

**ETHICS IN THE ECONOMY:
The need for morality in a competitive market
economy**

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March 1993*

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* This paper was originally submitted as a dissertation for the M.Phil. in Economics and Politics at Cambridge University in 1988.

CONTENTS

	<u>Page</u>
Introduction	1
1. The 'Naive Amoral Approach'	1
2. A Reappraisal	3
3. The Definition of Morality	4
4. The Sufficiency of Rules?	5
5. The Form of Morality	6
6. The Reality of Market Failure	7
Incomplete Information	8
Externalities	11
Redistribution	12
7. The Thesis in Practice	13
8. The Feedback Mechanism	14
The Competitive Ethos	14
The Nature of Morality	16
The Supply of Altruism	16
9. The Indirect Attack	18
Anonymity	18
Mobility	18
'Excessive' Accountability	19
Time Constraints	19
10. Conclusion	19
Bibliography	21

INTRODUCTION

"Greed is good...Greed is what made America great and greed will make America great again."

These words, uttered by Gordon Gekko in the film 'Wall Street', epitomise in a blatant way the view that moral behaviour is unnecessary for economic prosperity. Competition and self-interest have yielded economic benefits in the past and will do so again if only allowed free rein. Attitudes that curb the competitive spirit, such as the restraint of acquisitiveness, are naively short-sighted.

This nation has been opposed by most religious and philosophical opinion. It causes unease by contradicting our usual moral suppositions by arguing that greed, ruthlessness and pride are virtues and not vices after all. This understandable reaction has prompted the search for alternative systems more reliant upon benevolence and altruism, usually involving greater government intervention and collective ownership.

Such a reaction might be tempered by the suggestion that a competition exchange system does require participants to be morally retained after all. This is being belatedly realised by economists and explains why politicians supportive of a competitive system are moralising more than they once did. But if moral behaviour is economically important, the question then becomes one of whether the workings of the system are detrimental to adherence to this foundational moral code? If so, then an internal contradiction occurs in the workings of the system that would tend to its destruction. Consequently, the answers to these questions have great importance for how any economy is structured.

1. THE 'NAIVE AMORAL APPROACH'

The view that morality need not encroach into the workings of a market system has a long history in economic thought. Its basic premise is that moral restraint may be desirable in other areas of life, but it can be dispensed with in the economic sphere - indeed, in some instances, it may be beneficial if restraint and altruism were not expressed. This amoral view was founded upon the observation that since people frequently act in a selfish manner, it is more sensible to build one's economic system on this assumption than rely upon unselfishness:

...every man ought to be supposed a knave and to have no other end, in all his actions, than private interest. By this interest we must govern him and, by means of it, make him, notwithstanding his insatiable avarice and ambition, co-operate to the common good.¹

¹Hume, D., 1742; *Essays Moral, Political and Literary*, p.117-118, ed. T.H. Green and T.H. Grose, 1898, London, Longmans.

If it is admitted that most of us act selfishly for much of the time, and simple observation or introspection will confirm this, there would appear to be little wisdom in relying on self-denial for the successful working of economic policy. Such was the recommendation of Marshall (1930) and Robertson (1956).

The amoral approach goes beyond this purely pragmatic stance, however. Self-interest is not just an unpalatable reality but a desirable characteristic to be exploited by a competitive system. Adam Smith's concept of the 'invisible hand' predicted a socially desirable economic outcome from the interaction of self-interested people. Indeed, Smith stated that altruistic actions could be less economically beneficial than self-interested ones:

By pursuing his own interest (a person) frequently promotes that of society more effectually than when he really intends to promote it.²

The beneficial results of a self-interest driven exchange system find their ultimate embodiment in the converse fundamental theorem of welfare economics. Any desired Pareto-efficient outcome can be achieved by the exchange interaction of individuals who egotistically maximise their own utility, providing the original distribution of endowments is correct and certain rigorous assumptions are fulfilled. Although government intervention in the form of law-making is necessary to ensure that the ground rules of the system are set out and adhered to, the system is amoral in that it functions successfully if the participants act in a self-seeking manner. Not only is economic morality irrelevant (and occasionally retrogressive), but the motivation of people is made subordinate to the results achieved by their interaction.

This proposition can be illustrated by two examples. First, Mandeville's 'The Fable of the Bees' (1714) gives an allegorical reply to the moralists of the time who desired national prosperity but preached virtue and frugality. When the bees were prodigal, industry, trade and art flourished. When they eschewed luxury, industry slumped and the arts were neglected. The moral of the story was not to encourage excessive indulgence but to observe that a society without it will not prosper. Second, many advocate that the only responsibility of a company is to profit-maximise within the law. Firms should not contribute to charitable causes or take account of the social impact of their actions. To do so betrays the fact that the company enjoys a degree of monopoly power and could contribute to greater allocative efficiency by lowering prices instead. More benefit accrues to society if companies cannot and do not act like charities.

