



# ETHICS AND ECONOMICS

Lecture Notes for Week 4

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# Economics as a Social Science

In the first part of this chapter, we will explore the link between individuals and the social structures they are part of. In the second and in the third parts, we will discuss some topics from the philosophy of economics. Appendix 1 presents points for discussing the moral issues of "helping the poor" and "migration." Appendix 2 promotes Ludwig von Mises's *Human Action*.

## Individuals and Social Structures

We can begin analyzing this link by exploring the differences between individualism and holism on three different levels:

- **Ontological:**

Ontology studies the nature of being, existence, and reality. Extreme ontological individualism holds that social structures do not truly exist; they exist only in our minds. Adam Smith might be considered an ontological individualist.

Ontological holism, historically also known as organicism, posits that social structures are "organisms" that cannot be reduced to their parts. Émile Durkheim (1859–1917), one of the "fathers" of sociology, even believed in collective consciousness. Modern science distinguishes between complicated and complex systems. Complex systems are irreducible into their parts, whereas complicated systems can be reduced to their parts. Complex Systems Theory is a mathematical framework that analyzes complex systems. Social systems are complex systems.

Durkheim demonstrated the irreducibility of social facts to psychological facts through his study of suicide. He began with an empirical analysis of historical statistical data on suicide, where certain jumps in suicide rates could not be explained by individual-level psychological factors. From this, he deduced the existence of social facts that are not reducible to psychological facts. His explanation was that the psychological states of individual suicide victims are intermediate links (or by-products) in a causal chain stemming from "social integration." There exists an optimal level of integration, and deviations from this level increase the suicide

rate.

A scientific discipline can be defined either by its subject matter or its method. Durkheim believed in the "unity of science," meaning that scientific disciplines may not be distinguished by method. In this case, if social facts were reducible to psychological facts, sociology would be reducible to psychology, and sociology could not be defined as a separate field.

- **Methodological:**

Methodological individualism means that we develop knowledge by starting with individual actions, with social structures deriving from these actions. Current mainstream economics typically follows methodological individualism. Methodological holism, on the other hand, involves identifying and explaining parts of social structures in terms of the functions (or purposes) they serve for the social structure, rather than for individuals. This approach is known as Functionalism.

Functional analysis proceeds iteratively: we assume certain functions, then search for parts that fulfill these functions, which provides a functional explanation of the parts and a better understanding of the social structure. If this understanding is insufficient, we redefine the functions and repeat the process. Social sciences often work with manifest and latent functions. For example, a latent function of marriage might be maintaining an optimal degree of social integration. Parts can function differently within various structures. A family functions differently as part of the educational structure and as part of the economic structure. When the parts in question are individuals, psychology can be used to explain their behavior within these structures.

- **Political:**

Some individualists, such as Karl Popper (1902–1994) in his book *The Open Society and Its Enemies* (1945), argue that methodological holism threatens personal liberty and individual rights, potentially leading to totalitarianism. For example, Marxists might claim that the latent function of elections is to deceive the proletariat by giving them the illusion of choosing their oppressors. If this belief is accepted, why respect the outcome of elections?

Joseph Alois Schumpeter (1883–1950), a renowned economist and political scientist, argued that there is no logical reason why methodological holism must be linked with political holism.

How are social structures created? There are three basic positions:

- Superintelligent design,
- Intelligent design (Constructivism),
- Natural selection, which is based on three principles:
  - Later generations inherit traits more like their ancestors than like others,
  - Variation exists in every generation among these hereditary traits,
  - Differences in fitness to the environment exist among these hereditary traits.

## Definition of Economics and Coherent Schools of Contemporary Economics

What is economics? How can we distinguish economics from other social sciences?

We can use different strategies to base our answer on, such as:

- Specifying its subject matter, e.g., production, distribution, exchange, and consumption.
- Specifying the incentives for a rational individual that affect their actions and the consequences of those actions.

For example, John Stuart Mill (1806–1873) wrote: "Political economy... [is concerned with] such of the phenomena of the social state as take place in consequence of the pursuit of wealth." Mill assumes that individuals act rationally in their pursuit of tangible wealth. We could construct similar definitions, such as: "Economics is concerned with phenomena that occur as a consequence of the maximization of utility."

- Economics is concerned with phenomena that occur as a consequence of the allocation of scarce resources."

Economics is also concerned with economic structures, which are social structures where money is the medium of coordination. Using this strategy, we can distinguish different social sciences. For instance, a definition of political science could be: "Political science is concerned with political structures, which are social structures where power is the medium of coordination."

