

Economic Methodology

Understanding Economics as a Science

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Value Judgments in Economics

In this final chapter we move away from our chronological survey of economic methodology to consider a topic that is relevant to all the methodological approaches we have surveyed, and which has often been a significant point of contention for economists: **value judgments** in economics. The approach of this chapter differs from that of earlier chapters in being primarily analytical and paying less attention to historical developments. In addition, the discussion is also more sharply focused on the subject of economics. In this respect, this chapter provides an introduction to the methodology of normative reasoning in economics treated as an important dimension of economic methodology.

Value judgments are evaluative types of statements that range from appraisals (“That is an excellent book”) to prescriptions with no ethical content (“You should use this tool in this way”) to ethical prescriptions or moral judgments (“It’s morally wrong to steal”). Appraisals usually include language that is evaluative or that expresses an opinion. Prescriptions usually include language that recommends or expresses what ought to be done or should be the case. Generally, value judgments of all kinds are said to be normative. Only some of them are concerned specifically with ethics and morality, where the concern is with the fundamental aspects of “good” and the appropriate rules for right conduct. In contrast to all of these, statements that avoid appraisals or prescriptions are generally thought to be positive or value-free.

The standard view of most economists is that economics is a positive, value-free science with no place for value judgments of any kind. Widespread acceptance of this view dates back to the 1930s and Lionel Robbins’s (see Focus 2.1) influential claim that economics and ethics are “two fields of inquiry” between which “there is a logical gulf fixed which no ingenuity can disguise and no juxtaposition in space or time can bridge over” (Robbins 1935: 148).

The standard view also captures the received view thinking of the logical positivists of the Vienna Circle, who asserted that only two kinds of propositions can be regarded as scientific knowledge: analytic and synthetic *a posteriori* propositions (see p. 10). Since value judgments are neither, they have no place in science – or indeed in economics. The logical positivists thus characterized value judgments as expressions of feeling or attitude rather than as scientific statements, a view shared by Robbins. Their view

is known as emotivism (a form of non-cognitivism in ethics) from the idea that expressions of value are just “emotions” such as “ugh” or “ahh.”

Some two decades later Milton Friedman (see Chapter 2) echoed this view, stating that: “Positive economics is in principle independent of any particular ethical or normative judgments” (Friedman 1953: 4). Friedman also associated scientific statements with predictions, and clearly value judgments are not predictions. Today, many economics textbooks begin with a short statement about how the positive and the normative (as a general way of referring to value judgments) are entirely separate subjects of investigation. Economists are regarded as being concerned with the former as proper to the domain of science, leaving policy-makers and the public to deal with the latter in the domain of opinion. The view of economics that is emerging from this approach is one in which economics operates as a value-free science, and society then decides what value judgments to apply to its results.

This view, however, does not stand up to any reasonable examination. Indeed, it can be shown that value judgments enter into economics in a number of distinct ways: in the way in which the economy is investigated, in the often value-laden character of the concepts employed by economics, in the ethical views implied by the fundamental propositions of standard economics, and in how explanations in economics incorporate ethical values and moral norms.

It is true that we can distinguish the language of value judgments and evaluative statements from that of language that states facts. The former includes “ought”-type terms (both explicitly and implicitly), while the latter excludes them, and restricts itself to “is”-type terms. But economics as a subject of investigation does not preserve this distinction, despite its frequent claims of doing so, which means that values and facts are mixed up together in the subject, and value judgments play a larger role than is generally appreciated.

Here we explain this in four different ways:

- (i) in terms of the **methodological value judgments** made by economists;
- (ii) in connection with the **value-ladenness** of economic concepts and explanations;
- (iii) according to how value judgments in economics support particular ethical views; and
- (iv) in connection with how explanations in economics need to accommodate the ethical values and moral norms that people observe.

Methodological value judgments

Methodological value judgments in economics are evaluative judgments which economists make with respect to the methods and approaches they

choose to employ in their investigation of the economy. These are not the sort of value judgments which make ethical judgments about moral right and wrong, but are nonetheless normative in that they involve prescriptions or recommendations about how one ought to carry out economics. Indeed, the standard claim expressed by Robbins, Friedman, and many textbooks that economics ought to be a value-free science is itself a methodological value judgment, in that it tells how we ought to practice economics. In essence, methodological value judgments are practical or pragmatic – “how to do it” sorts of judgments – rather than ethical or moral value judgments. This is very much what Kuhn referred to when he spoke of the “disciplinary matrix” that operates in normal science (see Chapter 4).

The most important methodological value judgments in economics involve three kinds of choices made by economists regarding how economics should be carried out: (i) the choice of the subject matter to be investigated; (ii) the method to be used in investigating that subject matter; and (iii) the criteria, standards, and norms used to assess and judge the validity of the investigation’s outcomes.

Choice of subject matter

The choice of the subject matter to be investigated produces a point of entry. Since there is no necessity that a given subject matter be approached in any one particular way, the economist must make a methodological value judgment about what kinds of topics are worthy of investigation.