In similar ways, amoral actions on the part of individuals and firms are justified in terms of the collective benefit. According to Joan Robinson, this is why economics exists:

²Smith, A., 1776, *The Wealth of Nations*, Bk.IV, ch.II, (eds) R.H. Campbell and A.S. Skinner, 1976, Oxford, Clarendon Press.

It is the task of the economist to...justify the ways of Mammon to man. No-one likes to have a bad conscience... It is the business of economics, not to tell us what to do, but to show why what we are doing anyway is in accord with proper principles.³

The amoral laissez-faire approach succeeds in this task by claiming that a socially desirable outcome results from self-interested motivations. Morality becomes economically dispensable.

2. A REAPPRAISAL

The foregoing explanation is something of a caricature. Few economists would espouse such simplistic views and they were given by way of a contrast to what follows. The problem has been, however, that economists have sometimes acted 'as if' the exchange system could ignore its moral foundations. Of all the forms of control necessary for the acceptable working of such a system - distributional correctives, regulation of externalities and social checks needed for the market process to operate - it is the last that has been largely ignored (Hirsch, 1977).

Many factors account for this oversight. Perhaps the most convincing is that in the theoretical construct of complete Walrasian markets of perfect competition and complete information, a moral code is superfluous since prices convey all information and no-one wields power. Thankfully, this omission is being rectified with the realisation that the real world can never replicate the theory and so morality becomes operative (Boulding, 1973; Phelps, 1975; Collard, 1978).

Paradoxically, this realisation had been made long before by Adam Smith - the thinker most often attributed with the founding of the egotistical school. His view of morality was shaped by the natural law thinking of deistic philosophy. The 'invisible hand' represents the working of Providence in accordance with God's design, the 'workings of the system' ensure that the process will yield prosperity. Consequently, Smith not only praised sympathetic unselfishness highly but also thought that moral restraint would lead to prosperity:

By acting ...(morally) we necessarily pursue the most effectual means for promoting the happiness of mankind, and may therefore be said, in some sense, to co-operate with the Deity.

All members of human society stand in need of each other's assistance...where the necessary assistance is reciprocally afforded...the society flourishes and is happy.⁴

³Robinson, J., 1962, *Economic Philosophy*, p.21, London, C.A. Watts and Co. Ltd.

⁴Smith, A., 1759, *The Theory of Moral Sentiments*, III.v.7 and II.ii.3.1, (eds.) D.D. Raphael and A.L. Macfie, 1976, Oxford, Clarendon Press.

Many attempts have been made at reconciling the seemingly contradictory strands of Smith's thinking concerning self-interest and moral behaviour (see Wilson, 1976). Whether this is possible or not, Smith clearly considered reliance upon self-interest to be safe only when activities occurred within an appropriate social framework regulated by law, public disapproval and moral self-control. This could arise from a desire to be praiseworthy in the eyes of God (or the imagined 'Impartial Spectator') or by feelings of 'beneficence' - a heightened awareness of social obligation. Smith's position has been summarised thus:

*(Men) could safely be trusted to pursue their own self-interest without undue harm to the community not only because of the restrictions imposed by the law, but also because they were subject to built-in restraint derived from morals, religion, custom and education.*⁵

Consequently, the discovery of the need for morality is just a rediscovery of a theme in the thinking of Smith.

3. THE DEFINITION OF MORALITY

Writers may regard 'morality' as economically important, but of what does this form of social control consist? 'Morality' could be defined as a complete set of principles that should govern the whole of an individual's conduct according to particular beliefs. In the present context, however, it will be more convenient to refer to any action guided by principles other than the pursuit of egotistic self-interest as acting 'morally'. This could include actions motivated by altruism or love, with consideration given to the well-being of others, or simply the adherence to commonly accepted norms within society, such as refraining from theft or deceit. To act 'morally' is therefore just to refrain from acting according to one's immediate self-interest.⁶

In effect, this definition of moral behaviour comprises all actions that fall outside Williamson's (1985) notion of 'opportunism' - that is, self-interest seeking with guile. Opportunistic behaviour includes the normal egotistically motivated actions with their logical consequences in terms of lying, theft and fraud. Williamson attributes the problems of transaction governance to a combination of opportunism, bounded rationality and asset specificity. Without opportunism, a person's word is their bond and no strategic behaviour occurs through non-disclosure of information (eg. moral hazard). Contracts are easily executed because promises are self-enforcing.

