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**Efficiency, Rationality, Rationalism:  
A Critical Examination of the Role and Place of the Empiricist  
Separation Thesis in Business Ethics**

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# **Efficiency, Rationality, Rationalism: A Critical Examination of the Role and Place of the Empiricist Separation Thesis in Business Ethics**

## **ABSTRACT:**

One of the most influential theories in the domain of business ethics is the Stakeholder theory, formulated originally by Edward Freeman. One of the arguments of this theory is that value creators and value appropriators are not always the same people but what hinders the acceptance of many groups of value creators as legitimate stakeholders of a corporation, Freeman argues, is the dominance of the fact-value dichotomy in business. Now this dichotomy which has attained a near axiomatic status in business and classical economics owes its roots in the Humean law, or the Humean Separation Thesis which argues that legitimate knowledge only comprises of those statements which fulfil the empirical verifiability criterion. Ethical or moral statements by the virtue of being non verifiable empirically are considered as subjective emotional reactions. As a result, it is argued that if economics and economic decisions are to attain the objectivity and precision of a science, it must be value-free. This paper traces some of the arguments put forth against the near-hegemonic status of the Hume's Law in business, such as MacIntyre's argument against Emotivism; Jon Elster's arguments against the reason-rationalism dichotomy and Amartya Sen's argument against the self-interest and efficiency maximizing homo economicus. The aim of the paper is to establish that the fact-value dichotomy at work in business is a tenuous one, which has many critics including the stakeholder theory.

## **KEY WORDS**

Separation Thesis, Fact Value Dichotomy, Stakeholder Theory, Reason Vs. Rationality, Emotivism

## Introduction

The defenders of the concept of value-free economics argue that ethics and ethical practices belong to the realm of emotions, and as a result, cannot be part of the core decision-making processes of a business organisation. Critical literature challenging the concept of fact-value dichotomy in economic thought, or that of value-free economics, is both rich and abundant. Jon Elster distinguishes between ‘reason’ and ‘rationality’ to argue that the term ‘reason’, closely associated with virtue ethics, has strong normative connotations in so far as the exercise of reason entails evaluation of ethical worthiness of actions (2009). Rationality, on the other hand, consists of the exercise of the choice of the most efficient means to any given end. Rationality, in other words, requires eschewing of examination of ethical worth of any given action.

Rationality and its associated discourse of rationalism – with the emphasis on the choice of most efficient means to a given end, without any examination of the moral worth of the means or the end – find considerable acceptance in classical economic theory. Amartya Sen (1977) observes that the idea that each and every action is motivated by the urge for maximisation of self-interest has attained an almost axiomatic – and thereby, non-normative – status in economic theory with the result that no ethical motive is ever accepted as the basis of an economic decision-making process. This practice of purging of normative considerations from economic decision-making is based upon two principles: the first principle views and relegates ethics to the realm of subjective emotions, and the second principle is based upon the Humean Separation Thesis (Freeman 2015). While terms such as ethics and values are considered normative terms that are beyond the pale of verifiability and predictability, Freeman points out that the motive of shareholders’ value maximization of a business firm is curiously considered to be a value-free axiom. Freeman argues that on close scrutiny, it becomes clear that the idea – articulated by Milton Friedman – that the only purpose of business is the value maximization of its shareholders is not an empirically verifiable statement; rather, it is a normative or an ‘ought’

statement as much as the statement that a business firm must contribute towards reducing its carbon foot prints, or that it must pay living wages to its workers.