In neoclassical economics, for example, a key point of entry is the activity of choice, and economics is accordingly said to be about the choices made by people. This contrasts with the thinking of the eighteenth-century classical economists, such as Adam Smith and David Ricardo, who were interested in such topics as growth and distribution in the economy as a whole, and for whom these subjects were their point of entry.

Clearly, the methodological value judgments economists make about their points of entry and topics of investigation have a strong influence on what they identify – and indeed define – as the subject matter of economics. These kinds of value judgment are sometimes related to economists’ ethical views, but they may also be independent of their ethical views, so that even when economists keep their own ethical opinions to one side, they still have to make value judgments of the methodological kind.

Methods of investigation

Economists also make value judgments about the methods or approaches they believe should be used in an investigation of the economy. For example, neoclassical economists investigate the choices made by people in terms

of the theory of rational choice, which explains individuals' choices in terms of a set of conditions that apply to their preferences (completeness, reflexivity, and transitivity in risk-free situations).

However, there are other ways of explaining people's choices that violate these conditions on preferences (for example, that people's preferences may be "framed" by context), and there are also explanations of choice that say very little about preferences (for example, that people act out of habit).

Similarly, the classical economists made significant methodological value judgments when they employed the labor theory of value to investigate the role of growth and distribution in the economy. Whatever method or approach the economist adopts, then, reflects a methodological value judgment about how the investigation ought to proceed. Further, just as nothing necessitates one particular entry point into economics, so nothing necessitates one particular type of approach to it either, so economists must always make some sort of methodological value judgments.

Standards of validity

Economists also make methodological value judgments with respect to the criteria, standards, and norms that are used to assess the validity of the outcomes of their investigations. What counts as a valid result can involve many considerations, some of which have been explored in previous chapters (see also Focus 3.3). One important question concerns whether or not an explanation can be shown to be empirically adequate. But, as we have seen, there have been many views of what counts as empirical adequacy in this sense.

- Popper believed scientific results were not valid unless they had withstood attempts to falsify them, and even then he asserted that they were only provisionally valid. At the same time, empirical adequacy is not always emphasized, as many contributions in the history of economics have been theoretical, mathematical, and based on *a priori* thought experiments.
- Kuhn, by contrast, argued that normal science achieves its validity by providing solutions to puzzles within well-established paradigms. Clearly, economists have a range of views about what ought to be accepted as good explanations in economics, and this variety of views is a further measure of the extensive nature of methodological value judgments in economics.

In conclusion, we may say that these three forms of methodological value judgments concern the conduct of inquiry in economics – or how one

carries out economics, rather than the outcome of one's inquiry. Many economists recognize that value judgments arise in economics in this way, but nonetheless argue that, in contrast to the conduct of inquiry, the content of economics that results, that is, the subject apart from how people investigate it, is a value-free, or value-neutral subject matter.

Accordingly, their view is that once economists have made their decisions about how to proceed, economics can be regarded as a fully positive subject. Put differently, the only value judgments that pertain to economics are methodological ones. Against this, however, some argue that the very concepts and explanations of economics themselves are value-laden in the sense that they incorporate values that derive from their investigation. On this view, neither the subject matter (or content) of economics nor the way in which economic inquiries are conducted is value-free. Let us consider, then, whether economics' content can be thought to include values.

The value-ladenness of economic concepts and explanations

The case for saying that the content of economics is value-free rather than value-laden goes back to the distinction we make in language between evaluative assertions and fact-stating assertions. This **fact-value distinction** is famously associated with "Hume's guillotine" – the idea that statements using "is" language are completely different and cut off from those using "ought" language. David Hume had argued that that no inferences from the former can be made to the latter, or in other words that statements using "is" language never imply statements using "ought" language.

G.E. Moore later argued that attempting to infer what people ought to do from claims about the nature of the world committed the "naturalistic fallacy." According to this view, as long as economics is formulated in the value-free language of "is" statements, its content can always be thought to be positive and value-free. This view has been widely accepted by economists. For example, in his 1994 prestigious American Economics Association Ely Lecture Nobel Prize-winning economist Kenneth Arrow asserted:

I am old-fashioned enough to retain David Hume's view that one can never derive "ought" propositions from "is" propositions. The two issues, method and value, are distinct. (1)

Gunnar Myrdal (1898–1987, 1974 Nobel Prize with Friedrich von Hayek, "for their pioneering work in the theory of money and economic fluctuations and for their penetrating analysis of the interdependence of economic, social and institutional phenomena"), however, held an entirely different view of the matter.

A disinterested social science has never existed and, for logical reasons, cannot exist. The value connotations of our main concepts represent our interest in a matter, give direction to our thoughts and significance to our inferences ... contrary to widely held opinions, not only the practical conclusions from a scientific analysis, but this analysis itself depends necessarily on value premises. (1-2)

Myrdal's argument against the traditional view can be expressed as follows: economic concepts and explanations cannot be formulated in genuinely value-free language, even when using only "is" statements, since these statements invariably conceal evaluative terms that imply hidden "ought" statements. In other words, "is" statements and "ought" statements can never be fully separated in ordinary speech, because on closer examination the former implicitly contain the latter.