⁵Coats, A.W., 1971, ed., *The Classical Economists and Economic Policy*, p.9, London, Methuen.

⁶Some choice theorists deny that such action is possible since, if an action is chosen, it must, by definition, be maximising the well-being of the individual concerned. But, some 'moral' actions are of this kind (sacrificing short-term interests for long-term benefits), and some are not (self-sacrifice for others is possible). The latter notion is closely related to Sen's conception of 'commitment' (1977).

From this perspective, the competitive exchange model has been assuming the restraint of opportunism in commercial areas all along. The competitive person may be self-interested but his or her striving is limited by adherence to 'the rules of the game' when interaction occurs with other competitive people across markets. Standard models treat

...individuals as playing a game with fixed rules which they obey. They do not buy more than they can pay for, they do not embezzle funds, they do not rob banks.⁷

Consequently, such theories assume a compartmentalised view of human nature which can distinguish between legitimate and illegitimate methods of self-advancement. Hence firms must maximise profits without contravening pollution regulations; taxes can be avoided but not evaded; regulators should better their promotion prospects but not take bribes. The letter of the law must be kept but the spirit of the law is non-existent. It is on the realism of this dualistic assumption that much of the argument concerning the system's internal consistency turns and will be examined later. Suffice to say now, a competitive model without morality is only plausible by thinking of 'self-interest' as egotism within the rules rather than opportunism.

4. THE SUFFICIENCY OF RULES?

It might be argued that no apologist for the competitive system has ever been so naive about human nature. Rather than relying on self-control to restrain opportunism, the market system has used laws and regulations to preserve itself.

Hence exchange occurs in a legal framework of property rights, contracts, safety regulations and restrictions upon misleading advertisements. Legal sanctions bring individual self-interest into congruence with that of society when temptation to harm others arises. The legal system acts as a more reliable substitute for self-restraint.

It would be foolish to deny the role of law in the regulation of economic activity. But to claim that law dispenses with the necessity of personal morality is equally short-sighted. The problem at issue is how to ensure people stick to the rules of the game when this clashes with personal self-interest at a particular moment. Threats of fines and imprisonment have many shortcomings as a solution.

Most obviously, a legal system is expensive and 'wasteful' of resources with any attempt to make the threat of detection and heavy punishment more credible being costly. By contrast, self-restraint involves no external resources. In the context of safeguarding property, Robinson comments:

⁷ Quoted in Williamson (1985), p.49.

*To impose fear of punishment by force goes some way, but it is expensive, ineffective, and vulnerable to counter-attack. Honesty is much cheaper.*⁸

Practicalities of enforcement also limit the potency of legal processes. Detection will never be complete whilst some actions may be detrimental to others but not illegal (eg. predatory pricing). By contrast, moral restraint is far more pervasive since the fear of God or the disapproval of others are not limited by circumstance. In addition, certain actions desirable for a pleasant or efficient society (such as trust and courtesy) cannot be legislated for whilst others which have been (e.g. non-discriminatory employment) can be difficult to enforce for lack of external evidence. In many areas, morality is the only applicable restraint.

Finally, the whole legal system relies on those charged with the task of enforcement being bound by self-restraint themselves. If judges, police or regulators took bribes or sold their decisions to the highest bidder, the purpose of law in restraining self-interest is thwarted. That the competitive system needs legal decisions to be outside the price system prompted Arrow to conclude

*...the definition of property rights based on the price system depends precisely on the lack of universality of private property and the price system...To the extent that (the price system) is incomplete, it must be supplemented by an implicit or explicit social contract.*⁹

The implication of these observations is not that moral restraint can replace legal institutions, but that the two are complementary and mutually reinforcing. In the instances to be cited for why a moral code is needed, some are amenable to a legal solution and some are not. In those that are (eg. trading via contract), the aim is to show that a better solution arises if adherence to a moral code supplements the legal framework. But first some clarification on what 'moral code' is not is necessary.

5. THE FORM OF MORALITY

The definition of 'moral' behaviour adopted above is a wide one. For the purposes of the following discussion, however, it does not always include acting in accordance with 'non-truism' ('non-youism'). This phrase, coined by Wicksteed (1933), refers to the fact that someone engaged in a transaction need not be motivated by selfishness alone. They could have highly altruistic intentions. What is essential for the transaction to be efficient, however, is that those benevolent feelings do not extend to the person being transacted with. For instance, parents work and shop for the benefit of their children. Their altruism may not extend to their employer or grocer but neither are they completely self-centred. Non-tuism shows that selfishness is not necessary for exchange to occur, just that a

⁸ Robinson, op. cit. (1962, p.5.)