The aim of this paper is to argue that the notion of value-free economics is based upon a rather narrow and restrictive understanding of the concept of economic causality. In order to make this argument convincingly, the paper undertakes a two-fold path : firstly, it delineates the ongoing debate between those who uphold the fact-value dichotomy thesis's validity in economic theorising on the basis of the claims that ethics belongs to the domain of emotions, and that the separation thesis renders verifiability of ethical statements impossible, and those who critique them. Secondly, it traces the empiricist origins of the idea of value-free economics by examining how and why the separation thesis gained traction in classical economics. The paper charts how the idea of value-free economics with its emphasis on enhancement of efficiency, is based on the idea of fact-value dichotomy, which in turn, is based on the empiricist separation thesis first formulated by David Hume. According to Hume, the 'ought' statements cannot be deduced from the 'is' statements since the former entail unobservables which cannot be empirically verified, and therefore, are beyond the scope of valid knowledge. Hume is considered to have immense impact on the works of Adam Smith, the founding father of modern economics.

This Humean formulation known as the Separation Thesis gained much traction because it seemed to provide the much needed ammunition to purge sciences of metaphysics. In philosophy of science, a logical positivism and its later manifestation, logical empiricism claim that the unobservables cannot be part of epistemology because they lack the qualities of verifiability and predictability. Empiricism demands that all statements containing terms which refer to unobservables should be 'logically restructured' into ones which refer to only observables. Thus, causality is, for empiricism, a metaphysical term which needs to be

reformulated as conjunctions since they are all that senses have access to (Boyd 1991). Descartes states that reality is inaccessible since the human mind can experience only secondary qualities of objects, which are mediated by the mind itself. Descartes, however, acknowledges that objects of the material realm do possess primary qualities (Vernes 2000). Hume, drawing from John Locke, argues that valid knowledge is either a priori knowledge deduced from analytic statements, or they are 'matter of fact': knowledge which is gained by experience inductively. Hume points out that there is a contradiction between imaginative disorder and experiential order. In other words, the imagination can predict a priori many possible outcomes of a given action, or phenomenon but experience shows that only one or a few limited outcomes follow. Hume therefore privileges the perceptual order which experience witnesses over imagination, and argues that valid knowledge which is not analytic statement, is inductively gained knowledge of matters of fact which can thereby never be certain knowledge (Hume 2007). The emphasis that Hume puts on observability of a posteriori matters of fact as the basic criteria of their acceptability gives rise to the empiricist claim in logical empiricism that valid knowledge consists of empirically verifiable claims alone.

The paper is divided into three sections: the first section discusses the emotivist and the empiricist arguments made in favour of the fact-value dichotomy, and the counter arguments which defend the idea that ethics can be objective. This section articulates the views of the empiricist AJ Ayers, who argues that ethics cannot be objective because ethical statements entails expression of emotions, and not facts. Alasdair MacIntyre and Richard Boyd argue against this conceptualisation of ethics as being outside and beyond the realm of facts. This section also elaborates Wilfrid Sellars' interpretation of the Kantian moral imperatives to be able to strengthen arguments against emotivism. The second section examines how the emotivist and empiricist account of ethics engendered from the Humean separation thesis is

utilised in the field of economic philosophy to argue that the business decision-making process should be free of ethical considerations. This section will elaborate the arguments put forth against the separation thesis, especially by Elster, Sen and Freeman. The third and the final section argues that the emotivist and empiricist conception of the role of ethics in business is based on a rather narrow view of causality and causal relation between business and society.

## **1. Tracing the conceptual linkage between Empiricism, the fact-value dichotomy and Emotivism**

According to David Hume, there are two kinds of statements: analytic and synthetic statements. Analytic statements are the ones in which the conclusion is deducible from the premises. Analytic statements, thus, are source of a priori knowledge which is deducible. Synthetic statements, on the other hand, are about what Hume calls matters of fact, which contain a posteriori knowledge gained by experience inductively. The inductively-gained, a posteriori knowledge is accessed by senses. Hume argues that complex ideas are made of sense impressions which in turn, are made of sense data acquired by the senses. Hume also points out the contradiction between disorder of imagination and perceptual order. Citing the instance of a billiards ball hitting another at a given instance, Hume states that the imagination can think of numerous paths that the billiards ball can chart once it hits another ball, but perception or experience gives just one outcome. Likewise, when the sun sets on a given day, imagination can conjure up several scenarios about whether the sun will rise the next day, or not? Experience, however, shows that the sun rises around the same time, every day, during a particular season at a particular place. It is this chasm or contradiction between the numerous possibilities that imagination can conjure, and the few or one result or effect of a given cause which experience furnishes, that made Hume conclude that perception or experience is the sole