Essentially Myrdal's argument rests on a claim about the "depth" of meaning of the terms we use to identify concepts in economics. He believed that the terms used by economists cannot be defined strictly in relation to other economic concepts in a given explanation, but must also be seen as having a broad range of additional meanings and associations for people that come from outside the context of the explanation in which they are employed.

He gave the following examples of a number of terms that contained additional meanings: productivity, equilibrium, balance and adjustment. These latter meanings and associations typically involve values. Take, for example, the important microeconomic concept of perfect competition. In economics, perfect competition is defined in terms of the perfect information assumption and the assumption that when there are many firms, they are all unable to influence the price level. But the broader idea of "competition" for people outside of economics has many meanings that go well beyond the economist's definition. Moreover, this extended set of meanings is usually accompanied by various value judgments regarding the desirability or undesirability of competition ("competition is good" or "competition is harmful").

Of course, economists can always say that they are only interested in their own technical meaning of a term. But this does not eliminate the term's other meanings, and nor does it guarantee that economists will not also think in terms of these more extended meanings of the concept. It is also difficult to see how a concept in economics could ever be made a purely technical term, since that would require that it should have no ordinary associations whatsoever, thereby making it irrelevant to explaining the economy!

Myrdal's view complicates our understanding of the content of economics, and it makes a reasonable case for saying economics is value-laden rather than value-free. But it does not tell us anything about the extent of the problem. It could be the case that the value-ladenness of

economic concepts has little influence on economic explanations, and thus might be regarded as incidental. Myrdal's own view was quite the opposite: he believed that important value connotations could never be removed from economics and social science. Economics, that is, is strongly value-laden. This value-ladenness of economic concepts, moreover, generates an "economic point of view" that makes economics a thoroughly normative system. Interestingly, Myrdal again echoes much of Kuhn's notion of the "disciplinary matrix" (see p. 105):

The student of economics is taught "to think in economic terms." This means chiefly – or so we are repeatedly told – that he should cultivate the ability to see and understand economic phenomena, rapidly and exactly, in a specific light, i.e. observe them from a particular point of view and classify them according to certain theoretical categories. The actual choice of viewpoint and categories will, of course, depend, in the last resort, on the underlying epistemological approach. Once one has grown accustomed to thinking within the frame of the inherited normative system, which offers the assurance of a "beaten track," it becomes difficult to step aside and inspect the system from outside.

(Myrdal 1953: 22)

At the same time, obviously many concepts and explanations in economics have relatively little extra-economic value-laden content. Indeed, many concepts in economics are substantially technical, and arguably have very little extra-economic meaning. Consider the concept of an input-output table (developed by 1973 Nobel Prize laureate Wassily Leontief, "for the development of the input-output method and for its application to important economic problems") that refers to one way of explaining production interconnections between industries. This concept has limited popular meaning beyond the definition employed by economists. This does not mean, of course, that people do not make value judgments about the desirability or undesirability of thinking of an economy in terms of input-output relationships, but compared to other cases (such as the concept of competition) they are rather weakly attached to economists' understanding of the concept. Why, then, should they even be considered part of the economics concept? Might the economists' concept of an input-output table be essentially value-free?

Myrdal's view was that economic explanations always possess a substantial political significance, and so he would have insisted that even seemingly value-free concepts in economics, such as the input-output table, will always end up being value-laden. But note that this response is rather about the use and conduct of economics, and does not prove that every single economics concept is value-laden in a significant way. Some indeed appear to be, but others appear not to be.

We must conclude, then, that concepts and explanations in economics can be – but need not be – strongly value-laden. It depends on the concept and the uses to which it is put. This, however, still refutes the standard completely value-neutral view of economics content. It also creates a problem for us in that it still leaves us with no way of judging the extent or seriousness of value-ladenness in explanations in economics. On the one side we have Myrdal's view that it is a serious issue; on the other there is the possibility that a more "technical" economics might be consistent with a somewhat "weakened" value-neutrality view in which values underlie economic explanations, but have no special implications for any *particular* ethics or politics.

This suggests that we might be better able to assess the role that value judgments play in economics by examining particular theories and explanations. Further, rather than simply asking whether the concepts in economic explanations are value-laden, let us ask whether when we do find value-laden concepts in economic explanations whether they play any special role in promoting particular ethical theories (that is, theories about what is morally good or right and wrong, as well as the grounds for such judgments) to go along with those theories and explanations in economics. Such theories and explanations would then be strongly value-laden by virtue of implying specific moral judgments.

By comparison, cases where no particular moral judgments were implied would be weakly value-laden. Thus, instead of just looking at the "depth" of the meaning of the concepts used by economists, we will examine the role value-laden concepts play in theories with respect to promoting certain moral judgments. The example we will consider will be standard rational choice explanations.