⁹ Arrow, K.J., 1975, *Gifts and Exchanges*, p.24, in E.S. Phelps (ed), *Altruism, Morality and Economic Theory*, New York, Russell Sage Foundation.

particular chosen aim is pursued. It is equivalent to the concept of 'self-goal choice' (Sen, 1987) with the goal including the well-being of others. Although this modification ameliorates some of one's moral disquiet concerning a competitive system, it cannot dispense with morality. What is important is not just the goals of economic agents but the ways in which they attempt to achieve them. The exchange system falters if moral restraint is not shown in certain areas, irrespective of whether people buy and sell to benefit their families or the poor. Methods cannot be entirely subordinated to goals.

In addition to non-tuism, attempts have been made to analyse how an exchange system would be affected if people acted in accordance with different moral philosophies such as Kantian altruism or utilitarianism (Collard, 1978; Matthews, 1981). A comparison of the economic effects of such philosophies is outside the scope of this investigation.¹⁰ It must be observed, however, that the answer to egotistic exchange is not to base the system upon complete altruism - a philosophy which ranks personal well-being below or no higher than that of others. No price signals emerge since neither party to an exchange cares what the price is (Matthews, 1981). The other party benefits if they do not. Consequently, complete information would be needed to achieve a desirable distribution. Such a system would also fall foul of the general tendency of human nature to look after one's own interests rather than those of others, as well as these information limitations. The recent economic reforms in China and Russia seem to be an admission that a system relying heavily upon altruism falls prey to human selfishness. Against this background, the adherence to a moral code within an individualistic exchange system forms a compromise between the extremes of selfishness and complete altruism. The position was succinctly put by Robinson:

*A society of unmitigated egoists would knock itself to pieces; a perfectly altruistic individual would soon starve. There is a conflict between contrary tendencies, each of which is necessary to existence, and there must be a set of rules to reconcile them.*¹¹

The reasons why such a set of rules requires a moral as well as a legal basis can now be examined.

6. THE REALITY OF MARKET FAILURE

Economists may have been blinded to the importance of morality by the dazzling purity of the perfect market construct. This system, (comprising complete contingent markets, costless factor mobility, atomistic firms and independent agents), can only exist by assuming perfect information-gathering

¹⁰ My belief is in the Christian ideal of 'loving one's neighbour as oneself'. If widely applied, this should result in 'just' prices with full disclosure of information by both parties to a transaction who regard the others' welfare as highly as their own.

¹¹ Robinson, J., *Economic Philosophy*, p.4, London, C.A. Watts and Co. Ltd, 1962.

capabilities and independent utility functions. All the information that agents need to transact optimally are conveyed by prices. The purpose of the model is to shed light on the different results arising from the introduction of real world conditions (eg. monopolistic tendencies). In the transition from theory to reality, it may have been overlooked that morality, which becomes dispensable in a theoretical world of complete markets, becomes important in reality. The real world conditions responsible for this result are informational deficiencies, externalities and distributional questions.

Incomplete Information

The world is one of uncertainty about the future and ignorance of many contemporary circumstances. Hence, people wanting to make transactions are unsure of their income in a year's time, the precise attributes of the purchases they are making or the motivation of those with whom they are transacting. These deficiencies in information give scope for deception to be successful. In Williamson's terminology, opportunism is a problem when rationality is bounded.¹²

Information limitation is most influential in markets where the seller knows the attributes of a product better than the buyer ('asymmetric information'). This is only of consequence where the product is expensive or of some importance to the purchaser and then serious market failure can occur. Such problems have been illustrated by analyses of the markets for the service of a doctor (Arrow, 1963), for blood for transfusion (Titmuss, 1973) and for second-hand cars (Akerlof, 1970). In all these cases, the vendor has an incentive to exploit his or her superior knowledge to the detriment of the purchaser. If such exploitation occurs, a market mechanism will not match consumer wishes to the products delivered. Inefficiency and injustice result.

Devices to prevent such occurrences are sometimes employed. Doctors are highly trained before being allowed to practise whilst used-car salesmen give guarantees. But these are often insufficient to reassure the buyer. How can anyone judge whether a doctor is over-prescribing or that the engine fault developed after the purchase of the car? In the case of blood for transfusion, it was impossible to screen for the hepatitis virus and yet the seller knew their medical history and could assess its likelihood. In these instances, a moral commitment by the seller to eschew exploiting his or her superior knowledge allows the purchaser to assess adequately the product and take appropriate action. Doctors will be trusted, infected blood will not be given and a fair price will be paid for a used-car. Indeed, without such a commitment, there would be little demand for doctors and so medical professionals swear to attempt to save life wherever possible and avoid deliberate over-prescription. Such a code of ethics is an institutionalised form of morality to prevent patient exploitation. It is replicated in the code of ethics of other professions, such as lawyers and accountants. Without such commitment, demand for these services would be severely restricted.

