Understanding History

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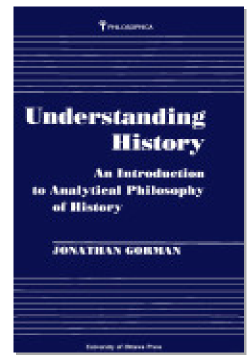

CHAPTER 6

Economic Reality

WE WERE ABLE IN CHAPTER 5 TO DEVELOP the traditional metaphysics of historical writing in a direction which permitted the basis of economic theory — the rational economic man assumptions — to be used. The contrast between the traditional and economic approaches, on this axis of interpretation, is not so marked as might be thought. We found that we could continue to suppose that the human world consists of desiring and purposive individual persons who have to be understood in empathetic terms. Dray's account of empathetic understanding in terms of a "calculation," which displays the appropriateness of an action given the individual's beliefs and purposes, was refined by characterizing the calculation as a cost-benefit analysis.

There is, however, an important limitation to this understanding of economic theory and its application within the traditional metaphysics. We may again recall from chapter 1 how an argument about the profitability of slavery might be used: if slavery was profitable, then "we are to understand why the slaveholders engaged in and continued with slavery until they were forcibly stopped. It was in their interests to do so." In chapter 5 we worked through one problem which this explanation involves: we have seen that, on the version of the traditional approach without the rational economic man assumptions, there remains a need to explain why people acted on the basis of the particular desires they did. We have dissolved this problem, while keeping the view that individuals must be understood empathetically, by noting that it can be costs and not desires which provide the foundation of the explanation. There remains, however, another problem still to be considered, which may yet prevent the question "was slavery profitable?" from being fully admitted to the traditional metaphysics. This is because the answer to this question operates in terms of people's *interests*, which is still an unclear notion. How is "interests" here to be understood?

Suppose that you have a desire — to own a Rolls-Royce, for example — which you judge to be of a certain strength. You judge that desire to have an associated cost. You perform a cost-benefit analysis and arrive at a net preference which is different from the desire. You choose to act according to the net preference. Your action has a consequence, which is in your interest. What does "interest" mean?

First, it may mean that the consequence is in your interest just because it is the fulfilment of your net preference, just because it is the expression of the result of your cost-benefit analysis.

Second, it may mean that the consequence is indeed the fulfilment of your original desire and not just of your net preference. If you accept that this consequence is in your interest then you are logically required to accept that you have miscalculated, misjudged what your desire was, misjudged its strength, or misjudged the amount of the cost. You will then be able to produce a cost-benefit analysis which displays the consequence (which is the fulfilment of your desire) as also a new net preference. This entails that your interest is the fulfilment of your net preference.

Third, it may mean that some other desire not in the original calculation is satisfied and with hindsight you prefer it that way. Again, if you accept that this is in your interest then you will have to allow that your desire is not what you thought, you will have to revise the original calculation, which again entails that your interest is the fulfilment of your net preference.

Fourth, it may mean that the consequence is the fulfilment of a net preference which you are *deemed* to have. If you accept this assessment of what your net preference is, then you must revise your calculation as appropriate, which again entails that your interest is the fulfilment of your net preference. If you do not accept the assessment then the claim that the consequence is in your interest is only true if there is a cost-benefit calculation displaying that it is.

Fifth, it may mean that the consequence is the fulfilment of a desire which you are deemed to have. If you accept this assessment of what your desire is, then you must revise your calculation as appropriate, which again entails that your interest is the fulfilment of your net preference. If you do not accept the assessment then again the claim is only true if there is a cost-benefit calculation displaying that it is.

In the first, second and third analyses of "interest" we find your interest to be your own net preference. If "interest" has this sense then we can, consistently with the traditional metaphysics, believe that slavery was in the interests of slaveholders, we can similarly believe that this explains why they engaged in it, and we can base these beliefs on our capacity to empathize with the slaveholders, through being able to work through their cost-benefit calculations of their net preferences.