The ethical commitments of rational choice explanations

Rational choice theory sees individuals' choices as rational when their preferences satisfy a set of formal conditions that allow us to regard those preferences as "well behaved." For example as noted above, individuals' preferences need to be transitive (meaning that if *a* is preferred to *b*, and *b* is preferred to *c*, then *c* cannot be preferred to *a*). Immediately we see a value judgment being made in terms of the meaning of the term "rational."

Though the concept of rationality used by economists is defined in a technical way in terms of the conditions required of preferences for making rational choices, for many people the meaning of "rational" includes the idea that it is good to be rational. This, of course, is a value judgment. Indeed, this value judgment is reinforced by rational choice theory's explanation of rationality in terms of a set of conditions individuals' preferences *ought* to

satisfy in order that their choices qualify as being rational. By stating what conditions preferences ought to satisfy, rational choice theory prescribes how individuals ought to choose in order to be rational. Thus, given that people often assume that being rational is good, rational choice theory relies on this value judgment to effectively say how individuals should choose in order to achieve the good state of affairs of being rational.

Rational choice theory, then, is value-laden in the sense of employing an important value judgment. To determine, however, whether it is strongly or weakly value-laden, we should go on to ask whether this value judgment implies any particular moral judgments and ethical views. Let us say a bit more, then, about what is involved in making rational choices.

Specifically, making rational choices means choosing so as to satisfy one's preferences (as the theory understands preferences). Satisfying preferences is, of course, just one interpretation of what making a rational choice might mean, since there are other ways in which we might explain how making a choice could be thought rational. For example, one could say a rational choice involves relying on reasons that others find persuasive. Or one could say that making a rational choice involves drawing on one's most firmly held beliefs. Interpreting rationality in terms of preference satisfaction, then, is only one way of explaining a rational choice, and thus involves what was explained above as making methodological value judgments, specifically, as concern the choice of subject matter and the method of investigation.

In rational choice theory, then, the definition of making a rational choice is in terms of choosing in such a way as to satisfy one's preferences. Further, acting so as to satisfy one's preferences is also explained as making oneself better off, so that being rational and satisfying one's preferences is precisely what it means to make oneself "better off."

This is often described in terms of maximizing individual utility. Sometimes maximizing utility is said to be a matter of acting selfishly, but such a definition is a mistake. One can make rational choices that satisfy one's preferences when those preferences concern making others better off: these preferences are sometimes called altruistic or other-regarding preferences. In this case, one makes oneself better off by making others better off. Maximizing utility, then, simply involves making rational choices that satisfy one's own preferences, whatever they may be and for whomever they benefit.

This understanding, it can then be seen, implies a particular set of moral judgments, because it provides a particular ethical interpretation of what it means to be better off. The idea of being "better off" makes a direct reference to the idea of what is "good" in life – a key concept of ethics. But there are, of course, many ethical views of what constitutes the good in life – and, accordingly, what people regarded as making one "better off:"

- One might be said to be better off when one is able to fulfill one's moral duties and act responsibly, whether or not this satisfies one's preferences.

- One might be said to be better off when fulfilling one's commitments to others, though this could in fact be contrary to one's preferences.
- One might be thought better off if able to develop one's capabilities.
- Or one might be said to be better off when one is able to act according to principles of justice, though this could be entirely irrelevant to what one's preferences might be.

In standard rational choice theory, however, one is only better off when acting in such a way as to satisfy one's preferences. With the good and the idea of being better off defined in this way, an ethics of the right and wrong things to do must always be formulated in these terms, rather than in terms of matters such as duty, commitments, capabilities, or justice. Both moral judgments and one specific set of grounds for them thus flow from how the theory is value-laden and how it employs a particular set of methodological value judgments.

The philosophers Daniel Hausman and Michael McPherson go further, explaining the basis for rational choice theory's identification of being better off with satisfying one's preferences in terms of another important value judgment that underlies rational choice theory – namely, the ethical principle of “minimal benevolence.” This principle says that, all things considered or putting aside other considerations (economics' standard *ceteris paribus* clause), people *ought* to be able to make themselves better off by satisfying their preferences. That saying this requires a value judgment reflects the fact that there are other ways people might be thought to be made better off. One could pose as an alternative ethical principle, for example, that people *ought* to be able to make themselves better off by acting virtuously or according to their duties, commitments, capabilities, or justice. Rather than relying on the principle of minimal benevolence, one might then rely on some principle that says people ought always do what is believed to be right, *ceteris paribus*. For Hausman and McPherson, however, it is the principle of minimal benevolence that completes the normative picture underlying standard rational choice theory.

Notice that a substantial amount of the normative force which the principle of moral benevolence has, or of its persuasiveness as a specific “ought” prescription, lies in the implicitly broad scope of its *ceteris paribus* clause. Essentially that clause allows us to disregard other theories of being better off such as concern duty, commitments, capabilities, and justice. This effectively isolates only that set of moral judgments that the preference satisfaction view of being better off entails, making it possible to talk about the specific ethical view to which rational choice theory is committed. Having done this, economists can make clear recommendations about policies that make people better off in terms of preference satisfaction, and should these policies produce, say, what others judge to be unjust outcomes, this can be ignored because it falls in the *ceteris paribus* clause.