¹²Williamson, O.E., 1985, *The Economic Institutions of Capitalism*, p.31, New York, The Free Press.

A related problem is the asymmetric information available to the parties of an insurance contract. This results first in 'adverse selection' when those most likely to suffer a loss are those who insure against it and then try to conceal this high probability (eg. recent death threats concealed from a life insurance company). Once cover is granted, the insurer faces the problem of 'moral hazard'. This ranges from taking fewer precautions against the insured-against event to deliberately causing it (eg. arson). If the insurer possessed more information, these difficulties would not arise and so costly efforts are made to discover concealed information and discourage abuses, ranging from medical examinations to no-claims bonuses. Such precautions cannot dispense with the value of the insured clients restraining themselves from exploiting their position, however. If honest answers were given and adequate precautions taken (as well as fraud being shunned), insurance premia would be more directly tailored to each client and the level of premia would fall overall. Without such deception, insurance becomes possible in some circumstances and cheaper in others. (More truthful disclosures would also reduce other information-gathering costs, such as tax inspectors.)

These examples concern uncertainty about current motivations. When future events are uncertain, a trading relationship can be governed by a contract which sets out the obligations of the parties if particular conditions arise. But human inability to foresee the future in sufficient detail means that contractual terms cannot cover every eventuality. This results in mutual trust and loyalty to the spirit of an agreement being extremely important.

This is best illustrated when a transaction requires significant costs to be incurred by one or both sides, such as search costs in locating a seller or specialised investments that a supplier must make to meet the specific requirements of a customer. Once such costs have been incurred, at least one side has an incentive for the relationship to continue and it is usually cemented by a long-term contract. The situation then becomes one of bilateral monopoly where prices do not convey enough information. For instance, it would be impractical to re-hire a workforce every day on the basis of wage rates offered or switch component suppliers at whim. In such conditions, the value of trust becomes apparent because all possible eventualities cannot be written into a contract and so clashes of interest must be prevented. This becomes impossible if either party acts opportunistically:

It is necessary for efficiency that parties to a contract... should feel, and be trusted to feel, an obligation to observe its spirit as well as its letter. If everyone is expected to exploit ruthlessly every short-run monopoly position when it is in his interest to do so, the division of labour will be seriously impaired.¹³

¹³Matthews, R.C.O., 1981, 'Morality, Competition and Efficiency', *Manchester School*, December, p.293.

Such inefficiency of opportunism is illustrated by the unwillingness of component suppliers to specialise without firm commitments by buyers, employees 'working to rule' and not allowing flexible operation and the 'poaching' of trained workers resulting in firms not bothering to provide training. Moral commitment and trust are not the only safeguards employed, however. Elaborate contracts are written and enforced, 'hostages' are taken to insure against opportunism (eg. loan security) whilst repeat orders and the importance of reputation give an incentive to trade fairly. Again, such devices can be costly and so rules and morality act as complements and not substitutes.¹⁴

Dore (1983) has explored the advantages of relational contracting in Japanese industry where there is application to the textile industry with its weaving suppliers as well as lifetime employment. Such trading between firms results in fewer bankruptcies of suppliers, greater specialisation and the sharing of cyclical profit and loss. In employment relationships,

*the contract is seen...less as any kind of bilateral bargain, than as an act of admission to an enterprise community wherein benevolence, goodwill and sincerity are explicitly expected to temper the pursuit of self-interest.*¹⁵

Dore believes that the resultant rise in X-efficiency outweighs the decline in allocative efficiency. Fostering mutual trust can be economically beneficial.

Finally, incomplete information produces difficulties manifested in principal-agent problems. Specialisation dictates that tasks must be delegated over a period of time so that a contract becomes necessary. But sometimes it is impossible for the principal to ensure that the agent is not abusing his or her position. For instance, an employer can find it difficult to know whether a worker is working hard or is slacking, whilst raising the level of supervision can be costly. Similarly, shareholders cannot be sure that managers are not making business decisions in their own interests rather than those of the firm. A partial solution is to devise reward structures which align the incentives of the agent to those of the principal (eg. profit-related pay). This can be complimented by agents being morally restrained from opportunism. Both Marshall and Smith considered that the public limited company could only survive if a sufficiently high standard of managerial commercial morality could be sustained.