The fourth and fifth analyses, by contrast, suggest that it is possible that there can be a cost-benefit calculation different from your own, one that you are "deemed" to have. This will differ from yours in three possible ways:

1. It is a valid calculation which can be worked through where yours cannot. However, to suppose this would be to deny the assumption that you are rational, so this is ruled out on the present traditional approach, since we assume on this approach that we must be able to "work through" a person's calculation (unless they are under the influence of drink or something similar which requires reference to causation).
2. This external calculation differs from yours in the assessment of the strength of your desire. However, the "strength" of your desire is measured by the cost you are *prepared* to pay to satisfy it, of which surely you are the only proper judge (even if you accept a different assessment later, you must still adopt it as yours), so we come to:
3. The external calculation differs from yours in the assessment of the cost which will *need* to be paid to satisfy it.

The difference between the external or "deemed" cost-benefit calculation and your own, therefore, is the difference between the externally assessed cost and the cost as you yourself perceive it. The externally assessed cost is sometimes called the "real" cost. The "reality" of this cost is warranted by the truth of the economic theory which is used as the basis for the external cost-benefit assessment. Your "interest" is thus the net preference defined in terms of that economic theory, and this need not agree with your own calculated net preference. It is essential to recognize that the cost-benefit analysis with which we *empathize* is entirely in terms of *perceived* costs and benefits. "Interests," by contrast, are now suggested to be real net benefits and not just perceived net benefits. The mark of the "reality" of benefit or cost is given by the economic theory itself.

The suggested explanation we quoted from in chapter 1 is as follows: if slavery was profitable, then we are to understand why the slaveholders engaged in and continued with slavery until they were forcibly stopped. It was in their interests to do so. If "interests" here is in terms of *perceived* net benefits, then the explanation is acceptable on the traditional metaphysics, for the desires and costs involved are the kinds of thing we can empathize with.

But we must recognize that, when we say that it was in someone's "interests" to do something, we may well mean "interests" in some objective sense, and we may well not include as a person's "interests" some haphazard set of desires and imprudently judged considerations which he just happened to have. "Interests" here may be better measured according to some independent standard of profitability, typically one derived from economic theory.

We have seen that, on the traditional approach, individual persons are to be taken to be essentially understandable in empathetic terms, and so, we have noted, must be the social practices and social institutions which comprise those individuals. Thus, if we are required to empathize with social reality in this way, we must question what is meant by "real" profit, question what room there is for an "independent" standard of profitability, question what relevance an "objective" economic theory or cost-benefit analysis can have to historical understanding. We can empathize with profitability. The profitability of slaveholders' actions is characterizable and explainable *only* in terms that the individual people themselves intend: in terms of *their* desires and beliefs about costs. *Believed* profit, therefore, is alone to be allowed on the traditional approach: one's actions are profitable just in so far as one finds them to be so, in one's own assessment.

But may not one's own assessment here be wildly irrational? Surely if a slaveholder gave away all his property, then he was bound to have acted unprofitably? To draw these conclusions requires an independent standard of profitability derived from accounting or economic theory. However intrinsically superior this independent and imposed standard of profitability may be supposed to be, unless it exactly matches the judgments of the individuals concerned, it is a worthless abstraction, for they are not acting in accordance with it. It is the individual person's *actual* beliefs and purposes, however foolish, which are alone real on the traditional approach, for they alone are to be empathized with. Only the actual beliefs and purposes are relevant to the understanding of profitable action, on the traditional assumptions made about human nature. Historical reality lies with actual beliefs and purposes, not with ideal rational ones. How else are people to be taken seriously as persons?