There is more to rational choice theory's ethical view, of course, in the form of the famous Pareto optimality principle, which offers a basis for policy recommendation in economics by treating preference satisfaction as the good. The Pareto principle prescribes policy changes that make at least one person better off without harming any other person as measured in terms of individuals' preference satisfaction. This involves an additional value judgment, since one might alternatively recommend policies that made some people better off and some people worse off if the gains to the former exceeded the losses to the latter. This latter principle is used, in fact, in cost-benefit analysis, where the goal is to maximize the net gains in people being better off across individuals.

The usual defense of the Pareto principle vis-à-vis cost-benefit analysis is that changes that make no one worse off are seen as "less controversial" than those that involve net gains, but also some losers. That is certainly true, but this does not make the Pareto principle any less of a value judgment. At the same time, this avoidance of controversy comes at the cost of relevance, since there are essentially no real-life circumstances in which a policy change does not harm someone. Nonetheless, the additional value judgment that comes with the Pareto principle is that absence of controversy is such an important good that even where net gains are extremely high and losses very small, the recommendation of this kind of outcome should be ruled out.

Cost-benefit analysis, in fact, is widely employed in real-world economic policy-making. It is for the purely practical reason that policy changes have winners and losers, and one way to evaluate such changes is to calculate the costs and benefits for each in order to determine the overall outcome. At the same time, there is nothing that prevents policy-makers from also considering other ethical issues side-by-side these cost-benefit judgments. Whether a change in policy infringes on individuals' rights, is perceived to be unjust, or worsens inequality are among the considerations that have been raised. Policy-makers, then, typically proceed in a more eclectic manner, or pluralistically, taking into consideration multiple ethical perspectives. However, whether thinking in terms of the Pareto principle or in terms of some sort of cost-benefit analysis, the economist is still employing a particular theory of ethics with a set of implied moral judgments about what people *ought* to do.

The important point in this respect is that economics is rarely free of ethical implications, and the issue is rather whether our economic theories are adequate to our ethical thinking or bias it toward certain views of right and wrong. Indeed, were economics free of all value judgments, it would provide no basis for policy recommendations of any sort!

To return to the argument regarding weakly and strongly value-laden economics, standard rational choice theory is not just value-laden, in the sense that it employs a set of value judgments (namely, people are better off in acting on their preferences, the principle of minimal benevolence,

and the Pareto principle) and a set of important methodological value judgments regarding the nature of choice, but it is also strongly value-laden in virtue of implying a particular set of moral judgments and a particular view of the foundations of ethics.

We may contrast standard rational choice theory, then, with other theories of choice that are also strongly value-laden but promote other views of moral right and wrong. We can also contrast it with economic explanations that are only weakly value-laden. In this latter case, value judgments may be involved, including methodological ones, but not the sort of value judgments that provide a basis for moral judgments and a particular view of ethics. The economic analysis of input-output relationships in production is one such example of this. Methodological value judgments underlie this type of explanation, but the sort of value judgments that support ethical claims about what is morally right and wrong do not.

This is not to imply, however, that economic analysis *should* be at most weakly value-laden. Determining what the goals of economic explanation ought to be is itself a methodological value judgment. Clearly in some circumstances it is an advantage for an explanation to be strongly value-laden if economic policy-makers hope to realize outcomes that have a certain moral quality.

Consider the Easterlin paradox that cross-sectional country data and within-country time-series suggest that there is no clear relation between economic growth of income and happiness. Most people believe that economic growth increases happiness. Suppose, then, that policy-makers wish to promote happiness as an economic outcome, and call upon economists to recommend policies that will help to achieve this goal. To explain how this might occur, economists would need to develop economic models of people that makes happiness rather than preference satisfaction their objective. The value judgment this entails is that happiness is good, and the associated ethical view would be that people ought to be able to achieve this good. This would therefore lead to the development of a strongly value-laden economics in the sense of supporting ethical claims about what is morally right and wrong, because this sort of analysis answers the questions posed by policy-makers.

Accommodating ethical values and norms

There is a fourth way in which economics incorporates value judgments. Irrespective of whether or not an economic explanation is strongly or weakly value-laden, economists often find themselves called upon to explain behavior that is believed to be motivated by or influenced by ethical values people have and by the moral norms they observe. In such circumstances, economists then need to fit their accounts of economic

behavior to include motivations that operate in ethical life, making the values and norms people observe part of their economic explanations.

It is true that in offering such explanations some economists will seek to reinterpret moral motivations as the disguised pursuit of self-interest (a reductionist argument), but we saw above – in connection with standard rational choice theory – that maximizing utility need not be understood as acting selfishly or strictly in terms of self-interest, for example, as when we say people act to satisfy altruistic preferences. Indeed, there are no restrictions on the content of people's preferences in rational choice theory, or what sorts of things people prefer. Rational choice theory only employs a set of formal conditions that apply to preferences if their choices are to be regarded as rational – it says nothing about the kinds of things individuals prefer or their motivations for preferring them.