Consequently, in a world of incomplete information and contracts, widespread moral behaviour will enable the existence of some markets and the more efficient functioning of others.

¹⁴The intuitive appeal of relying on trust in a long-term relationship is illustrated by the marriage service in which open-ended commitments are given. This contrasts sharply with some marriages which involve a detailed legal contract specifying who gets what in the event of divorce.

¹⁵Dore, R., 'Goodwill and the Spirit of Market Capitalism', *British Journal of Sociology*, December, 1983, p.459-482.

*Elemental personal values of honesty, truthfulness, trust, restraint and obligation are all necessary inputs to an efficient (as well as pleasant) contractual society.*¹⁶

Externalities

The complete markets model proves to be inadequate when a person's actions have consequences for others which cannot be mediated through markets. Clearly, in a world where such externalities are common, the co-ordination of actions becomes extremely important. But since there are many occasions when the unco-ordinated interaction of self-interested individuals yields socially sub-optimal results, self-interest is not a successful, universal co-ordinating principle.

The most famous theoretical example of the problem is the Prisoner's Dilemma (eg. Sen, 1974). If both prisoners are self-interested and cheat on the other, both will be worse off than if they had co-operated. But even if one guarantees to co-operate, the other still has an incentive to cheat and will again produce a collectively sub-optimal outcome. In such co-ordination problems, the difficulty comes in two parts. First, how are individuals to be convinced that a co-ordinated solution is in the long-term interests of themselves and society? Second, how can they be induced to adhere to that solution when such behaviour would clash with their immediate benefit? Essentially, how is free-riding to be prevented?

The initial co-ordination problem can be solved by the imposition of law or the emergence of conventions. Sugden (1986) even claims that most laws are simply the codification of conventions that have spontaneously arisen from experience of co-ordination difficulties. This remains an open question but what is agreed is that conventions are vital for the smooth running of a society beset by externalities. This is most obvious when questions of pure co-ordination are considered. For instance, without a convention like 'give way to traffic from the right', motorists would suffer more crashes and unnecessary delays at roundabouts. Such conventions, although somewhat arbitrary, are self-reinforcing since non-adherents will find their behaviour costly whilst the more who follow the convention, the more beneficial it will be. The conventions of currency, language, measurements and shop hours need to be adhered to for the exchange process to be possible at all.

It has also been claimed, by Hume for instance, that property is another spontaneously generated convention. In a Hobbesian 'state of nature', with everyone fighting for possession of property, little productive activity or investment would be undertaken for fear of dispossession by force. But the introduction of a convention prohibiting theft means that far less effort need be expended on protection of property in terms of locks and policemen, and that trade and investment can occur without fear of loss. For instance, without property rights in the form of patents, there

¹⁶Hirsch, F., 'The Ideological Underlay of Inflation', in F Hirsch and J Goldthorpe, (eds.), *The Political Economy of Inflation*, Cambridge, Mass., Harvard University Press, 1978, p.274.

would be little reward in developing better products. The general respect of property rights is essential for the efficient running of an exchange system.

The final form of convention governs situations where particular individuals repeatedly interact. In such circumstances, game theory predicts that a convention of 'tit-for-tat' will be most profitable for any individual. That is, co-operation is offered first and continued with if the other party reciprocates, but if they cheat they are paid back until willing to co-operate again. If such a convention is followed, trust can be preserved between self-interested individuals for their mutual benefit, although this benefit must be recognised by both parties. By extension, this convention can lead to the provision of public goods amongst a small group so long as free-riding can be disciplined. Hence, adherence to conventions is sometimes necessary for the existence of an exchange system and sometimes aids its working. but the existence of an established convention does not guarantee compliance, particularly when it cuts across individual self-interest. There may be a convention encouraging me not to drop litter but what is to stop me doing so when no-one can see me and a fine is unlikely? What is even more difficult is to restrain me from adding to other people's litter. The only solution has been to invest conventions and laws with moral authority (dictating what is right or wrong) so that people feel guilty when contravening them for their own self-interest. Such guilt about litter or theft saves the employment of many road sweepers and policemen, whilst guilt from cheating on a trading partner sustains trust relationships. In addition, the moral authority given to conventions of reciprocity enables the provision of some public goods (eg. blood donation, RNLI) in the face of widespread free-riding (Sugden, 1984). Some writers (eg. Hirsch, 1978) have even suggested that the solution to cost-push inflation is to encourage moral restraint in wage bargaining so as to yield the same real wage increases without the inflation.

