

## ECONOMIC THEORY IN THE SEARCH FOR PHILOSOPHICAL FOUNDATIONS<sup>1</sup>

**Leonid Tutov**

Lomonosov Moscow State University, Russia

E-mail: l.tutov@yandex.ru

### —Abstract—

*Neoclassical economics (NCE - thereafter) has difficulty in solving complex theoretical and practical problems. In such a situation, the role of its philosophical foundations increases. NCE is based on the methodological postulates of positivism. However, the status and perspectives of the positivist methodology to maintain a dominant position in the world of science are the subject of intense debate, as with this approach, sciences lose their worldview function and ontological foundations. The purpose of the report is to justify the continuing relevance of the methodology of positivism for the development of economic theory.*

**Key Words:** Neoclassical economics, Positivist methodology, Scientific Research Programmes,

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### 1. INTRODUCTION

Modern economic science is going through difficult times. This situation is increasingly diagnosed as a crisis. The crisis manifest itself in the fact that theoretical problems in economics can't be solved by the existing methods. In addition, "theoretical economics wasn't able to find effective solutions of economic policy problems" (Polterovich, 1997:47). The crisis that we speak of concerns essentially Neoclassical economics, which for a long time has maintained the status of mainstream.

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the world of science are the subject of intense debate, as with this approach, sciences lose their worldview function and ontological foundations. Economic theory is forced to deal with dichotomies: realistic – unrealistic, operational – inoperational, functional – instrumental, useful – unuseful, organic – mechanical, etc.

The situation is further complicated because, with regard to philosophy, there is no concept of mainstream. However, the history of philosophy allows us to make a conclusion that at different stages of development of human thought certain philosophical principles and approaches were more or less in demand. In addition to schools that maintained leader status, there were other schools that could be called alternative.

However, in contrast to modern economic theory in which alternative economic theories appear minor because of being unable to theoretically and methodologically compete with neo-classics, in philosophy alternative theories look self-sufficient and theoretically coherent.

A historical view confirms this situation. Thus, in the period of antiquity it should be noted that the philosophical principles proposed by Aristotle served as a basis for the development of economic doctrines. Despite the fact that the ancient world was rich with numerous philosophical schools, their usefulness for economic theory is less obvious. In the middle Ages the views of F. Aquinas gave the key to the explanation of economic reality. In the New time philosophers have had a significant impact on the emerging economic science. The ideas of both rationalists and representatives of empiricism were in demand. However, due to the weak empirical base of the economic science, a confrontation between rationalism and empiricism existed. The theoretical and empirical weakness of economic science was then filled not only by philosophy, but also the methodology of natural science. This circumstance contributed to the growing influence of a certain philosophical school. We are talking about the above-mentioned positivism, which initially began as an interdisciplinary study, because it allowed the use of methodological principles and provisions of some sciences in other sciences.

More than 150 years have passed from the time when positivism was established as a distinct philosophical school . But does positivism still have methodological perspectives, considering that the modern economic science needs radical restructuring?

The aim of this study is to justify the continuing relevance of the methodology of positivism for the development of economic theory

The influence of positivism in our time is associated with using ideas of Kuhn's theory of paradigms and Lakatos' Scientific Research Programmes.

Maki (2012) believes that the approach of Kuhn's and I. Lakatos with regard to the economic sphere belongs in the past, because, using the methodology of paradigms and research programmes, it is impossible to affirmatively answer such questions as: Are economic theories falsifiable and overall empirically testable? Does a particular direction of economic studies demonstrate progress?

For his part, Maki (2012) proposes to clarify the concept of "realism" in the sphere of economic theory. The realism of economic concepts (preferences, expectations, money, prices) depends on the human mind. If in the sphere of natural science realism is confirmed by advances in science, in Economics a large role in the recognition of whether theories are true belongs to disciplinary communities (Maki, 2012:3).

C. Toulmin (Toulmin, 1972:23) formulates another solution. He links the development of science with the formation and functioning of the standards of rationality and understanding (matrix of understanding), based on the use of the evolutionary principle. That which does not fit into a "matrix of understanding" is viewed as an anomaly, the removal of which, i.e. the improvement of understanding, acts as a stimulus for the evolution of science. The rationality of scientific knowledge is its conformity to the accepted standards of understanding.

The standards of rationality change as a result of the process of continuous selection of conceptual innovations. However, the content of economic theories is not seen as a logical system of statements, but as a kind of a population of concepts. The evolution of science is similar to the theory of evolution of Charles Darwin. The conceptual populations are subject to change, which leads to a change of methods and goals of scientific activity. Emerging conceptual innovations are subjected to critical selection, and noticeable changes occur only under certain conditions. Only those conceptual variants are retained that are better adapted to the demands of the intellectual environment.

