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Series Standing Order ISBN 978-0-230-00232-6 (hardcover)

Series Standing Order ISBN 978-0-230-00233-3 (paperback)

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Philosophy of Economics

Don Ross

University of Cape Town, South Africa
Georgia State University, United States

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First published 2014 by
PALGRAVE MACMILLAN

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Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

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ISBN 978-0-230-30297-6 ISBN 978-1-137-31875-6 (eBook)
DOI 10.1057/9781137318756

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

A catalogue record for this book is available from the Library of Congress.

*This book is dedicated to my wife, Dr Nelleke Bak.
A happy life partnership produces a unique economic
effect, pervasive endogeneity of utility. In other words:
Nelleke's presence and support makes everything I like
better than it would otherwise be.*

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Preface and Acknowledgments

This book is an opinionated tour through what I consider to be the most important issues in the philosophy of economics. It asks: What is economics fundamentally *about*? It appears to be about aspects of behavior and social organization. But then how and why does it differ from other sciences – in particular, psychology and sociology – that study these topics?

In calling the book ‘opinionated’ I refer to the fact that although I try to be fair and accurate in stating the views of others whom I criticize, I have not tried to represent or survey all or even most of the leading positions in the literature. This is therefore not an even-handed survey of ‘the’ philosophy of economics. It states *my* philosophy of economics.

Chapter 1 explains the distinctive philosophical ground on which I stand, and contrasts it with some alternative philosophical attitudes. So I will not outline or defend that in this preface. And throughout the book I make clear whenever I align myself with one side of a currently live controversy among economists.

However, a prospective reader looking quickly at the book to determine whether she is likely to find opinions sympathetic or contrary to her own might appreciate some simple slogan statements. My general philosophical stance is that of a naturalistic philosopher of science. It is the mission of scientific institutions to strive to provide a complete objective account of the universe at all scales of description. This ambition can never be realized, but that is only because scientists will never be able to make every possible observation or take every possible measurement – not because there is a rival path to knowledge, such as religion or intuitive insight, that performs better in some domains of inquiry. Economics is part of science, though economists, like most other scientists, often engage in activity other than seeking objective knowledge. In particular, they are often preoccupied with offering practical and policy advice that should be crucially based on

such objective knowledge as they have obtained. As for grand economic doctrine, my views are in the tradition usually called ‘mainstream’. That label mainly just conveys a set of negatives: I am not a Marxist, nor an Austrian, nor a critical realist. But I think that all of the leading mainstream economists, including Smith, Walras, Marshall, Keynes, Hayek, Frisch, Tinbergen, Schumpeter, Samuelson, Arrow, Schelling, Friedman, and Stiglitz, are ‘leading’ because they have contributed lasting and important insights, notwithstanding their sharp disagreements with one another on many questions.

This book is intended to be accessible to a senior student of philosophy or economics – or, for that matter, of psychology, or sociology, or any other social or behavioral science. What I mean by this is that it does not contain specialized mathematics, and when it addresses or uses technical concepts that are unique to a particular discipline these are introduced and explained in the text. (Sometimes this happens in footnotes, however, so a reader who encounters something she doesn’t understand should check those.)

At the same time, the book defends an original and distinctive view of economics, and of a number of methodological controversies in economics, that I hope will interest professional scholars. They will know where they can speed-read while familiar concepts are being explained for the benefit of less expert readers, and they can judge for themselves where it is worth slowing down to digest and engage with a novel perspective.

Some student readers may want to read this book alongside a more conventionally constructed textbook on the philosophy of economics. The only truly up-to-date such book currently on the market is Julian Reiss’s *Philosophy of Economics* (Routledge, 2013). I recommend it, though noting that there is much in it with which I disagree, and that I am less sympathetic than Reiss is to the style of philosophy called ‘analytic’.

Other student readers may want a less philosophical and less dialectical non-technical survey of the contemporary state of economics. There is a splendid such source on the market, Diane Coyle’s *The Soulful Science* (Princeton University Press, 2007). I urge everyone with any interest in economics to read Coyle. It is ideal preparation for this one.

Finally, some student readers may want to complement this book with a concise history of economic thought that narrates the story 'straight up' and is less preoccupied with critical questions of methodology. To these readers I recommend Roger Backhouse's *The Ordinary Business of Life* (Princeton University Press, 2002).

I am grateful to a number of people whose assistance was crucial to the production of this book. Vittorio Bufacchi commissioned it on behalf of the publisher, and was tolerant – indeed strongly supportive – when I requested indulgence to go beyond the original (generous) timeframe he set for the project, and when I asked if I could make it substantially longer than initially agreed. My regular collaborator and friend Glenn Harrison commented extensively on each chapter draft and suggested numerous improvements, refinements and corrections. I have learned more about economics over the years from Glenn than from any other single person. The book also profits from comments I gratefully received from Ken Binmore, Harold Kincaid and Andreas Papandreou. Carsten Hermann-Pilath read the manuscript after I sent it to him with little time remaining for further work on it (at least if I was not to abuse the patience of Vittorio intolerably), and reassured me with his response. Of course some errors will still have slid past all of these first-rate intellectual filters, and they are my fault.