Notice, however, that it may well be proper to persuade a person to act in accordance with some independent standard of profitability, and the slaveholder who was a good businessman may well have adopted an efficient standard for himself. We may use such an independent standard in judgment of a person's foolishness: a person who accepts appointment as a trustee, say, will have a duty to act profitably in certain circumstances. Again, however, imposed and independent duties and standards are irrelevant to the explanation of action unless they are adopted or accepted by the person concerned, and it is then their adoption or acceptance which makes them relevant, and not their independent reality, if any. We may *blame* a trustee who acts unprofitably by adopting for himself a foolish standard of profitability, but we *understand* his action on the basis of the foolish standard, not on the basis of a proper one. Similarly (unless we hold him blameless because of the costs he faced), we may blame a slaveholder for falsely supposing blacks to be innately inferior and suitable for enslavement, yet we understand his actions on the basis of this false belief, not on the basis of a true one.

It follows from this that economic theory can be used in history in two ways: first, individual people are assumed to be believing and desiring purposive beings with whom we *must* empathize. This is the traditional approach. We then use the rational economic man assumptions to characterize the calculations of these people. We insist that social reality be understood in terms of such individuals. An argument such as "if slavery was profitable then we are to understand why the slaveholders engaged in and continued with slavery until they were forcibly stopped. It was in their interests to do so" may then be used, but only if "interests" is understood in terms of the actual adopted net preferences of the people concerned. This is because we can empathize with these calculations.

But the second way of using economic theory is to specify an economic reality which is to some extent independent of individuals, a reality of practices or institutions or "firms." We are not required to assume individual people to be believing and desiring purposive beings with whom we *must* empathize. Here we have an explicit contrast with the assumptions made by the traditional approach, for on this second view we can choose to ignore what people thought, we can refuse to take seriously their own understanding of how they acted, and we can explain their actions on independent "objective" grounds. These grounds may be anachronistic in that they might be unintelligible to the people concerned, and express our ways of understanding rather than theirs.

Understanding social reality we may now hold to involve the provision of cost-benefit calculations of "interest" which are in principle independent of those actually adopted by the individual persons who constitute the practice or institution or firm under study. While people may still be assumed to be believing and desiring purposive beings — for there is no requirement here that this be denied — their actual calculations are not regarded as explanatory of the consequences of their actions, unless they happen to coincide with the "real" calculations. Given this, empathetic understanding is neither necessary nor sufficient for historical explanation, and the historian who is committed to the traditional view that we *must* understand individuals in empathetic terms cannot use the economic approach in this second way.

This second approach thus denies the traditional view that it is necessary to empathize with economic or social reality. Social and economic matters have a kind of reality (which "objective" economic theory helps us to understand) which is explained independently of the perceptions of the people involved. But, while the economic reality of practices, institutions and firms which is here referred to is *explained* independently of individual *perceptions*, it does not follow that it is a third kind of metaphysical entity, one which is independent of individual people in its entirety. "Individualism" as a social theory has many elements, and we should distinguish the view that *explanation* must be in terms of individual perceptions from the view that *reality* consists only of individuals. The former view, at this point, may be denied, but the latter need not. There is, of course, yet a third position here: Marxism for example, which denies that social reality consists only of individuals, and indeed sees economic reality as having a life or causal progress of its own.

We noted earlier (in chapter 5) that the traditional approach required "slavery" (for example) to be understood in individualistic terms, so that we should not suppose social reality to have a life or causal progress of its own. Firms and other social institutions are sometimes said to "cause" things to happen, and it is true that, from a metaphysical point of view, any entities which bear causal relations to each other must be among the fundamental entities of the world. However, the individualist, while permitted to deny the need for empathetic understanding, will hold that talk of "causation" by firms and the like is just a manner of speaking and no more than shorthand for the operations of individual people: firms we should understand to exist as functions of individual people and their actions, in the following way.