source of valid knowledge. Anything which cannot be verified by experience is suspected of belonging to the realm of metaphysical speculation (Hume 2007). This Humean privileging of experience and perception gave rise to both empiricism in sciences, and to the separation thesis. Before Hume, Cartesian rationalism argued that knowledge of the material, physical world could be gained from 'first principles' alone. Empiricism with its emphasis on empirical observations, and experiments privileged observation over first principles, and inductive knowledge over a priori knowledge. The aim is to purge the sciences of remnants of metaphysics (Bunge 2000). This Humean equating of the unobservable with the unreal or the fictitious, gave rise to the separation thesis which states that the 'ought' statements cannot be valid since they are not deducible from the 'is' statements or the observable ones. Ethical statements which are all 'ought statements' thus get relegated to the position of metaphysical assertions which cannot be verified or falsified, and hence, cannot be part of any objective science.

This gives rise to the theory of emotivism which views ethical statements as expressions of emotions, and not of facts (Voorhoeve 2009). Voorhoeve observes:

“Factual judgements can be true or false, and in the realm of facts there are rational criteria by which we may come to agree/ which things are true or false. By contrast, emotivists held that moral value judgements, being mere expressions of attitudes or feelings, are not true or false; they also held that agreement in morals can only be achieved by whatever non-rational means one can use to get people's emotional responses in line. To illustrate: since a person's feelings about lying are not fully constrained by the facts, two people could agree on the facts in a case of lying but have different attitudes towards it” (2009, 112).

Expressivism, earlier known as emotivism, is a set of theories which hold that the basis of all morality lies neither in the external world (following from Hume's separation thesis) nor in universal or transcendental reason but within individuals themselves. For MacIntyre, expressivism is a subversive critique of modern morality as it lays bare what is implicit in all claims which try to situate morality in a transcendent, context-independent framework.

The classic expression of emotivism is found in Charles Stevenson's *Ethics and Language*, which argued that asserted sentences are of three types: descriptive (concerning true and false), emotive (concerning approval and disapproval), and descriptive combined with emotive. For Stevenson, the statement 'x is good' does not ultimately refer to the reasons that justify the goodness of x but to a simple but irreducible point: 'I approve of x'. Why? For Stevenson, while descriptive statements can appeal to sense-experience – a criterion which lies outside myself – emotive statements (such as statements of morality) have no such access to an external reality that can prove me wrong.

Yet if the basis of morality lies within a person, why do moral beliefs not change drastically from individual to individual? In response, Alan Gibbard presents a sophisticated expressivist theory which argues that normative statements are not simply an expression of individual preferences (or desires, or attitudes, concerns, passions, endorsements) but also disclose allegiance to a set of norms (which the individual herself may never make explicit, even to herself). Thus, apart from individual dispositions, morality is also based on social consensus, but this consensus is sometimes ruptured when dispositions change or when there is confusion over the rank-ordering of goods (e.g. is it better to do some wrong for a greater right?). And individual dispositions themselves can be incoherent at times, so what I perceive to be the conflict between my tottering belief and what increasingly seems to be the truth or the correct moral position is in fact, according to the expressivist view, a conflict between two parts of myself battling for dominance.



Thus, expressivism generally holds that when two people disagree over a moral statement, they are disagreeing over their own preferences, attitudes and states of mind, which explains why so many moral disagreements are interminable and rarely reach any closure. However, successful persuasion does occur when a participant for some reason changes her mind over the issue. In *Ethics in the Conflicts of Modernity*, MacIntyre points out that this tenet of expressivism contradicts our common self-perception; I perceive the cause of a change in my opinion not as a change in my desire or attitude, but in the realization that I was *mistaken*, that I was not cognizant with the truth of the matter, a truth whose truthfulness does not, in my perception, depend on what others say, but on facts which are independent of them or of me. Yet, expressivists can easily refute this criticism by claiming that this common-sense belief so deeply ingrained in us is part of our spontaneous ideology and may itself stand in need of correction.