An altruistic preference, we saw, is one that places a value on someone else being better off, rather than on serving one's own personal interests. One way of representing such a preference is in terms of consumption externalities whereby the satisfaction of another person's preference raises one's own utility. Though such a preference could be linked to any number of the ethical values held by people, such as kindness toward others, fairness, equality, etc., economists need not explain which ethical values lie behind a set of altruistic preferences or how they underlie those preferences. They only need be able to explain how people might exercise such preferences when they are said to act in the interest of others. In this case, then, an economic explanation accommodates an ethical phenomenon. We might say that the economic explanation conforms to the moral landscape.

This type of explanation goes back to the writings of Adam Smith, who used the concept of compensating differentials to explain differences in wages in labor markets reflecting what contemporary theory refers to as differences in preferences for different kinds of employment. Smith was interested in explaining why less desirable jobs, such as those that are dangerous and dirty, are paid higher wages than jobs that are more desirable. Contemporary labor markets also exhibit this variation in wages reflecting the differences in desirability of jobs, and one reason we might emphasize that explains why people consider some jobs desirable is that they involve charitable purposes. If we suppose that the many people who choose to work in charitable organizations do so because they are motivated by their ethical goals, then in this case the explanation of wage differences accommodates the ethical values people possess. As with altruistic preferences, there is no need to explain what those values are or how they underlie people's preferences, but the economic explanation nonetheless must incorporate the fact that people do possess ethical values.

Another type of ethical phenomenon economists have increasingly sought to explain are moral norms. These are the widely held rules or conventions about what is right or wrong – they are relatively free-standing in

that they are not tied to any particular set of ethical values, and indeed are often subscribed to equally by people who hold different ethical values. In this respect again, economists need not concern themselves with the question of why certain norms exist – this remains the concern of moral philosophers and social scientists – but only with the impact of these norms on the shape of the economy.

Consider the fact that there are many market interactions in economies that depend on the concept of trust with respect to people's responsibilities for fulfilling the terms of contracts. One basis for the confidence people have that contract terms will generally be fulfilled is the presence of moral norms which guide people's interactions. Moral norms effectively govern people's expectations about what they can count on. Whether or not self-interest is at play in people's observance of moral norms, those norms themselves are nonetheless framed as what people ought to do.

Implicit in the idea of an economic contract, then, is the idea that people *ought* to observe the norm of complying with contracts. But when one speaks of contracts, one must recognize that they presuppose the existence of private property. Thus one reason people believe contracts should be observed is their respect for the institution of private property. Here again, then, economic explanations incorporate value judgments and ethical views of right and wrong. Indeed, the latter are often so much a part of how economists explain the economy that it is difficult to say where economics ends and ethics begins.

One further example can be made to emphasize this point. Though standard rational choice theory makes no claims about the content of people's preferences, society does express values about what people's preferences should be.

- First, most societies reject malevolent preferences, or those that concern doing harm to others.
- Second, individuals may have preferences that are not in their own best interest, so that satisfying them cannot really be said to make them better off.
- Third, if we allow that people's preferences are influenced by the information they have about the world, we can see that in some circumstances a lack of information may lead people to express a preference they would not express were they better informed.

In all three of the cases outlined above, social values play a role in determining what people's "rational" preferences ought to be, where this generally means their being informed and ethically acceptable. This, of course, involves a different meaning of the term "rational" from that used when we consider standard rational choice theory. But for rational choice theory to underlie real world economic policy-making, it needs to accommodate how people might wish rational choices to be "rational." Thus, if they are

to be useful, economic explanations of people's choices need to be structured so as to incorporate society's value judgments.

Economics as a useful subject

This last point suggests a fitting conclusion to our discussion of value judgments in economics, and one that offers us a further perspective on economic methodology. When we say explanations in economics need to incorporate people's value judgments to present a more appropriate picture of the world, we assume implicitly that economics needs to be useful for people in economic life. Indeed, it is hard to imagine how economic explanations might be produced that totally disregarded their usefulness. Is it even possible to describe and explain economic life in such a way as to have no significance or meaning whatsoever for people's own understanding of the economy? Quite the contrary, economic explanations always aim to inform us about how their economic life works, and thus they always address people's concerns and interests, which in turn reflect their values.

Thus the ideal of economics as a positive, value-free science seems to have been misconceived from the start. A thoroughly value-free economics would be useless because it would tell us nothing about our concerns, interests, and values. Why, then, has being a value-free science been a long-standing goal of economics?

Here we must go back to the historical character of economic methodology, and in particular to the important influence of the philosophy of science advanced by the logical positivists. In the social turmoil of the first half of the twentieth century, the Vienna Circle hoped that science could be a refuge for objective thinking about the world that seemed impossible in all other arenas at a time of great social conflict.

Accordingly, they established the ideal of a science that could not be abused by politics and ideology, framing this ideal in terms of the goal of value-free science. They were correct to assert that science should not be manipulated in order to promote political and ideological ambitions. But using science constructively is not the same as abusing it, and one of the greatest values of science is its usefulness. Economics, then, can be useful, also value-laden, and not politically manipulative and ideological. The important thing is to be clear about the value judgments that are being employed in any particular theory.