The existence of conventions signals how co-ordination could take place if enough people adhered to them. The underpinning of morality reinforces the likelihood of co-operation by inducing compliance and giving assurance that other people will comply. Widespread adherence to a moral code promotes the effective working of conventions.

Redistribution

Of all the claims made for a competitive system, the desirability of the resulting distribution of income has never been one. A Walrasian system may yield a Pareto optimal distribution but this could be obnoxious to most people. This lacuna occurs because the theory assumes that people do not care about the conditions of others - utility functions are independent. But since sympathy and envy do exist, distribution becomes important and the problem arises as to how the most desired distribution is to be attained. The solutions proposed have centred around reliance upon charitable giving and redistribution through taxes which are voted upon.

Private charitable activity can relieve need extremely efficiently since private charities may gain information and supply relief in a less costly manner than government agencies. Donors can react more quickly to situations of poverty whilst the blood donor system is more efficient than one which pays for blood transfusions (Titmuss, 1973). But for such voluntary help to be given, donors must be altruistic enough to overcome the temptation to free-ride or else the reciprocal convention of helping those less well-off than oneself must be given moral force. Either way, the restraint on narrow self-interest is necessary.

However, if sole reliance was placed upon voluntary donation, it would be unable to produce a 'socially desired' level of redistribution. Such a system would suffer from free-riding by those who wish to see a particular degree of redistribution but do not wish to contribute to it, and from apathy from those who think their contribution would be so small relative to the task as to be pointless. Hence redistribution also occurs via a tax system using compulsion. Obviously, the degree of 'compulsion' felt depends upon the altruism of taxpayers and the form of voting system. For instance, a majority vote for redistribution could be withheld if the transfer was from those above modal income to those below it whereas a majority of beneficiaries is always possible for transfers from those with incomes above the mean to those below it. (The income distribution is skewed.) Also, if high marginal tax rates on high earners do have significant disincentive effects, then the beneficiaries of redistribution may need to restrain their short-term desires for high tax rates, in order to enjoy longer term benefits.

Therefore, whether redistribution is achieved through voluntary donation or the tax system, adherence to a moral code can yield significant benefits in certain circumstances.

7. THE THESIS IN PRACTICE

The analysis so far attempted to show why a degree of moral restraint is necessary for the existence and successful working of a competitive exchange system, largely because laws are inadequate. The 'morality thesis' predicts that where the pursuit of narrow self-interest is not exalted, a market-based system will operate more effectively than where it is. This is a variation of Weber's thesis associating the development of capitalism with the influence of Protestantism and he made a similar point:

*The universal reign of absolute unscrupulousness in the pursuit of selfish interests by the making of money has a specific characteristic of precisely those countries whose bourgeois-capitalistic development...has remained backward*¹⁷

The outworking of this principle is illustrated by two examples at opposite extremes - Southern Italy and Japan. In a study of a region of Southern Italy, E.C Banfield (1958) attributed the state of economic underdevelopment to the moral attitude of the people, as well as the physical conditions. This attitude was described as 'amoral familist' and seeks to maximise the short-term material advantage of one's nuclear family assuming everyone else will do likewise. This resulted in the absence of involvement in public affairs (no charity work, local newspapers or hospitals) and forms of organisation that were economically damaging (extended families could not agree on the amalgamation of family land and so scattered plots were inefficiently cultivated). Laws were disregarded when there was no fear of punishment and so legally enforceable transactions were rarely entered into. Banfield concluded that unless the social morality of the region changed, economic development could not occur.

Japanese society is at the other end of the moral spectrum where individuals frequently put the interests of employer, family and society in general above their own. Morishima (1982) attributes this characteristic to the adaptation of Chinese Confucianism when imported into Japan. More emphasis was placed upon loyalty, bravery and obedience and has yielded a strongly collective Japanese mentality. Consequently, there is greater group loyalty (particularly to companies) and durability in commercial relationships (Dore, 1983) as well as harmonious industrial relations, less litigation and lower crime rates per head. Japan's economic success can be partly attributed to this ethos of self-restraint for the collective good.

The 'morality thesis' is not a rigid principle but some evidence exists for the assertion that moral restraint is beneficial to a market system. The question now becomes one of whether the workings of such a system make such restraint more or less likely.

8. THE FEEDBACK MECHANISM

Ever since the development of the market system, there have been conflicting views as to whether competition ameliorates selfishness or reinforces it. Hirschman (1982b) has labelled these rival interpretations the 'doux (soft) commerce' and 'self-destruction' theses respectively. They explicitly examine how economic institutions mould preferences rather than taking them as given. The

¹⁷Weber, M., *The Protestant Ethic and the Spirit of Capitalism*, tr. by T. Parsons, London, George Allen and Unwin, 1930, p.57.

disagreement between the two approaches turns on three issues - the ethos of competition, the nature of moral character and the supply of altruism.

