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0521344506 - The Boundaries of Economics

Edited by Gordon C. Winston and Richard F. Teichgraeber III

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CHAPTER 1

Introduction**GORDON C. WINSTON**

All but one of the chapters in this volume were written as public lectures for a general university audience. All examine the boundaries – at least parts of the boundaries – of the discipline of economics with two aims in mind. First, they seek to give noneconomists insights into the way economics works, the way economists think about human behavior, and the way their mode of thought differs from that prevailing in other disciplines. Second, they attempt to give economists fresh insights into the way they do their work, on the premise that looking at, and across, the boundaries of a subject – looking at what it is not – is often useful for understanding what it is. And to both groups these chapters are meant to give a sense of the often significant changes now taking place in these boundaries.

The lectures were given at Tulane University in 1985. The Murphy Institute of Political Economy and Policy Analysis was just then establishing an interdisciplinary undergraduate program in political economy, and I was invited for the spring term as the first Murphy Institute Visiting Professor. I was assigned three duties: to teach an undergraduate class on economics in the context of other disciplines, to organize an interdisciplinary faculty seminar, and to arrange for a series of public speakers. In all instances, the topics to be addressed were broadly the same. As a device for increasing the productivity of a visiting professor, this combination of activities was surprisingly effective; the same sorts of ideas could be discussed at the same time with eager but naïve undergraduates and with skeptical and sophisticated colleagues from economics and other disciplines (economics, history, philosophy, sociology, and political science were represented in the faculty seminar), and I could invite speakers whose ideas I found interesting and exciting and to the point – which I did.

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The experience was exceptionally fruitful for me and for the participants. Its tangible results are presented here with the conviction that they will prove useful to a wider audience of economists and noneconomists.

Under the “Boundaries of Economics” title, the lectures considered, in various ways, economists’ understanding of human behavior and the relation of their understanding to that of other disciplines. The intellectual traffic went both ways. The emphasis was on the bending and shaping and exporting and invading of the conventional stuff of economics.

The “boundaries” metaphor seemed particularly appropriate and serves now to unite the chapters in this volume. Boundaries define and delineate and differentiate, in this case setting economic inquiry off from other ways of understanding human behavior. Boundaries define the limits of the subject, from both sides. The two-way intellectual traffic – imperialist forays of economic methodology into philosophy, psychology, and the law, and the invasion of our territory by psychologists, sociobiologists, and rhetoricians – has recently flowed across the borders of economics in high volume. It appears we are in something of a rush hour. And partly in consequence, shifts and changes in the boundaries of economics seem to be taking place at an accelerated rate – even things like personal relationships, self-control, emotion, and addiction are becoming legitimate areas of economic research (Schelling 1984; Elster 1985; Schultze 1985; Winston 1985; Frank 1986).

Of course, the boundary that encircles economics is a long and winding one. Economics is intellectually adjacent to many other disciplines; no single collection of essays can avoid large gaps and holes. So the chapters in this volume do not systematically march around the perimeter of the subject; instead, they conduct a selective walking tour of a few important parts of it. The most serious omission, in terms of currently exciting and productive activities over the border, is the interaction between economics and psychology, and economics and political science (as distinct from political philosophy) – the work of people like Kahneman and Tversky (1982), Scitovsky (1985), and Frank (1986) and that of Axelrod (1984), Cohen and Axelrod (1984), and Elster (1985). Gary Becker gave a talk on addiction in the lecture series – he returned to the rational addict theme of the Stigler–Becker (1977) model – but it was not based on a written paper and so could not be included in this collection. McCloskey’s emphasis on persuasion and mine on repetitive behavior in perspective time should be of some value to psychologists and sociologists, though neither can be said

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to be a significant border crossing in those directions. But if there is little here on the psychological and political parts of the boundary, those between economics and philosophy are well explored by McPherson and Hausman, the segment between economics and political philosophy is examined by Gray, and that between economic methodology and literary criticism by McCloskey.

Two powerful themes of modern economics are central to these chapters: information and the economic role of morality. The first has arguably been the most important area of research in conventional economics for the past two or three decades; in Chapter 2, McCloskey calls expected utility “the leading novelty in economic theory since the 1940s.” Information has come to be recognized as, simultaneously, a commodity that is produced with costly resources and an essential component of rational economic choice: Information is both a component and an object of rational choice. And more recently Herbert Simon’s (1955) idea of bounded rationality is playing an increasingly central role in economic thinking as the implications of its constraint on rational decision making are extended and developed. Williamson’s (1985) transactions cost analysis alone would justify that statement, but there are others, like Heiner’s (1983) examination of cognitive capabilities and situational complexity. “Efficient markets” describe markets as information-processing institutions. Asymmetries of information among economic actors are ubiquitous.