Political economy changed its name to economics at the end of the 19th century. Economics, like ethics, is a tradition. Throughout its history, various theoretical systems have been developed, such as Adam Smith's system, J.S. Mill's system, Alfred Marshall's system, and the Keynesian system.

Contemporary economics has three coherent schools:

- The Neoclassical Synthesis,
- Post-Keynesian Economics,
- The Austrian School.

The Neoclassical Synthesis is the mainstream economics typically taught in standard microeconomics and macroeconomics courses. Few universities offer courses on other schools.

## Selected Topics from the Philosophy of Economics

Philosophical problems associated with economics are modifications of the philosophical problems of social sciences, which are themselves modifications of the philosophical problems of sciences.

- **Epistemology and methodology:** What is the nature of economic knowledge? What methods can be used to obtain economic knowledge?
  - Positive economics, which was contrasted with normative economics at the turn of the 19th and 20th centuries, has always tried to adopt the structure of theories and methodology from the natural sciences. This approach is

called Naturalism. It can be criticized as follows: Sciences work with laws that can be used for predictions. Economic phenomena are too irregular to fit into a framework of laws. While empirical regularities can be found, can they be generalized into universal laws, like ballistic curves are linked with Newton's law of motion? This makes predictions weak. However, in economics, the goal may not be prediction but interpretation—understanding the meaning of individual actions or the functions of economic structures. Thus, good economic knowledge may be interpretive, not predictive.

- **Verification of economic theories:** Sciences use the method of induction to derive theories from observations or experiments and verify these theories with additional observations or experiments. Successful predictions are crucial for verification, and successful technologies embody successful predictions. However, verifying economic theories using facts is less conclusive due to causal complications. J.S. Mill (1806–1873) suggested a two – stage modification of induction more suited for social sciences: distinguishing between a posteriori and a priori induction. Induction a posteriori explains facts with a limited number of causal factors. Induction a priori deductively investigates the combined effects of facts explained a posteriori. The same set of facts explained a posteriori may support multiple theories.
- **Instrumentalism in economics:** Milton Friedman (1912–2006) argued in his 1953 essay *The Methodology of Positive Economics* that theories and models are tools for prediction, not understanding. A theory should be judged by its predictive power for the class of phenomena it seeks to explain. Unrealistic assumptions are not problematic if they lead to accurate predictions.
- **Falsificationism:** In the early Enlightenment, there was a belief in the linear development of science through induction from empirical facts and verification via successful predictions. Karl Popper (1902–1994) developed Falsificationism, which is based on the idea that "absolute" verification is impossible. A theory is considered true as long as it has not been falsified.

Theories that cannot be falsified are not scientific. Instead of verifying, we should attempt to falsify, which is a key part of the scientific process.

- **Economic theories as structures:**

- Thomas Kuhn (1922–1996) introduced the concept of "paradigm shifts" in his 1962 book *The Structure of Scientific Revolutions*. A paradigm is a widely accepted framework that defines scientific research within a field, including theories, methods, standards, and assumptions. Scientific fields progress not only through linear development but also through paradigm shifts, where new discoveries challenge existing frameworks and open new approaches. The notion of scientific truth at any given time is determined by a consensus within the scientific community.
- Imre Lakatos (1922–1974) developed the concept of "research programmes" to reconcile the perceived conflict between Popper's Falsificationism and Kuhn's "revolutionary" structure of science. Lakatos's research programmes consist of a "hard core" of fundamental assumptions protected by a "protective belt" of auxiliary hypotheses. Progress is judged by a programme's ability to predict novel facts and expand explanatory power over time, distinguishing between "progressive" and "degenerative" programmes. Examples of research programmes in economics include the Neoclassical Synthesis (mainstream), Post-Keynesian Economics, Austrian Economics, Public Economics, International Economics, and Economic Growth Theories.

- **Economics and social justice:** An important aspect of economic policy is redistribution, and positive economics that current economics wants to be does not offer sufficient tools for analyzing redistribution. Positive economics emphasizes the distinction between facts and values and is centered in handling facts, but normative economists argue this is difficult because:

- Economists must articulate the incomplete goals and constraints provided by politicians.



- Economic science, as a human activity, is influenced by values.
- Economic theory is built around a normative theory of rationality.
- People's views of right and wrong depend on their social environment.
- People's judgments are clouded by their personal interests.