The mechanism of evolution of conceptual populations results from the interaction of inter-scientific (logic thinking) and extra-scientific (social, economic, psychological) factors. The survival of concepts is determined by the importance of their contribution to a better understanding. The evolution of theory

depends on historically evolving standards of rationality that are, in return, influenced by the evolving disciplines.

C. Toulmin (Toulmin, 1972:25) denies the objective nature of science, draws the concept of truth from epistemology, offering pragmatic and instrumentalist approaches. He opposes formal logic as a criterion of rationality and emphasizes the important role of the specific historical approach and methods of socio-economic and humanitarian disciplines.

In order to answer the main question of the report, it is necessary to show the advantages and limitations of the positivist methodology and the alternative concepts that could serve as the basis for a new mainstream.

## **2. THE BASIC POSTULATES OF POSITIVISM: ADVANTAGES AND LIMITATIONS**

The most important postulates of positivism include the following:

- Scientism and the rejection of ideological functions, and any form of metaphysics.
- Cumulativity, as the development of science is presented as the accumulation of knowledge. An old theory is included into a new theory as a special case.
- Subjectivity: scientific concepts, formulas, laws are devoid of objective content and have little in common with those phenomena to which they relate.
- Conventionalism, because the fundamental principles of science and axioms constitute conditional assumptions, agreements for convenience.
- Skepticism, and relativism: only phenomena can be understood. Truth is relative and/or not understandable. Any scientific theories are temporarily used misconceptions.
- There are two basic principles of verifying the truth or falsity of knowledge, and thereby justify its scientific status: verification and falsification.
- Reductionism: theoretical knowledge is a result of the generalization of empirical knowledge. Pragmatism, as knowledge is required to achieve practical goals and should be useful.
- The economy of thinking as a basic principle of knowledge.

- Formalism. The rigor and universality of scientific language, finding expression, for example in the form of physicalism and of panlogism.
- Evolutionism. The evolutionary principle is at the core of any development.

The presented postulates of positivism give a generalized characteristic of this direction at various stages and therefore have some element of conditionality. Thus, T. Kuhn's theory of the revolutionary change of paradigms is not consistent with the above-mentioned evolutionary principle of positivism.

Nevertheless, the projection of the positivistic methodology on the field of economic science allows us to detect a number of cognitive capabilities.

The advantages of positivism:

- Tries to maintain the scientific status of economic knowledge, offers scientific criteria.
- Provides a model for the development of science, shows the forms and reveals the universal structure of knowledge (scientific research programme, "hard core", "protective belt", paradigm). Strives to make the knowledge operational.
- Substantiates the relevance of the principle of verification of economic knowledge.
- Proves a close link between science and economic policy, attaching great importance to the accuracy of predictions.

Limitations of the methodology of positivism:

- Cannot claim the status of a universal scientific methodology, because it does not meet the principles of a modern postnonclassical science.
- Distorts the relationship of the empirical and theoretical levels of knowledge, either contrasting them, reducing theoretical knowledge to the empirical, or arguing that expert knowledge has no independent status; this contributes to the excessive formalization and lack of realism in modern Economics. M. Friedman in his work "The Methodology of Positive Economics" (Friedman, 1953) declared that the quality of a theoretical model does not depend on the accuracy of its assumptions, but is entirely determined by its ability to give reasonably accurate predictions.

- The instrumentalist approach is becoming dominant to the detriment of other explanatory principles; the ontological layer of knowledge is supplanted. John M. Keynes called economic theory a "branch of logic".
- In general, positivism is adverse to new forms of rationality, as well as to nonrational and irrational knowledge.

Note that positivist methodological assumption can be found not only in neo-classical economic theory in its extended format, but also (up to a limit) in new institutional Economics, Austrian Economics, neokeynesian and postkeynesian economics, as well as new schools in Economics: experimental and behavioral Economics, neuroeconomics, which confirms the idea that modern economic theory is a synthesis of some key research areas and doesn't just equal neo-classics.

### **3. ALTERNATIVE APPROACHES**

These suggested approaches can be considered as alternative methodologies: postmodernism, structuralism, pragmatism, realism, hermeneutics.

Pragmatism, taken as an alternative to positivism, cannot be considered as such in terms of content. The emphasis is on the factor of practice, which is used as the main methodological principle. The pairing of concepts and beliefs with their efficiency allows to clarify and solve important theoretical problems. For example, the question of truth is not connected with the reflection of reality in theory and suggests that in some situation beliefs can be true, while in another they can be false. In other words, the concept of "truth" has an adaptive character. In "Pragmatism" William James wrote: "Whenever a dispute is serious, we ought to be able to show some practical difference that must follow from one side or the other's being right" (James, 1896). Later H. Putnam proposed to replace the concept of truth by the notion of suitability. In contrast to positivism, in pragmatism there is no opposition between judgments of fact and judgments of value, since the first contains an axiological component. Knowledge is true not only when it works to achieve a goal, but when it also serves moral ideals and humanistic values. The principles of pragmatism are reflected in the above-mentioned approach of M. Friedman on the importance of projections and unrealistic assumptions.