A firm comes into "existence" through a number of people coming together with shared beliefs and desires in pursuit of a common stated purpose or set of purposes. The "purposes" of the firm are specified real purposes of individuals. Once specified or adopted, however, members of the firm and outsiders ascribe a personality to the firm (one which legal systems can recognize),[1] and the original specified real purposes of the constituent individuals are also fictionally ascribed to the firm, which remains a hypothetical entity. The firm thus exists as a hypothetical entity in virtue of the actual beliefs and desires of real individuals. The individuals involved have formed the firm (typically) by explicit agreement, by contractual articles of association, and the firm thus exists in virtue of what is called in political theory a social contract.[2] The "consent" which may be supposed to warrant the creation of a State or similar large-scale social institution other than a firm is standardly described as "tacit." The existence of a social institution does not require explicit agreement rather than, for example, habitual behaviour or tradition. Firms are not metaphysically better placed than societies.

The contract or contracts (whether explicit, tacit or working through habitually co-ordinated behaviour), which create or continue the firm, involve a commitment on the part of individuals to act in accordance with the stated beliefs and purposes of the firm, even though their actual beliefs and purposes may be different or may change. The rules, roles, purposes and offices which the creation of the firm specifies are matters of belief and desire which founding and subsequent members of the firm adopt for themselves insofar as they are members. The firm may then have purposes which differ from those of the constituent individuals in the following way: the "purposes of the firm" are actually purposes which the individuals involved are *deemed* to have. This "deeming" may be by the managers of the firm, the customers, the shareholders, or a court; or it may be by historians generations after the actions at issue. The individuals involved are deemed to have them in virtue of their commitment (an expression of a shared expectation) to have them, which commitment is a consequence of their obligation under the terms of the contract, or a consequence of habitual features of their way of life. The carrying out of an obligation to the firm is itself a net preference of the individuals involved, although the desires and perceived costs which warrant the individual's net preference here are matters outside the firm's stated range of proper considerations.

The cost-benefit calculation which the individual *actually* has will thus typically be different from that of the firm, and thus different from the cost-benefit calculation which this individual is *deemed* to have as occupying an appropriate office in the firm. Thus the individual's actual net preference might well depend, for example, on his personal assessment of the risk of loss of reputation (or even affection) for breach of contract of employment, whereas this could not be included in the cost-benefit calculation of the firm "itself." The cost-benefit calculation on the part of the firm is a model which the members of the firm are deemed to share, and it is a calculation which is "real," where "reality" is determined by the truth of an objective economic theory. It is possible for the firm to be characterized by all involved, including historians of it, as being an entity of which the rational economic man assumptions are true. In so far as the individuals of the firm carry out its stated purpose they act according to a real cost-benefit analysis, whether or not they know that they are doing so.

In conclusion, we explain people's actions, on the non-traditional yet individualist approach, not necessarily in terms of beliefs and desires we can actually empathize with, but in terms of the beliefs and desires we deem them to have in the light of an independent economic theory. We are warranted in doing so by their commitment to or tacit acceptance of the actual practices of the institution of which they are members, which institution is a social construction in terms of individuals' beliefs and desires, a construction which is assumed by us, on empirical grounds, to be formulated in terms of the rational economic man assumptions.

We wish to know whether answering the question "was slavery profitable?" is a way of achieving knowledge. "Profitability" may now be interpreted in two ways, matching the two senses of "interest" now explained. Where interest can be empathized with, then knowledge is founded on that basis, given that the traditional metaphysics which understands people as purposive beings is itself rationally justifiable. Where "interest" is given a full economic interpretation which does not necessarily involve empathizing with the calculations of individual people, then the claims that are made are based on an economic theory which must itself be rationally founded in some way.

So far as the first interpretation goes, we showed in chapter 5 the sense in which "is slavery profitable?" is to be admitted as a proper question within the traditional metaphysics. It only remains to discuss the rational justification for that metaphysics, and this will take place in chapter 7. We need to be clear how the second approach, that using economic theory, can be warranted, however.

Friedman described the assumptions of rational economic man theory as having the status of a scientific hypothesis. We have interpreted this so far, as broadly speaking Friedman would wish us to do, in terms of the Popperian approach to science outlined in chapter 3. On our conditional assumption of empiricism, we have treated rational economic man theory as empirically testable, and not as itself a metaphysical assumption. We have said no more than that it presupposes a metaphysical assumption, namely that people are purposive beings.