## Summary

The first part explores the distinctions between individualism and holism at three levels: ontological, methodological, and political.

### 1. **Ontological:**

Ontological individualism suggests that social structures exist only in our minds, while ontological holism, exemplified by Émile Durkheim, posits that social structures are irreducible to individual parts, likening them to organisms. Durkheim's study of suicide illustrates how social facts cannot be reduced to psychological facts, highlighting the existence of social structures.

### 2. **Methodological:**

Methodological individualism starts with individual actions, suggesting that social structures are derived from these actions, a view commonly held in mainstream economics. In contrast, methodological holism, or Functionalism, focuses on identifying parts of social structures based on their functions for the system as a whole.

### 3. **Political:**

Some, like Karl Popper, argue that methodological holism threatens individual liberty and can lead to totalitarianism. However, Joseph Schumpeter counters that methodological holism does not necessarily align with political holism.

Finally in the first part, the creation of social structures is discussed through three views: superintelligent design, intelligent design (constructivism), and natural selection, which involves variation and environmental fitness.

The second part defines economics and distinguishes it from other social sciences through various strategies. Different definitions can focus on economics' subject matter, such as production, distribution, and consumption, and the incentives driving rational individual actions, like the pursuit of wealth. John Stuart Mill's view of political economy is used as an example, and alternative definitions based on utility maximization or resource allocation are also provided.

Economics can also be defined as the scientific discipline concerned with economic structures; social structures in which money coordinates social interactions. The text notes that political economy transitioned to "economics" at the end of the 19th century, evolving through various systems, such as those of Alfred Marshall and Keynes.

The second part concludes by identifying three coherent contemporary schools of economic thought: the Neoclassical Synthesis, Post-Keynesian Economics, and the Austrian School, with the Neoclassical Synthesis being the mainstream approach taught in most universities.

The third part addresses philosophical problems in economics, which are linked to broader philosophical issues in social sciences and sciences. Key areas include:

1. **Epistemology and Methodology:** Positive Economics borrows methods from natural sciences, focusing on prediction and verification. However, economic phenomena are often too irregular for strict laws, suggesting that economic knowledge may be more interpretive than predictive.
  - **Verification:** J.S. Mill's distinction between a posteriori and a priori induction is presented as in his opinion suitable for verification in social sciences.
  - **Instrumentalism:** Milton Friedman argues that theories should be judged by their predictive power, not their realism.
  - **Falsificationism:** Karl Popper introduced Falsificationism, asserting that theories cannot be absolutely verified, only falsified. A theory is considered scientific if it can be tested and potentially disproved.

- **Theories as Structures:** Thomas Kuhn introduced the concept of paradigm shifts, where scientific fields evolve through periods of normal science interrupted by revolutionary changes. Imre Lakatos developed the idea of research programmes, which consist of a "hard core" of assumptions and auxiliary hypotheses, with progress measured by a programme's ability to predict new facts.
2. **Economics and Social Justice:** Redistribution is an important issue in economic policy, but positive economics does not offer adequate tools for analyzing it. The distinction between facts and values is crucial, but normative economists argue that values inevitably influence economic analysis due to factors such as social environment and personal interests.

# Appendix 1: Helping to the Poor, Migration

Allowing immigration can be one form of helping the poor.

## **Ethical questions:**

- Is there a duty to help those who are starving?
- Should we be equally concerned for everyone?

Let's summarize four approaches to these questions: Ethical Egoism, Social Contract Theory, the Utilitarian approach, and the Christian approach.

**Ethical Egoism:** It is a normative ethical theory that posits individuals should act in their own self-interest, and this is morally right. According to ethical egoism, the welfare of the individual should be the primary concern, and actions are considered morally acceptable if they benefit the individual performing them. This differs from psychological egoism, which suggests people naturally act in their self-interest. Ethical egoism argues that pursuing one's own interests can ultimately benefit society, as individuals working toward their goals can lead to a more efficient and harmonious social structure. Critics argue that it justifies harmful behavior toward others and neglects altruism and collective welfare.

Psychological egoism believes that self-interest is a human psychological fact, not an ethical issue. Altruism, according to this view, is not possible, as any apparent altruistic action is really motivated by self-interest.