Structuralism (Barthes, 1968; Derrida, 1973; Lacan, 1988; Levi-Strauss, 1978; Foucault, 1961) can be seen as a development of the ideas of logical positivism, as it relates to the transition from a descriptive and empirical approach to abstract-theoretical methods. Structuralism is an interdisciplinary direction. Originating

from structural linguistics, it has spread to a number of social and humanitarian Sciences. The main feature of structuralism is the application of the structural method of modeling, the method of formalization and mathematical tools. Structure as a set of relations between objects serves as a central concept. These relations are invariant and do not change with various internal and external transformations. The structure is based on three fundamental assumptions, namely:

- The priority of the whole over the part.
- Self-regulation, involving the free action of rules within the system.
- Transformation, i.e. the transition from one substructure to another based on the rules of generation. Thus, the structure allows to subsequently derive one object from another, by following strictly defined rules.

The advantages of structuralism as a research methodology include the following:

- The emphasis is on qualitative change and radical restructuring of the foundations of object.
- A high level of abstraction allows for generalizing and creating a universal model. These provisions are of interest to economic science.

However, there are limitations:

- The knowledge of structures does not allow to penetrate the essence of economic events. Context and the individual characteristics of the author must be considered.
- Eclecticism, which is manifested in the connection of unconscious mechanisms governing the culture, and broad generalizations.
- Antisubjectivism, as an attempt to return to objective knowledge, really meaning the expulsion of man beyond its limits. This is contrary to the principles of a modern postnonclassical science, suggesting the involvement of man in the object of study.

A discussion on hermeneutics and its methodological perspectives, which methodologically is a completely opposite approach to positivism, is important. This is because philosophical hermeneutics is interpreted as a theory of understanding and interpretation of texts, historical monuments and cultural phenomena.

The postulates of hermeneutics can be summarized to the following provisions:

- Intuitionism. Rationality is boring and sober prudence, ignoring all the sublime, the aesthetic and the ethical, so the role of direct contemplation and intuition is great.
- The antithesis between reason and tradition doesn't exist, however, tradition has some historical fact, like the beauty of nature, so it does not need a reasonable basis, and acts as a kind of self-evidence.
- The priority of methodological holism. First, one must understand the whole so that parts and elements become clear (Schleiermacher,1799). Cognition is carried out according to the rules of the hermeneutic circle, suggesting that approaching the text with a known previous understanding of it as a whole, the interpreter clarifies its components and the result is a greater appreciation of the whole (Gadamer, 1960).
- Psychological insight. Thanks to psychological integration one can penetrate the inner world of the authors of ancient texts, any historical figures, and on this basis reconstruct historical events, understand them more deeply than they were aware of by the participants in these events (Schleiermacher, 1799).
- Subjectivism and agnosticism. We can understand the facts relating to society only from within on the basis of perception of our own psychological condition. Nature to us is silent, alien, outer (Dilthey,1880).
- The rejection of scientific methods of cognition. There is a "tension" between truth and the scientific method. If the application of inductive methods is appropriate for the natural Sciences, the Humanities cannot be measured by the scale of progressive knowledge of laws (Gadamer,1960).
- Understanding is the main method of the Humanities, which involves understanding the meaning of cultural-historical phenomena by the methods of dialogue, empathy.



- Specifically historical approach. It is important to understand what constitutes this particular person, nation, state, how they were formed.
- A negative attitude to the utilitarian approach. Everything isn't measured by the effectiveness of the obtained results. Man is a spiritual being who is responsible to society. All that he discovers is secondary, limited in relation to him.
- Constructivism. True understanding is not only reproductive but always a productive attitude.
- The ontology of language. Being is language. The essence of language is a game that involves not behavior and the mental Constitution of that who creates a piece of art or enjoys it, but a way of being of works of art. Games provide aesthetically disinterested pleasure, and, consequently, cognition (Gadamer,1960).

The identified methodological principles of hermeneutics can be found in the theories of the representatives of the historical school of Germany and traditional institutionalism. In addition, their meaningful intersection with the methodological principles of modern science should be noted. We are talking about the collective scientific and educational activities; the contextuality of knowledge; humanistic values of information; methodological pluralism; constructivism.

As an alternative methodology, we can consider the approach proposed in postmodernism. In the same way as positivism, postmodernism is not a homogeneous direction. Moreover, the scope of postmodernism, given its nature, is difficult to define. It is no coincidence that postmodernism is methodologically closely correlated with poststructuralism and postpragmatism. Therefore, the provisions presented as the basic methodological principles of postmodernism are also conditional. As masterminds, allowed to form a portrait of postmodernism and project its position in the field of economic science, the report examines R.Rorty (Rorty, 1989) and D.McCloskey (McCloskey, 1998).