In all this there has been a transformation of – and growing sophistication in – the way we treat information. If expected utility has been the leading novelty since the 1940s, its step away from determinism was, in retrospect, a small and rather timid one – perfect knowledge about events was there replaced by perfect knowledge about the probabilities of those events. Bayesian learning could relax that strong probabilistic information requirement, but only for some kinds of events (the repetitive ones on which part of my chapter focuses).

Things opened up more sweepingly with Akerlof’s (1970) introduction of information asymmetries between economic actors – his formal recognition of the fact that buyers and sellers and employers and workers typically *know* very different things and typically know different amounts about the same things. Most recently, there has been a renewed appreciation of “Knightian uncertainty” or (surprise) an appreciation of the fact that many important things that happen cannot be predicted with sufficient

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clarity even to be included in the list of events over which probabilities can be specified. There are important things – unique things, my chapter stresses – that will not be on anyone’s list of possible states of nature. For them, expected utility is without meaning and Bayesian learning cannot take place. Appreciation of the fact that information has important *unknowable* components, of course, goes along with the resurgence of interest in Austrian subjectivism (see Kirzner 1973) and with Shackle’s (1958) persistent efforts to induce economists to take time – past, present, and future – more seriously in their analysis, a task I have carried another step farther in my chapter.

As John Gray makes admirably clear in Chapter 4, the structure of Hayek’s conception of society rests crucially on information, knowledge, for he sees a free society as a device by which individuals can utilize information they do not possess – actors can benefit from knowledge they do not, themselves, have. One function of institutions, including market institutions, is this dissemination of the results of socially usable information. McPherson, in Chapter 5, notes how Rawls’s “veil of ignorance” protects one’s choices about social organization from the personalistic contamination of self-interest, allowing collective choice without personal competition: People achieve a Kantian universalism simply because they cannot guess how they, as individuals, will fare.

McCloskey’s discussion of rhetoric is a discussion of the way information is transmitted *persuasively* among people – in this case among economists. One of his definitions of “rhetoric” is simply “the paying of attention to one’s audience.” From his perspective as a philosopher of science, Hausman asks in Chapter 6 how economists evaluate information and how, particularly, they make peace with the largely unverified nature of economic information. Finally, my own chapter examines information in time: the different pieces of information available to analyst and subject because of their time perspectives; the difference in the degree to which the information requirements of rational choice are satisfied by repetitive and by unique events; the information revealed when transactions are examined with a sharply focused unit time.

It is no coincidence that economists’ attention to information has led them recently, if reluctantly, to an increased attention to morality, the second recurrent theme of these chapters. That movement is uncomfortable to a number of economists, sometimes deeply so, as the threat of

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being enveloped by something inherently squishy challenges the scientist's white-coated dispassion. Aside from McCloskey's question of whether we really do persuade one another with that official, positivist, and scientific rhetoric, the explicit consideration of morality in economics is forced on us by our consideration of asymmetric information.

As long as we dealt only with fully informed actors – and fully informed, it must be assumed, about the intention of their fellow actors – it was possible to take for granted the moral context of their actions. Fully informed people could, acting rationally, protect themselves, and any quirky moralisms they wanted to bring in could be consigned to the preference function with all those other messy psychological imponderables. But as Akerlof's (1970) early lemons papers made clear, once we analyzed dealings between uninformed people or, worse still, between people when one knew more about the transaction than the other – the city slicker and the bumpkin – it became necessary to ask how far those people with superior information would push their advantage. The opportunities opened up, by virtue of their superior knowledge, to doctors, people buying insurance, and used-car salesmen trying to unload their lemons inevitably raise questions of morality and of the strength, direction, and source of internalized, self-imposed constraints on pure self-interest (see Bok 1978; Reder 1979; McPherson 1984).

Moral behavior is no longer peripheral to our understanding of economic behavior. "Cheating," "altruism," "guile," "opportunism," "deception," and "moral hazard" have become key words in modern economic theories. Information asymmetries introduce the dark strategic side of economic behavior, calculating and deceitful. And they thereby sharply increase the relevance of economic analysis to the tasks of disciplines like the law that must deal with those behaviors.

This Machiavellian side of rational economic behavior is unexpectedly revealed when private transactions are examined with temporal meticulousness in the last section of my chapter. It is shown that the problems of free riding usually attributed to public-goods transactions adhere, too, to private transactions as they take place in time. Gray's and McPherson's chapters address different aspects of morality. McPherson describes Rawls's use of welfare economics to think carefully about key issues of moral philosophy – of economic justice – and, at the same time, to broaden the domain of economic inquiry more explicitly to recognize

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economic justice. Gray's critique of Hayek's intellectual scheme questions Hayek's presumption of a benign evolution of social institutions that rejected the demands of a theistic morality.