While MacIntyre acknowledges that despite numerous attempts, emotivism (or its more sophisticated successor, expressivism) has not been decisively refuted, he proposes an alternative framework which would respond to the challenge by positing an account of human flourishing. MacIntyre notes that in the case of animals, certain acts contribute to its flourishing, while some others impair the latter. Starving to death, for instance, is not an animal good, neither is it regarded as a desirable human end. Thus, actions that contribute to human flourishing can be termed objectively ethical, irrespective of whether some or many individuals consider it good or bad.

Of all accounts of human flourishing, the Aristotelian account decisively links flourishing or eudaimonia to happiness, and to the exercise of reason. For Aristotle, the capacity to reason is the ‘characteristic activity’ of humans. The aim of this paper is to counter emotivism and the separation thesis by articulating a naturalist, non-essentialist account of human flourishing, which entails a broader understanding of causality and by examining its implications for the value-free economics discourse.

## **II. Separation Thesis and Emotivism at work in economic philosophy**

Empiricism by pointing out the contradiction between imaginative disorder and perceptual order, gave rise to scepticism about validity of knowledge which is not gained empirically. The aim was to separate and distinguish between metaphysics and science. Facts are only those which can be empirically verified. As of result of Humean empiricist scepticism, in the field of philosophy of science arose logical empiricism; in the field of ethics, arose emotivism which drawing from the empiricist separation thesis, maintains the fact-value dichotomy. Values, or ethics are manifestations of emotions or preferences which have no empirical or factual basis, and hence, are devoid of objectivity. The application of this emotivist thesis in the field of economics has given rise to the discourse that values or ethics cannot be part of economic decision-making processes as the former lack objectivity. This section will first outline some of the emotivist arguments made in favour of the value-free economics discourse. It will then counter the arguments of the discourse drawing from the works of three philosophers: Jon Elster, Amartya Sen and Edward Freeman. But before initiating discussion into the critiques of value-free economics discourse, it is important to articulate the difference between economic reasoning which entails practical reasoning, and which consists of moral reasoning.

### **II.1. Practical Reasoning and Hypothetical Imperative**

Consider the following two statements:

I. To manufacture glassware, sand is a raw material.

II. Given the rising concern of non bio-degradability of plastic, consumers must replace the use of plastic bottles with glass bottles.

If a young entrepreneur decides to start glassware manufacturing, the first statement will be for her an instance of hypothetical imperative which entails exercising of practical reasoning. According to Kant, the mind organises and orders sense data through the exercise of categories of understanding, which are innate conceptual capabilities of humans. Categories of understanding are, therefore, rules by which sense data is organised into objects and phenomena. Rules refer to 'ought' statements, and 'ought' statements are of two kinds: hypothetical and categorical. Hypothetical ought statements are those which entail the exercise of practical reason (Sellars 2002). If a subject wants X as an end, she must choose Y means. In the case of the example above, if an entrepreneur wants to start glassware manufacturing, she must ensure that her plant has supply of sand as it is a primary raw material. But, the second statement is not an hypothetical ought statement since it does not merely indicate that what constitutes a means to a given end, but also indicates reflection upon the desirability (or the lack of it) of the choice of an end over other alternatives. Moral reasoning entails going beyond practical reasoning over to mull over the desirability of an end, and this is a crucial difference between practical reasoning and moral reasoning for sure. This difference, however, does not favour the emotivist argument that moral reasoning belongs to the realm of individual or subjective choices and preferences, devoid of objectivity. In the case of statement II above, an emotivist or a moral relativist might argue that whether a manufacturer or a consumer prefers the manufacture and use of plastic bottle (given its inexpensiveness, its durability) over glass bottle (which is brittle but less damaging for the bio-diversity of an ecological system) is a matter of personal choice and emotional preference alone, but an MacIntyrean interpretations of statements I and II will point out that while it is true that statement I entails exercise of practical reason in a manner which statement II does not, nonetheless the categorical imperative articulated in statement II is objective in so far as it is scientifically proven that the protein cells responsible for bio-degradation of plastic has been isolated only very recently, and as of now, not much data is available about its efficacy. As a result, the choice of use of glass bottle over plastic bottle is not merely a matter of personal choice