D. McCloskey, criticizing neoclassical, positivist-based systems, says that being calculating cannot be considered man's main feature, as this trait can be detected in animals (rats) and even plants. We must take into account unique human qualities such as faith, hope, love, justice (McCloskey, 2010:302). Without these virtues being calculating the prudence becomes a Vice – greed. Note that the unique qualities are associated with speech activity and hidden meaning.

D.McCloskey sees the future of economic science in the return to universal values and its main slogan: " Life should be itself" (McCloskey 1998).

In addition, typical for post-modernism is the decentration of the subject, knowledge, text, and as a result – the absence of causal relationships and value orientations. Postmodernism abandons rationality, at the same time trying to avoid accusations of irrationalism (D. McCloskey). One of the forms of understanding reality is intuition. Typical for postmodernism is the lack of true knowledge and universal criteria. The result is defundamentalism and the priority of everyday knowledge as well as pluralism of opinions. Furthermore, postmodernism is characterized by:

- A narrative approach to research.
- The autonomy of knowledge and the loss of contact with reality. A simulacrum is an image of absent reality.
- The fragmentation: knowledge is treated as local in the cultural and historical context. Constructivism on the basis of the interpretations of the researcher and his involvement in the context, on the one hand, and the deconstruction of presence, and thus the death of the subject, on the other.
- The theoretical anti-humanism and lack of creative freedom. Human thinking is determined by language structures.

On a positive plain it's worth noting the critical potential of postmodernism in relation to its predecessors, allowing clear theoretical and methodological space for new ideas. Additional value is provided by Criticism of the mechanistic neoclassical, which manifests itself in giving undue weight to statistical significance, a separation of knowledge from reality and a belief in social engineering. Statistical and econometric procedures supersede the question of economic relevance of the results and can't give an answer to human questions. McCloskey demonstrates this understanding (McCloskey,1998). Also D.McCloskey rightly argues that one theory can't reflect all the phenomena of economic life, and therefore there is a need for different approaches and points of view that complement each other. This understanding aligns her position with the theory of scientific research programs of I. Lakatos, when there are competing theories, due to the complexity of the object of study or a different set of objects in one subject area. Thus, the difference in approaches is due to objective factors, and to a lesser extent to the subjectivity of the researchers themselves, which, however, cannot be ruled out completely. An important cognitive advantage of postmodernism is linked to the use of metaphor, because, similarly to the method

of extrapolation, it binds the available area of knowledge to that which is yet to be attained.

D. McCloskey criticizes the ten basic postulates of modernism that we can find in several areas of economic theory. A brief list of them is the following:

- The goal of science is prediction and control.
- Only observed consequences (or predictions) obtained based on the theory affect its status as truth.
- Observability means objective, reproducible experiments.
- If an empirical consequence of a theory turns out to be false, the theory is considered false.
- We need to appreciate objective reality; subjective "observation" (introspection) is not scientific knowledge, because the objective and the subjective cannot be associated.
- The dictum of Lord Kelvin: "If You are not able to Express your knowledge about the subject in numbers, this knowledge is meager and unsatisfactory".
- Introspection, metaphysical belief, aesthetics, etc. may be present at the discovery of a hypothesis, but cannot be used for its justification.
- The task of methodology is to separate scientific knowledge from the unscientific, the positive from the normative.
- The scientific explanation of an event includes the event in one of the General laws.
- Scientists, economists, for example, do not have to say anything about values - moral or artistic – as scientists" (McCloskey,1998).

D. McCloskey, ironically, says that if one follows these regulations and considers them true principles, then during the inspection of libraries, a significant portion of the books will have to be sent to the fire, as they are nothing but sophistry and delusion. Denying the principles of modernism as prospects for economic science, D. McCloskey thereby tries to question the future of the methodology of positivism.

The limitations of postmodernism are associated with the impossibility of building fundamental theoretical concepts on its basis. The lack of criteria of truth of

knowledge, methodological fuzziness, loss of values, the construction of a non-existent reality actually leads to methodological nihilism.

The deformation of generic methods is reflected in special economic methods. Thus, the method of discrete structural alternatives is implemented in the form of a person choosing the bad before the worse.

#### **4. CONCLUSION**

Comparative analysis showed that the presented approaches are unable to compete with the positivist methodology, which continues to be the preferred alternative in the solution of complex theoretical problems of contemporary economic science. But the positivist approach seems to be preferred in the form of preferences of bad before worse, in the words of postmodernism.

Therefore, for a new economic science with its requests (operationalism, realism, usefulness, value-semantic orientation, humanistic orientation) the principles of any one direction are not enough. A synthesis of different approaches and principles is what needs to be discussed (Tutov, 2015).

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