Unless we take the claim that "if *A* prefers *X* to *Y*, then *A* will choose *X* over *Y*" to be an empty definition, we have seen that we need to understand this claim by specifying an independent characterization of preference and an independent characterization of choice. However, preference is not empirically observable. We can introspect it in ourselves, and we can empathize with it in others, but it is not to be known about in any other way. Preference is a notion which is essential to the understanding of others as desiring and purposive beings, and stands or falls with the metaphysical assumption that persons are such beings.

The attempt to make preference equivalent to revealed preference, which is actual choice, makes it empty. It is sometimes thought that this is worth doing because choice, at least, is empirically observable. However, the supposition that choice is empirically observable is also quite wrong. How can we tell that some entity is choosing *X* over *Y*? We have to supply our experience of the facts here, to achieve this result, with some prior notion of what the alternatives facing the entity are. Let us suppose our entity is moving along a road, which forks. It "chooses" road *X*, say. We can only say, firstly, that this is a "choice" at all if we suppose that it *could* have done something else. If it was impossible for it to do anything else, then we must revise our description. The entity may be a tramcar, for example, running on rails in the road which do not fork. Whether the entity could have done other than it did is a question about *possibilities* for it, and we saw in chapter 3 that we cannot observe possibilities.

Nevertheless, suppose our entity is a choosing entity and does make a choice in the circumstances. It does not follow that, in choosing road *X*, the entity is choosing road *X* over road *Y*. This only follows if taking road *Y* is a perceived alternative for that entity. If the alternative perceived by the entity were retracing its path, *Z*, then its actual choice is not of *X* over *Y* but of *X* over *Z*. Again, however, we cannot observe the perceived alternative for that entity. Nor can we observe whether there was just one perceived alternative, or how long the list was. In fact we have to import a very great many complex background and a priori assumptions if we are to describe some experienced event as being a choice of *X* over *Y*. The so-called "revealed preference" for *X* over *Y*, which we earlier allowed, may sometimes be the only evidence for actual preference, is not actually *revealed* at all.

Neither preference nor choice are terms describing what is purely empirically observable. To apply the notions of preference and choice to experience requires background metaphysical assumptions about the kinds of entities we are dealing with, and further assumptions about the information they have and how they deal with it. It turns out that we are forced to treat the rational economic man assumptions as not deriving from empirical evidence alone, for the empirical evidence is interpreted in the light of the assumptions. That an economic theory constructed on the basis of these assumptions is empirically testable does not mean that experience alone warrants the truth of economic theory.

We find that the rational justification for the use of economic theory presupposes some interplay between empirical and metaphysical assumptions, some interplay between experience and the a priori assumptions we bring to experience. Knowledge, we have seen, requires rational justification. We are called upon, if we seek knowledge, to justify the metaphysical assumptions involved. Our use of the economic approach to history thus needs rational justification. This use embodies certain traditional metaphysical assumptions which have now been made clear. The traditional and the econometric approaches to history embody different fundamental assumptions which need justification if either approach is to provide knowledge. Moreover, we have seen that historical approaches can conflict, and thus the question of the justification of the relevant assumptions is crucial to historical practice. The rational justification for such assumptions will be examined in the next chapter.

NOTES

1. While the analysis of a "firm" is particularly relevant here because it is the economic approach which is being examined, this is not the only grouping which may have legal personality. For a different analysis, see Roger Scruton, "Corporate persons," in *Proceedings of the Aristotelian Society*, supplementary volume LXIII, 1989, p. 239, and the response by John Finnis in the same volume.

2. There are many kinds of social contract. Begin with T. Hobbes, *Leviathan*, 1651. Recent works in the tradition are J. Rawls, *A Theory of Justice*, Oxford University Press, 1972, and D. Gauthier, *Morals by Agreement*, Oxford: Clarendon Press, 1986.