The general philosophy of science that forms the backdrop to my view of the philosophy of economics was developed with another treasured collaborator, James Ladyman, mainly in our book *Every Thing Must Go* (Oxford University Press, 2007). I did not burden James, whose main interests are in physics and mathematics, with drafts of the present book. But his learning and wisdom nevertheless strongly inform it.

My deepest debt of all is to my wife, Nelleke Bak. Nelleke is a philosopher of education, and what she knows of economics is mainly based on putting up with impolite shop-talk when we dine with my colleagues. She was thus an excellent filter for testing my effort to write a book that could be followed by a – very studious and intellectually alert – non-economist. She read every sentence of the book and made many of them less mysterious. Along with that she checked the concordance of the references and prepared the whole package nicely for the publisher. All of this she did *for no pay*, thus refuting a generalization about people that is frequently attributed to economists.

Parts of Chapter 3 are drawn from my article ‘Game theory’ in *The Stanford Encyclopedia of Philosophy* (SEP), available at <http://plato.stanford.edu/archives/win2012/entries/game-theory/>. SEP holds exclusive electronic distribution rights to this material, not superseded by the copyright on the present book. I thank the SEP editors for permission to distribute this material in any electronic version of the book that Palgrave Macmillan might choose to issue.

An outline of many of the themes of this book is due to appear as a chapter in Byron Kaldis, Ed., *Mind and Society: Cognitive Science meets the Social Sciences*, to be published by Springer. A few passages from the chapter reappear in this book. Some themes are treated more extensively in the book, others in the chapter; in the latter cases, this is noted in the text.

Series Editor's Preface

It is not easy being a student of philosophy these days. All the different areas of philosophy are reaching ever-increasing levels of complexity and sophistication, a fact which is reflected in the specialized literature and readership each branch of philosophy enjoys. And yet, anyone who studies philosophy is expected to have a solid grasp of the most current issues being debated in most, if not all, other areas of philosophy. It is an understatement to say that students of philosophy today are faced with a Herculean task.

The books in this new book series by Palgrave Macmillan are meant to help all philosophers, established and aspiring, to understand, appreciate and engage with the intricacies which characterize all the many faces of philosophy. They are also ideal teaching tools as textbooks for more advanced students. These books may not be meant primarily for those who have yet to read their first book of philosophy, but all students with a basic knowledge of philosophy will benefit greatly from reading these exciting and original works, which will enable anyone to engage with all the defining issues in contemporary philosophy.

There are three main aspects that make the Palgrave Philosophy Today series distinctive and attractive. First, each book is relatively short. Second, the books are commissioned from some of the best-known, established and upcoming international scholars in each area of philosophy. Third, while the primary purpose is to offer an informed assessment of opinion on a key area of philosophical study, each title presents a distinct interpretation from someone who is closely involved with current work in the field.

This book on philosophy of economics, by one of the world's leading scholars in the discipline, is both authoritative and highly original. Unlike most other books in the philosophy of economics, which aim to bring clarity to the key concepts that pertain to economic thinking, Ross

takes an innovative approach, grounding his analysis in naturalistic philosophy of science.

This is an ambitious book, written by a scholar equally dexterous in the abstract reasoning distinctive to philosophy and in the technicalities of economics, which puts forward a completely novel way of presenting the philosophy of economics. The targeted readership for this book is not just the philosopher with an interest in making sense of economic realities, but also the economist interested in understanding the nature and logic of their discipline. This book could change the way we think about economics, and philosophy's contribution toward this paradigmatic shift.

Economics has evolved into a highly technical discipline, and philosophers writing about economics have not always kept pace with these developments. This is arguably the first book by a philosopher that engages with all the technical tools that are the modern economist's bread-and-butter. Don Ross has written a book that is destined to become pivotal for all future discussions in philosophy of economics.

List of Acronyms

BES	behavioural economics in the scanner
BOLD	blood-oxygen-level dependence
CGE	computable general equilibrium
CPT	cumulative prospect theory
CRRA	constant relative risk aversion
DE	development economics
DMRS	diminishing marginal rates of substitution
DSCGE	dynamic, stochastic computable general equilibrium
EMH	efficient markets hypothesis
EP	economic psychologism
EUT	expected utility theory
fMRI	functional magnetic resonance imaging
GARP	generalized axiom of revealed preference
GE	general equilibrium
GT	game theory
IKE	imperfect knowledge economics
IO	industrial organization
LLR	larger, later reward
MI	methodological individualism
NE	Nash equilibrium
ORT	ordinal utility theory
PD	prisoner's dilemma
PE	partial equilibrium
QRE	quantal response equilibrium
RDEU	rank-dependent expected utility
REH	rational expectations hypothesis
RPT	revealed preference theory
SARP	strong axiom of revealed preference
SPE	sub-game perfect equilibrium
SSR	smaller, sooner reward

SV	subjective value
vNMuf	von Neumann–Morgenstern utility function
WARP	weak axiom of revealed preference