Perhaps Keynes's words from the very end of his 1936 *The General Theory of Employment Interest and Money* offer us both the proper caution and insight into how we should see the discipline of economics:

At the present moment people are unusually expectant of a more fundamental diagnosis; more particularly ready to receive it; eager to try it out,

if it should be even plausible. But apart from this contemporary mood, the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil.

Looking backward: looking forward

Toward the end of the nineteenth century the American social reformer Edward Bellamy projected the course of the century to follow by imagining how people might look back upon the twentieth century from the year 2000. In fact, he was really looking backward at his own century, hoping that it held clues to the future, but he thought this exercise in imagination might enable him to see things his contemporaries overlooked. Some one hundred years later, just past the end of the twentieth century, we find ourselves in a similar position. We would like to know how economic methodology might develop in the future, but we have only its past to go on. Like Bellamy, we cannot look back on the present from a time in the future to view how economic methodology will develop. Nonetheless, like Bellamy the past is something we do know about, and it tells us us much about the foundations on which economic methodology has developed to date. Perhaps "foundations" is the wrong word to be used in this context, or perhaps we should recognise that there are multiple foundations and therefore many possible future directions for the development of economic methodology. This book has sought to describe those foundations.

Exercises

- 1 Give examples of the different kinds of methodological value judgments.
- 2 What is the basis for the strong distinction between positive and normative economics found in so many textbooks?
- 3 How did Myrdal argue that economics is value-laden?

- 4 What value judgments enter into standard rationality theory? What methodological value judgments?
- 5 How do cost-benefit judgments differ from Pareto recommendations?
- 6 What are moral norms, and what role do they play in economic analysis?
- 7 In economics, various types of unemployment are distinguished: frictional, natural, cyclical, structural, and voluntary. Identify the implicit values these concepts may convey.
- 8 Robbins defines economics as "the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses." Identify the kinds of values that are implied by this definition.

Relevant readings

- Arrow, Kenneth (1994) "Methodological Individualism and Social Knowledge," *American Economic Review* 84(2): 1-9.
Arrow's view of some of the main principles of neoclassical economics.
- Bellamy, Edward (1967) *Looking Backward: 2000-1887*, ed. by J. Thomas, Cambridge: Belknap Press of Harvard University Press.
Bellamy's famous tract and a good example of utopian reasoning as a form of explanation.
- Blaug, Mark (1998) "The Positive-Normative Distinction," in John B. Davis, D. Wade Hands, and Uskali Mäki (eds), *The Handbook of Economic Methodology*, Cheltenham: Edward Elgar Publishing, pp. 370-4.
An influential account of value judgments in economics.
- Easterlin, Richard (1974) "Does Economic Growth Improve the Human Lot? Some Empirical Evidence," in Paul David and Melvin Reder (eds), *Nations and Households in Economic Growth: Essays in Honor of Moses Abramowitz*, New York: Academic Press, pp. 89-125.
Easterlin's original finding regarding happiness and economic growth.
- Hausman, Daniel and Michael McPherson (2006) *Economic Analysis, Moral Philosophy and Public Policy*, 2nd edn, Cambridge: Cambridge University Press.
A comprehensive introduction to the relationships between economics and ethics.
- Myrdal, Gunnar (1953) *The Political Element in the Development of Economic Theory*, translated by Paul Streeten, London: Routledge.
Myrdal's work in which he introduced the idea of implicit values.
- Myrdal, Gunnar (1958) *Value in Social Theory*, ed. and intro. Paul Streeten, London: Routledge.
Myrdal's main statement regarding values in economics.
- Sen, Amartya (1987) *On Ethics and Economics*, Oxford: Basil Blackwell.
An influential account of the historical connections between ethics and economics.

Focus 7.1 Logical Positivism and Ordinalist Utility Theory

Every new student of economics learns that individual behavior is explained as utility maximizing, and that utility is understood in terms of preferences and indifference curves. They learn that an individual can only say whether one bundle of goods is preferred to another (or the individual is indifferent between them), and that the individual cannot say how much more one bundle of goods is preferred to another – that is, how much more utility the individual would get from one bundle compared to another.

If an individual were able to say by how much he preferred one bundle of goods to another, it would be necessary to measure utility. This is the concept of cardinal utility, employed by Alfred Marshall, A.C. Pigou, and other early neoclassical utility theorists, and which was central to the “old” welfare economics. Using money as the measuring rod of utility, and assuming that money exhibits diminishing marginal utility, they generally argued that economic policy should transfer wealth from the rich to the poor, since this would increase total utility within society.

The current concept of utility, which entered economics in the 1930s under the influence of John R. Hicks (1972 Nobel Prize) and Roy Allen, and which only requires that individuals can compare bundles of goods, is ordinal utility. It provides the basis for the “new” welfare economics formulated in terms of Pareto recommendations, and underlies the First Fundamental Theorem of modern welfare economics that a perfectly competitive economy maximizes social welfare by a Pareto-optimal allocation of resources (see Focus 1.3). Pareto recommendations only require that one person be made better off (according to their own preferences) without making anyone else worse off, and thus avoid making any (cardinal) interpersonal comparisons of utility across individuals, as are involved in the “old” welfare economics.