Ethical egoism, on the other hand, asserts that each person ought to pursue their own interests. In its radical form, self-interest accounts for all obligations. Supporters argue that altruism conflicts with self-realization and that ethical egoism aligns with the "invisible hand" and Social Contract Theory. Critics, however, contend that ethical egoism promotes wickedness and is unacceptably arbitrary, asking: What makes me (or my community) so special? Common sense morality suggests we should treat people equally unless there is a good reason not to.

**Social Contract Theory:** It posits that individuals, either explicitly or implicitly, consent to form a society and accept certain moral and political obligations in exchange for the benefits of communal living. In the state of nature, individuals have complete freedom but lack security and order. By agreeing to a social contract, they create a government or authority that enforces laws and norms, providing protection while limiting some personal freedoms. This theory underpins modern political philosophy and discussions on government legitimacy and individual rights.

A social contract helps solve coordination problems, such as those seen in the Prisoner's Dilemma. Key figures like Thomas Hobbes believed that a strong, centralized authority is necessary to avoid chaos. Other important philosophers, such as John Locke and Jean-Jacques Rousseau, focused on individual rights and democracy.

Social Contract Theory addresses questions like:

- What moral rules must we follow? Rules that promote harmonious social living.
- Why is it rational to follow moral rules? Because society enforces them, and they reduce transaction costs.
- When is it rational to break the rules? If we do not benefit from the arrangement or if others do not follow the rules.
- How much can morality demand from us? Supererogatory acts, like sacrificing one's life, cannot be part of the social contract.

Challenges to Social Contract Theory include the implicit nature of the contract and whether everyone truly participates in the social contract.

**Utilitarianism:** It prescribes that we should be equally concerned for everyone, but this can be criticized as too demanding and disruptive of personal relationships.

**Christian Approach:** Helping the poor is a core prescription of Christianity, based on divine command rather than reason. The philosophical question raised by Plato, asking whether actions are right because the gods command them or whether the gods command them because they are right, applies here as well. Thomas Aquinas' natural law theory suggests that helping the poor is a moral obligation rooted in human dignity and justice.

**Conclusion of the ethical debate:** Different approaches yield different conclusions on helping the poor. We feel we ought to help our neighbors, but who counts as our neighbor?

**Economic and Political Debate:**

- **Economic impacts:** Helping the poor boosts consumer spending, stimulates economic growth, and improves human capital through education and healthcare, leading to a more productive workforce. It also reduces costs related to social issues like crime. However, concerns about dependency and fiscal burdens highlight the need for efficient program design.
- **Political impacts:** Assisting the poor shapes policy priorities, influences elections, and fosters social stability. Politicians focusing on poverty reduction often gain support from lower-income voters. However, these initiatives may face resistance from fiscal conservatives, raising debates over taxation and government spending. Internationally, poverty reduction enhances a country's reputation and diplomatic relations, while empowering marginalized communities can shift governance toward inclusivity.
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## Migration

In recent years, Europe has experienced a significant influx of migrants and refugees from the Middle East, Africa, and South Asia, fleeing conflict, persecution, and poverty in search of safety and better opportunities. This migration has sparked considerable debate and varying responses across European nations. Some countries have welcomed migrants and integrated them into their societies, while others have implemented strict border controls and immigration policies. This movement has also raised critical discussions about humanitarian obligations, economic impacts, cultural integration, and security concerns, highlighting the need for a cohesive and comprehensive approach to migration within the European Union.

**Ethical questions:** Is there a duty to accept immigrants? Should we accept all immigrants?

### **Related questions:**

- **What are the causes of immigration to Europe?** Both push factors, such as war in the country of origin, and pull factors, such as better economic conditions in the target country, play a role and can be difficult to distinguish in individual cases.
- **Should distinctions be made between asylum seekers and economic migrants?** Distinctions between asylum seekers and economic migrants are crucial because their motivations, legal statuses, and the frameworks governing their treatment differ significantly. Asylum seekers flee persecution based on race, religion, nationality, political opinion, or social group membership and are protected under international law, specifically the 1951 Refugee Convention. Economic migrants, on the other hand, move primarily to improve their economic situation and do not qualify for international protection under the Refugee Convention.
- **What are the economic consequences of high immigration?** High immigration can have both positive and negative economic consequences. On the positive side, immigrants can fill labor shortages, contribute to innovation, and boost consumer demand. They often take jobs that are hard to fill locally, enhancing productivity in industries like agriculture, construction, and healthcare. Immigrants can also help balance aging societies by replenishing the workforce and supporting social welfare systems through taxes. However, high immigration can also strain public services like education, healthcare, and housing. If not properly managed, it can create competition for jobs, lower wages for low-skilled workers, and lead to social tensions.
- **Does high immigration affect European identity?** High immigration profoundly impacts European identity by both enriching culture and challenging social cohesion. While it promotes cultural exchange and innovation, it can also create concerns about the preservation of national values and social unity. Rapid demographic changes can fuel nationalism and anti-immigration sentiments, leading to political and social tensions.
- **Who is responsible for immigration policy in the EU?** Immigration policy in the EU is a shared responsibility between the EU institutions and individual member states. The European Commission proposes legislation, while the European Parliament and the Council of the European Union adopt policies. Member states

