet of positivism is not the only well expressed point in his *'Logic of Scientific Discovery'*. Popper not only discards the criterion of verification, but also seeks to redefine the purpose of philosophy of science. *The Logic of Scientific Discovery* attempts to identify the purpose of philosophy of science as an endeavor at understanding growth in scientific knowledge. Scientists, and economists insofar as they consider themselves dealing with empirical investigations, should in the Popperian system, attempt not producing hypotheses for experiential confirmation, but on the contrary produce hypotheses that may be falsified or refuted by experience. Falsification, and not confirmation, is the Popperian criterion of scientific significance. A proposition such as 'all swans are white'²⁰, may be refuted by bringing in

¹⁸ The first book of *Essays Concerning Human Understanding*

¹⁹ The second and third books of *Essays Concerning Human Understanding*.

²⁰ Karl Popper's famous example

Work on methodology of economics invariably treats it from a purely epistemological point of view, at the expense of almost always ignoring the relationship between methodology and the underpinnings of ethical theory and tenets of liberalism that go in to shaping methodology. Agreed discussions in pure philosophy of science have a direct influence on methodological discussions in empirical disciplines such as economics, one must pay attention to how discussions in pure philosophy of science impact moral philosophy, and how moral philosophy in turn impacts methodology in a subject such as economics or political economy.

While the role of philosophers of science from the logical positivists onwards to the post-positivists, such as Popper and Kuhn, is acknowledged, the role that ethical theory in general has played in methodology cannot be overlooked. By ethical theory, I here mean the substantive discussions in utilitarianism and deontology, the two representative polarities of liberal thought. Insofar as utilitarian and deontological thought, have both developed in response to debates in liberal epistemology, a mention of how an interplay between these alternative systems of thought has affected the development of methodology in turn is demanded.

An historical introduction to how liberal epistemology influenced ethical theory must begin with the paradigm of the Hume Vs. Kant debate, and how this in turn manifests in the form of the utilitarian Vs. deontological debate during the pre-positivist era, and in the form of economic efficiency Vs. deontological rights debate during the positivist and the post-positivist periods. While philosophers of science of the positivist era have restricted themselves to methodology as it concerns the systematization of the utilitarian side of the debate into the subject of economic theory alone, a review of the larger debate in liberalism, i.e., between the utilitarians and the deontologists during the pre-positivist era, and the consequentialists and the rights theorists during the positivist era, will place the methodology of economics in a proper perspective of liberal epistemology.

The Pre-Positivist Paradigm

Hume's *'Essays Concerning Human Understanding'* and Kant's *'Critique of Pure Reason'*, together not only comprise a representation of the pre-positivist epistemology in general, but also comprise the pre-positivist paradigm in ethical theory and political economy as well. If Hume's work consisted of dismantling the role of a-priori in arriving at causal connections, Kant's critique attempts to resurrect the role of reason in human understanding of the world.

It must be indicated that the specific way in which Hume's irrefutable²² attack on the role of the a-priori reason and causation have the consequence of utilitarianism lies in Hume's granting recognition only to 'observables', as against intangible values in the determination of human motivation. It is these 'observables' which become a utilitarian's consequences, and it is to these that the utilitarian attempts to place the yardstick of the calculus of felicity. The Benthamite translation of Hume's epistemology in to the full blown doctrine of utilitarianism, apart from Adam Smith's²³ partaking in the Humean

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revolt against intangibles, becomes then, the foundation of pre-positivist liberalism, and subsequently the fertile grounds in which economic theory grew

The less talked about stream of thought in general accounts of philosophy of economics, however, remains the one influenced by Kant. Kant's attempt to rescue reason from Hume's attacks on the basis of his 'synthetic-a-priori' keeps alive any hope for a-priorism and subsequently becomes a basis of deontological moral theory that has paralleled utilitarianism. A revival of Kantian version of liberalism is what constitutes Rawlsian theories of justice. In his *'Theory of Justice'*, John Rawls comes out with the most potent Kantian expression of discontentment against utilitarian tenets. It is precisely in the expression of this discontentment that one may locate the challenge that contemporary philosophy of economics took up. Arrow, Harsanyi, Sen are good examples of contemporary theorists who have attempted a utilitarian-positivist response to contemporary Kantian challenges