Though the themes of information and morality run through all of these chapters, a brief precis of each will give a sense of their strong individuality.

In "Towards a Rhetoric of Economics," Donald McCloskey further develops the theme that has increasingly dominated his work (McCloskey 1983, 1985) – the need for economists to recognize that the way they persuade one another, their rhetoric, is not what they think it is and that they will be better economists, practicing better economics, if they become aware of the actual rhetoric of their discipline. This chapter is both an extension of that theme and an excellent introduction to it for those who have not before sat through one of McCloskey's delightful sermons. He urges economists (and others, incidentally) to look into their souls and recognize the rhetoric that lies there, often denied but rarely hidden. We are not the objective scientists of positivist mythology, but quite fallible humans, trying to understand a complicated reality and to persuade one another that we do. We persuade with a wide variety of devices including, but certainly not restricted to, mathematical and scientific devices. The device of primary interest in this chapter is our pervasive use of metaphor and analogy and the various forms it takes in economic discourse – as when Gary Becker likens a family's children to a stock of capital or when mathematical metaphor is used in modeling economic reality. Finally, McCloskey demonstrates the promise of a two-way flow across the boundary that separates economics from literary criticism, calling on I. A. Richards's insights to tell economists more about preference functions and ways we can better understand "metapreferences" – our preferences about preference functions.

My own chapter, "Three Problems with the Treatment of Time in Economics," has a simple theme – that economists (and other social scientists, though less is made of them) properly shy away from the metaphysical conundrums of the Nature of Time that preoccupy physicists and philosophers of science and theologians, but that economists err on the other side, paying too little careful attention to the time context of the people and activities they study. And it costs them. That argument is supported by three instances. The first is economists' tendency to attribute to the people we study the same omniscient ability to move about in time that we enjoy

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as analysts – a tendency illustrated by our long-standing ambivalence about the rationality of discounting the future. The second instance is our failure to distinguish between, on the one hand, economic decisions about repetitive events – where the information requirements of the rational choice model are nicely satisfied and one has the ability to adjust toward the real-world equivalent of an optimum – and, on the other, economic decisions about unique events – where rational choice theory is less obviously helpful. The final instance of a too casual treatment of time involves the selection of an analytical time unit: What seems a quintessentially pedestrian matter turns out to have unexpected consequences for economic analysis, as illustrated by the appearance of a genuine free-rider problem of classic proportions in private transactions, when they are viewed carefully as a sequence of actions in time.

With John Gray's "Hayek, the Scottish School, and Contemporary Economics," the discussion shifts away from admonitions to economists about the way they ought to do economics, which might characterize the first two chapters, to the examination of a leading economist who has never been accepted within the boundaries of economics, yet has won the Nobel Prize in Economics and has had formidable influence on the development of the field. The chapter is both an effective introduction to the distinctive features of Hayek's economics by a leading Hayek scholar and a thoughtful critique of its consistency, achieved by comparing Hayek's conceptions with those well-analyzed ideas of Burke, Smith, Hume, and Hobbes.

The central Hayekian theme is knowledge – information – and its embeddedness in and development through social institutions including, most explicitly, the market. Hayek's "knowledge" is much more than the "information" of much modern economics, information as the explicit knowledge of the individual rational decision maker à la Becker or von Neumann–Morgenstern (1944) or even Simon (1955). In Hayek, knowledge is the massive accumulated sum of individual information, the results of which are made available to people within society through social institutions; the *results* of knowledge are usable without explicit or even articulable forms of knowledge. Social institutions, then, allow the *use* of that tacit, unarticulated, even inchoate knowledge.

This is not a theme unfamiliar in modern economics. Arrow's (1974) *Limits of Organization* and much of the information economics that preceded it reach similar conclusions, if in a narrower setting, as does

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Williamson's (1985) systematic examination of the implications of bounded rationality for social interaction in organizations and the evolution of institutions to protect (Hobbesian) individuals in their social and market interactions. And the study of "relational exchange" between individuals (see Goldberg 1980; Okun 1981; Schultze 1985) has brought increasing attention to the information and economic role of noneconomic institutions.

All of this makes more important Gray's argument that this "epistemological turn" in Hayek's thinking is independent of and not supported by his presumption of an optimistically evolving set of institutions, increasingly in the service of improved human well-being. The temptation to slide from the careful functionalism of Arrow's analysis to the optimism of Hayek's is great and quite useful to identify since it seems clear that mainline "information economics" is moving toward the more sweeping Hayekian issues – from the explicit information available to individual decision makers to organizations and their ability to use information that few individuals within them have – and toward the optimistic temptations to which Hayek succumbed.