maintain control over aspects such as legal immigration, integration, and border management, but the EU has established common standards for asylum procedures. Agencies like Frontex help coordinate border management.

- **What policies could address immigration in Europe?** A comprehensive approach is needed, including stronger border management through Frontex, fair asylum procedures, equitable distribution of asylum seekers, and integration programs offering language training, education, and employment support. Policies should also address the root causes of migration through foreign aid and conflict resolution, establish legal migration pathways, and promote cooperation among EU member states to share the migration burden evenly. Public awareness campaigns are essential to counter xenophobia, and international collaboration is crucial for managing migration flows.
- **How could these policies be assessed?** The effectiveness of immigration policies can be evaluated through both quantitative and qualitative measures, such as key performance indicators (KPIs) for processing asylum applications and integration success rates. Surveys and feedback from immigrants and local communities provide insights into the impact of programs. Economic analyses can measure contributions to GDP, labor market participation, and tax revenues, while social cohesion metrics track levels of xenophobia and hate crimes. Cost-benefit analyses compare financial costs to benefits like social stability and economic growth. Compliance and enforcement measures ensure member states adhere to EU policies, and longitudinal studies can assess long-term outcomes like educational attainment and career progression. Comparing EU policies with international benchmarks helps identify best practices and areas for improvement.



## Appendix 2: Ludwig von Mises: “Human Action”

Ludwig von Mises (1881–1973) was a prominent Austrian economist and a leading figure in the Austrian School of economic thought. Known for his rigorous defense of classical liberalism and free-market capitalism, von Mises made significant contributions to economic theory, particularly in the areas of praxeology (the study of human action), monetary theory, and the critique of socialism. His seminal works, such as *Human Action* and *Socialism*, emphasize the importance of individual choice, the role of market mechanisms in efficiently allocating resources, and the dangers of central planning. Von Mises' ideas have had a lasting impact on economic thought, influencing both academic discourse and public policy debates on economic freedom and the role of government in the economy.

### ***Box: Importance of the Analysis of Human Action***

*Preunderstanding of human actions can be formulated as the Law of Intentions in Folk Psychology: If we want something and believe that an action can achieve it, then we take that action. This law makes actions intelligible, but its use for predictions is questionable. Wants and beliefs explain reasons, but is it possible to use them in causal analysis? Are they causes? Scientific laws that enable predictions are about causes and effects, and without scientific laws or empirical regularities that could become scientific laws, predictability is low.*

*How can we address this problem?*

- *One option is to adopt an interpretationalist approach, placing high importance on interpretations and less on predictions.*
- *Another option is to become a behaviorist. Behaviorists move away from folk psychology and instead of analyzing unmeasurable wants and beliefs, they focus on the influence of measurable environmental factors on actions. Behaviorists use the Law of Effects: If a behavior is reinforced, it will be repeated more*

*frequently (or with greater intensity or duration), and if it is punished, it will be repeated less frequently (or with lower intensity or duration).*

- *A third option is to switch from folk psychology to rational choice theory. In this approach, we assume that people optimize—meaning in economics, that consumers maximize utility and firms maximize profit. A key assumption in rational choice theory is the assumption of perfect information. Without this assumption, economists differ on the importance of subjectivity. For instance, the Austrian School places great importance on subjectivity, sharply distinguishing economics from natural sciences.*

*Human Action*, first published in 1949, is a comprehensive treatise on economic theory and the foundational text of praxeology, the study of human behavior and decision-making. In this seminal work, von Mises argues that all human actions are purposeful and driven by individual preferences and subjective values. He emphasizes the importance of understanding economics as a science of human action rather than merely focusing on empirical data and statistical analysis. Like other Austrian economists, von Mises assumes subjectivity in utility and elsewhere, which is why he starts his analysis from actions themselves, avoiding the need to analyze the motives behind those actions.