Indeed, one of the main reasons for economists’ adoption of ordinal utility theory was their skepticism regarding interpersonal utility comparisons as expressed forcefully by Lionel Robbins in his *An Essay on the Nature and Significance of Economic Science* (see Focus 2.1). The *Essay* is famous for advancing the standard textbook definition of economics as the allocation of scarce resources across unlimited ends. It is also famous among historians of economics for changing the conception of economics from being concerned with a single domain of life – material welfare in the eyes of Marshall – to being a subject concerned with the whole of life, and thus an entire branch of practical reason. But for economists, the *Essay* was crucial for its critique of interpersonal utility comparisons, which Robbins argued are meaningless. His argument was that we cannot

compare the utility of two persons by saying cardinally how satisfied they each are from the goods they consume, because in his view there is no objective basis on which two individuals' degrees of satisfaction can be compared.

It is a comparison which necessarily falls outside the scope of any positive science. To state that A's preference stands above B's in order of importance is entirely different from stating that A prefers n to m and B prefers n and m in a different order. It involves an element of conventional evaluation. Hence it is essentially normative. It has no place in pure science. (p. 139)

This, in turn, meant that the scope of economic policy should be appropriately narrowed.

Hence the extension of the Law of Diminishing Marginal Utility... is illegitimate. And the arguments based upon it therefore are lacking in scientific foundations... [and do] not justify the inference that transferences from the rich to the poor will increase total satisfaction. (p. 141)

Robbins, then, provided the key argument for economists for moving from the cardinal to the ordinal concept of utility and for the re-direction of economic policy by arguing that interpersonal comparisons of utility were conventional and normative, and therefore did not belong in science.

He thus portrayed economics as a science essentially in the same way the logical positivists had understood science when they demarcated science from pseudo-science. The influence of the logical positivists was at its height when Robbins wrote the *Essay*, and for them only analytic and synthetic *a posteriori* statements were scientific, where the latter could be demonstrated by observation. As interpersonal utility comparisons concerned satisfaction from consumption, they seemed untestable, and therefore could only be conventional, normative, and meaningless. It was this methodological judgment, then, that justified Robbins' effective call for banishing the cardinal utility concept from economics and reframing of welfare economics.

However, we have seen that the logical positivists' attempt to demarcate science and pseudo-science was not successful, that empirical concepts are often theory-laden, and that economic concepts are often value-laden. In addition, psychologists have shown, contrary to the assertions of Robbins, that it is quite possible to measure the subjective satisfaction individuals receive from consumption, so that interpersonal "utility" comparisons can indeed be made.

This has led in recent years to the development of “happiness” indices that provide methods for measuring individuals’ subjective well-being, and the rise of the “happiness” approach to economic policy that recalls the broad scope of the “old” welfare economics. At the same time, there has been a development of non-utility approaches to making interpersonal comparisons across individuals that measure well-being in objective rather than subjective terms, such as the capability approach, in which individuals are compared according to such measures as educational level and health care access.

The legacy of logical positivists in economics, then, is a mixed one. On the one hand, their commitment to empirical science has been sustained – and arguably strengthened significantly – in postwar econometric and more recent experimental economics practice. On the other hand, their goal of demarcating science from pseudo-science has been largely abandoned as the variety of approaches in economics multiplies with an increased appreciation of the many “foundations” on which economics can be developed. In economics, like in physics, there is no unifying framework. For that reason, the philosopher of science Nancy Cartwright prefers to characterize both disciplines as a patchwork: “we live in a dappled world, a world rich in different things, with different natures, behaving in different ways. The laws that describe this world are a patchwork, not a pyramid” (p. 1).

Relevant readings

Cartwright, Nancy (1999) *The Dappled World: A Study of the Boundaries of Science*, Cambridge: Cambridge University Press.

Anti-reductionist view by one of the leading philosophers of science.

Cooter, Robert and Peter Rappoport (1984) “Were the Ordinalists Wrong About Welfare Economics?,” *Journal of Economic Literature* 22: 507–30.

A re-appraisal of the “old” welfare economics vis-à-vis the “new” welfare economics.

Kahneman, Daniel and Alan Kruger (2006) “Developments in the Measure of Subjective Well-Being,” *Journal of Economic Perspectives* 20(1): 1–24.

An introduction to the “happiness” approach.

Layard, Richard (2005) *Happiness: Lessons from a New Science*, London: Penguin.

An influential analysis of happiness in economics.

Meikle, Scott (2001) “Quality and Quantity in Economics: The Metaphysical Construction of the Economic Realm,” in U. Mäki (ed.), *The Economic World View*, Cambridge: Cambridge University Press, pp. 32–54.

A discussion of the change in economics from being concerned with a single domain of life to a branch of practical reason.

Sen, Amartya (1999) *Development as Freedom*, New York: Knopf.

An introduction to the capability approach.