or subjective preference but an objectively valid choice given the validity of the end of conservation of bio-diversity.

## **II.2. Jon Elster and Reason vs. Rationality**

Elster argues that exercise of reason – in the Aristotelian sense of the term – entails not just practical reasoning about the choice of most efficient means to any given end, but also reflection upon the desirability or undesirability of the end itself from the perspective of the common good. It is only when a consumer cares for the common good which the environment is, will she take into account the scientific evidence which highlight the causal linkage between increased plastic usage and destruction of bio-diversity, including water bodies where marine life is dying because of pollution caused by plastic. Thus, reason is exercised only when the ethical desirability of both means and ends are examined. The exercise of rationalism, on the other hand, entails the of most efficient – in terms of cost and time effectiveness – means to any given end. Elster argues that that rationalism is what is considered as reason in classical economics.

## **II.3. Amartya Sen and ‘rational fools’**

Sen makes an argument similar to that of Elster when he observes that in classical economics, it is an unquestionable axiom that humans pursue self-interest, and that the pursuit of self-interest entails the pursuit of economic efficiency. Hence, each and every choice in the course of decision-making and action is viewed as choice driven self interest, which in turn, is driven by practical reasoning that privileges efficiency (Sen 1977). Sen critiques this axiomatic status of the self interest driven man in his book, *Idea of Justice* where he points out that the problem with John Rawls’ theory of ‘behind the veil of ignorance’ is that Rawls uncritically assumes that agents who must take decisions behind the veil of interest, always act out of self-interest, and – very

crucially – have the same understanding of what constitutes self-interest. Sen argues that pursuit of self-interest cannot be equated with the pursuit of economic efficiency alone. At this juncture, the Sen’s critique of economic efficiency will be juxtaposed with John Locke’s concept of efficiency. Thus, the application of the fact-value dichotomy thesis in the field of economics resulted in the rise of the discourse of value-free economics which argues that economic decision making entails only practical reasoning (in the Kantian sense) of the choice of best or effective means to any given end. Any other consideration is a matter of personal or subjective preference. But this stranglehold of emotivism over economics can be countered by a naturalist and causal-explanatory account of the ethical choices. Simultaneously, the unchallenged axioms of economics such as rationalism (as explained by Elster), and self-interest (as explained by Sen) can be critiqued by pointing out how rationalism entails a narrow understanding of means and end, and how self-interest is defined narrowly in economic theory as the pursuit of efficiency alone.

#### **II. 4. Freeman and the shareholder value maximisation thesis**

Finally, Edward Freeman (2017) challenges the axiomatic status of the argument that since economics and economic decision -making should be value free (because values belong to the realm of metaphysics, as per empiricism and of emotions and subjective choices as per emotivism), the only responsibility of a business manager as a part of the corporate governance structure should be to maximise value creation for shareholders. Freeman points out this axiom is yet another instance of unexamined dogma which is elevated to the status of objective truth in economic discourse. There is nothing empirically, and hence, objectively obvious as to why should a manager consider the furthering of the investors’ interests as the sole responsibility of the firm when many other players contribute towards the creation of value of the firm. The identification of value with physical assets itself is an unexamined axiom, Aoki (2017) points out.