The link between pre-positivist liberal epistemology and the positivist speculation about the appropriate methodology of economics, which can be found in the kinship between positivism and utilitarian thought, serves as a further link between the more contemporary positivist speculation and ethical theory. If pre-positivist epistemology helped define pre-positivist ethical theory, in terms of utilitarian thought being traceable to Hume, and theories of justice being traceable to Kant, it is safe to trace positivism in economics to utilitarianism, and any attacks against positivism in economic theory from within contemporary liberalism to their roots in Kant.

Kenneth Arrow's Defense of Ordinalist Utilitarianism

Arrow begins his article *'Some Ordinalist Notes on Rawls's Theory of Justice'*, by affirming the point that methodological foundations of economic policy judgement is some version of utilitarianism²⁴. Arrow pitching himself against Rawls not only illustrates an economist's re-affirmation of a traditional alliance to the criterion of economic optimality of utility, i.e., as a criterion of cognitive significance (because the notion of utility is an observable, and fits the criterion of verification and measurement), but also illustrates how contemporary methodologists seek to define themselves in opposition to the deontological attack from within²⁵ liberal philosophy: "Philosophers have been more prone to analyzing what individuals should want, where economists have been content to identify 'should' with 'is' for the individual"

The first defense of utilitarian-positivist thought against the Rawlsian theory that Arrow offers, is based on discarding a typically deontological point of view espoused by Rawls (in this case, the pre-eminence Rawls attaches to liberty over any other utilitarian consideration). Arrow tries to achieve this by an appeal to empirical verification. While Rawls's attachment of importance to liberty is based on a version of Kantian a-priorism (the categorical imperative that actors would choose from behind the veil of ignorance), Arrow would have us believe that such importance be given to a notion such as liberty

²⁴ Ken Arrow "The implicit ethical basis of economic policy judgment is some version of utilitarianism"

²⁵ Attacks from outside liberal philosophy have included those from the various fashionable schools of thought of the continent: post-modernists, deconstructionists, etc.

only subject to empirical judgement, and should it become a matter of empirical judgment, Arrow would, as he does, want us to be convinced that it could be reduced to a utilitarian category, an observable, something that can be measured, and something that is amenable to measurement by a calculus of felicity

The second major issue that Arrow addresses in his article is the maxmin notion that Rawls employs. The maxmin rule is essentially a dictum that individuals, when placed in an analytically contrived position of equal ignorance (i.e., the Original Position, or behind the Veil of Ignorance), would make decisions in an a-priorically chosen way (as against under the influence of the so-called utilitarian consequences or observables), that would best reflect a distribution of goods that allows inequality only when there is an increase of the lot of the least well off. It must be noted at once that the original position²⁶ is an hypothetical situation created to facilitate the deontologist's version of non-utilitarian decision making by economic actors. By taking issue with both, Rawls's *Difference Principle* (i.e., primacy of liberty tenet), and his maxmin principle, Arrow is essentially trying to reduce a very powerful deontological position into very utilitarian denominators.

Arrow's success or failure at these two illustrative attempts, does not undermine the mere fact that the continued scope for debate between the deontological view-points, such as the ones carried by either the difference principle or the maxmin principle, and the utilitarian view points, such as Arrow's, continues to shape contemporary philosophy of economics. Utilitarian-positivism continues to be defined not merely by its inherent logic, but by its antitheses as well. Deontological ethical theory is one of those antitheses from within liberal philosophy.

²⁶ Some economists such as W.S. Vickrey and J.C. Harsanyi have used the notion of original position, in their special case they tried to provide a contractarian basis for utilitarianism.

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