Michael McPherson's "Reuniting Economics and Philosophy" looks at the sharply increased interest economists have shown in moral philosophy in the past decade and the sharply increased interest moral philosophers have shown in economics. He asks what caused it and what has come of it. An important part of the answer to the first question lies in the contradiction between the social ferment of the late 1960s and the sterility of the economist's neoclassical analysis or the moral philosopher's linguistic analysis. Each discipline provided a push, inducing socially concerned scholars to search for ideas more relevant to the world they lived in. Into this came the strong pull, too, of John Rawls's (1971) *Theory of Justice*. In one stroke, a major philosopher, in a major book, demonstrated that one could think carefully and substantively about so passionate an issue as justice. And he did it by using welfare economists' tools – their rhetoric – in unaccustomed ways to illuminate deeply meaningful questions far outside the economist's accepted purview. This was heady stuff for the unsatisfied young economist and an eloquent demonstration to philosophers of the power of the economist's vocabulary. Though the traffic over the boundary between economics and moral philosophy turned out to be more complicated than was originally

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expected – McPherson gives us what amounts to a general theory of such boundary crossings as they evolve from discovery to high promise, then disappointment growing with familiarity – an association has been established in which both moral philosophy and economics are now significantly different.

Aside from its insights and thoughtful analysis of an important event in both economics and philosophy, McPherson's chapter is a nearly perfect, if unplanned, illustration of much of what McCloskey has been saying to economists about disciplinary rhetoric, the way scholars actually persuade each other, and the benefits to understanding of using a richer rhetorical menu. The chapter is autobiographical, using the story of one economist's seduction by moral philosophy as a personalized way of discussing the interaction between the two disciplines. It describes a genuine conversation between moral philosophers and economists and, what is even more important, a conversation in which each group has broadened its own disciplinary rhetoric to incorporate the alien rhetoric of the other. It is important to both the McPherson and McCloskey stories that these rhetorical assimilations were not made at the expense of the disciplines' traditional ways of thinking but, instead, augmented those conventional vocabularies and significantly expanded the discipline in the process. Social philosophy has gained a rigor of analysis and a capacity to say something careful about issues of great passion; economics has acquired a broader compass and a capacity to use its tools in a richer domain.

In Daniel Hausman's "Economic Methodology and Philosophy of Science," a philosopher of science asks why there has been so little traffic over a boundary one would expect to be quite narrow and heavily traveled – that between economic methodology and the philosophy of science. Why, particularly, has most economic methodology been written (and rather badly) by economists who do not have a very sophisticated understanding of the philosophy of science? In Hausman's useful sketch of the history of economic methodology, starting with Mill and, really, coming back to Mill, he describes the power of a defunct positivism, aided by Friedman's persuasive rhetoric, to make economists highly uncomfortable with the untested propositions that ground their discipline.

If McPherson concludes that the traffic over the boundary between economics and moral philosophy has carried considerable mutual gains from trade, Hausman concludes that it is a mistake to expect that

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economists and philosophers of science will have the same objectives motivating their interest in economists' methodology. Economists are interested in economic methodology because they want to do better economics (witness the McCloskey and Winston arguments on methodology) whereas philosophers are interested in economic methodology because they hope to understand more fully the development of knowledge in an important discipline. Their objectives are different, and in the greater modesty of postpositivism, the role of the philosopher of science is not to tell economists how to get their methods right but to study and make sense (if possible) of the way economists *do* their economics. And if McCloskey is successful in inducing economists to recognize the very large role that rhetoric plays in the way they do their economics, it would appear that philosophers of science will soon be studying literary criticism in order to understand how social scientists go about their jobs.

Finally, it will be useful to note that none of the chapters indulges in economist bashing. That may be clear by now, but it is important. The authors are often critical of the current state of economics – they argue for more coherence, more recognition of its limits, more respect for its methods of argumentation – but they do so with a respect for the value of economics as a way of illuminating human behavior. In some of the chapters some of the time, this attitude is almost a passion. Economics is limited in its capacity to penetrate the mysteries of human behavior, not by some lamentable stupidity on the part of its practitioners, but by the inherent and inescapable complexity of the subject – human behavior – it has taken on. The volume implicitly, like McPherson's chapter explicitly, has as a major objective the identification of the boundaries of our ignorance with the conviction that, as we become clearer about what we do not (and often cannot) know, we will be clearer, too, about the way people behave. It is simply uninteresting, in the implicit view of these authors, that economics is an imperfect "science" – it exists in an imperfect world and confronts issues of mind-boggling complexity. What matters is that economic understanding be improved, not that it aspire to perfection.

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