One of the most influential theories in the field of business ethics is the Stakeholder Theory, first formulated by Edward Freeman in the second half of the 20<sup>th</sup> century. This theory emerged in the backdrop of the backlash against the much-quoted, much-discussed Thomas Friedman article wherein he asserted that the only ‘ethical’ responsibility of business is to work towards the attainment of ‘maximization’ of interests of the shareholders. The stakeholder theory challenged this attempt to equate a company’s interests with the interests of its shareholders, by positing the idea that value is created for a company not only by those who are its financiers, and therefore, own the tangible physical and financial assets, but also other players without whose participation, value cannot be created. Freeman, thus, aimed at challenging the dominance of the shareholder in the corporate governance structure (wherein the manager’s sole responsibility is to further the interests of the stockholders alone) by positing the concept of the stakeholder. According to the stakeholder theory, the aim of business is to create value, but value is created not just by the financiers who invest in a company by purchasing and trading in its stocks and bonds, but also by other ‘stakeholders’ such as the consumers, the workers, the community which contributes resources to the company. In other words, a stakeholder of a firm is not just its shareholders but all others who contribute towards the creation of value for the company (Aoki, 2017, Freeman 2015).

The first key argument of the Stakeholder Theory is, therefore, that value creation and value appropriation are not always by the same set of actors in a corporation. The second vital argument of the stakeholders is that the reason why value-creators who are not stockholders of a corporation are not recognised as its legitimate stakeholders because of the dominance of the fact-value dichotomy in Wall Street. Hilary Putnam describes the fact-value dichotomy as the separation of the descriptive and the normative/prescriptive and traces its genesis in the Separation Thesis of David Hume, as well as the Analytic-Synthetic statements distinction to be found in Kantian philosophy. Putnam’s critique of the fact-value dichotomy or the separation thesis majorly influenced Freeman’s critique of the near-hegemonic status of the Separation

Thesis in business (Freeman 2012). Warren Buffet recognises that derivatives as dangerous for the economy but continues to trade in them as if the facts don't affect his decisions and actions to develop newer ethics.

The aim or the telos of business is therefore to create value, but because of the dominance of the Separation Thesis in business – which perceives business and economics as an objective science free from ethical considerations which cannot be objectively or empirically verified or falsified – value creation and value appropriation are both viewed as being the result of the endeavour of a single actor: the shareholder. The Stakeholder Theory endeavours to demonstrate that firstly, value is created by other participants as well such as the employees, the community, the consumers; and secondly, contrary to the assumption of the interpretation of the Separation Thesis deployed in business which views business decision as being free of subjective considerations and hence, objective, business decisions are normative in nature. The normative aspect of business decisions in the corporate governance structure reflects the interests of the shareholders. The aim of the Stakeholder Theory is therefore two-folds: it aims to counter the assumption that economics is free of subjective stances, and to establish the process of value-creation in business entail participation of actors besides the shareholders, who should therefore be recognised as legitimate stakeholders. This recognition of legitimate stakeholders of business can be brought about only when the 'closed narrative core' of business gives way to an 'open narrative core', and there is recognition on the part of each stakeholder of the role and contributions of other stakeholders, towards creation of value in business. To put it succinctly, the Stakeholder theory advocates that there is the need for a sustained engagement amongst various stakeholder networks.

### **III. Overcoming the narrow account of causal relation in economic thinking**

So far, the paper has argued and demonstrated that fact-value dichotomy which the Humean separation thesis asserts can be countered by a naturalist, causal explanatory account of ethical decision which draws from Macintyre's Aristotelian account of flourishing. Once the fact-value dichotomy is challenged, the hegemony of emotivism in economic theory which argues for value-free economics can also be challenged. Drawing from the works of Elster, Sen and Freeman, we argue that emotivism bolsters the axiomatic status in economic philosophy of concepts such as rationalism, self-interest, homo-economicus, and shareholder value maximisation are based on very narrow accounts of economic causality, which themselves are normative in nature. The aim is not to eschew normativity in the name of defending some fictitious account of objectivity in economic decision-making, but rather to broaden the recognised causal chain and structure and acknowledge hitherto unacknowledged factors which are very much part of economic discourses.

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