The Competitive Ethos

The general opinion in eighteenth century Britain was that trade had a great civilising and morally bettering effect. This opinion rested on the belief that producers and traders had to establish a good reputation to be successful in localised and personal markets. Other virtues associated with commercial pressures were the habits of industry, frugality, probity and punctuality. Hence, Tom Paine could remark:

The invention of commerce...is the greatest approach towards universal civilisation that has yet been made by any means not immediately flowing from moral principles¹⁸

In the Corn Law debate, Cobden claimed that trade between nations would make them more interdependent so that war would become too costly. The general opinion of writers from Montesquieu to JS Mill was that competition fostered virtue by forcing the producer to satisfy the customer. Competition and morality were mutually reinforcing.

This view has been subsequently attacked by many writers, notably Marx. The simplest observation to make is that competition rewards low-cost production irrespective of the way in which lower costs were achieved. There then arises the inevitable temptation for producers to mislead customers and break regulations if a competitive advantage can be achieved by so doing. Furthermore, a competitive system is working well if producers wishing to act in a moral way (such as a restricting pollution in excess of regulatory requirements) are prevented from doing so. By exalting ends above means, the competitive ethos directly conflicts with the dictates of morality in certain circumstances.

This difficulty could be ameliorated by tougher regulation. There is no solution, however, to a deeper problem of competition - its eulogization of hedonism and position, with the resulting promotion of envy. This is the result of competitive firms trying to sell more than consumers need through the devices of advertising and consumer credit (Bell, 1976). The self-regarding objectives of individuals must be enlisted for the sales effort because the advertiser has few other motivations to work on. Hence,

Consumer advertising comprises a persistent series of invitations and imperatives to the individual to look after himself and his immediate family; self-interest becomes the social norm, even the duty¹⁹

¹⁸Hirschmann, A.O., 'Rival Interpretations of Market Society: Civilising, Destructive or Feeble?', *Journal of Economic Literature*, December, 1982b, p.1465.

Companies preach values to their customers which they would not want their employees to adhere to. This is particularly harmful to feelings of benevolence through the institutionalisation of envy, which is deliberately encouraged by some sales efforts. Indeed, the competitive system might not work well at all unless participants care about their position relative to others (Knight, 1935). Such an environment can be uncondusive to encouraging self-restraint for the benefit of others. Summarising the views of Rousseau and Smith, Michael Ignatieff concluded:

*The common threat to virtue in market society...lies in envy and emulation, the desire for invidious distinction that estranges men from themselves and others*²⁰

The Nature of Morality

Crucial to the optimistic view of competition is that individuals can operate according to different moral principles in different spheres of life. Individuals are to be self-interested in business and at work but restrained when tempted to break the law or asked to vote on taxes. Meade (1974) explicitly states that the 'Good Society' might best be prompted by such schizophrenia - self-seeking in trade, altruistic at the ballot box. This is only tenable if one believes in the ability of people to strictly compartmentalise their motivations:

*...the competitiveness of the market need not corrupt a man...for the reason that any person is more than a trader...(A) unitary human consciousness is a focus for many interests, of which the market will be only one.*²¹

Clearly, the issue turns on one's belief concerning human nature. The schizophrenia view does not always accord well with moral intuition. Who would wish their daughter to marry a 'competitive and calculating' man - even if he tried to keep it to his work? It is hard to imagine a businessman who evades taxes and yet votes for higher tax rates.

Certainly those who take an holistic approach to human nature predict the infection of moral behaviour by competition:

*Judaism has always understood that morality is not divisible. Immorality in the economic sphere, and the encouragement of immediate gratification and self-aggrandisement, soon spread to sexual immorality and crimes of violence.*²²

¹⁹Hirsch, F., *The Social Limits to Growth*, London, Routledge and Kegan Paul, 1977, p.82.

²⁰Ignatieff, M., *The Needs of Strangers*, London, Chatto and Windus, 1984, p.120.

²¹Downie, R.S., 'Comment', in T. Wilson and A.S. Skinner (eds.), *The Market and the State*, Oxford, Oxford University Press, 1976, p.102.

²²Tamari, M., 1987, *With all your Possessions*, New York, The Free Press.

The resolution of the conflict between the schizophrenic and holistic beliefs is possible only in the opinion of the individual. Those who wish to be optimistic about the competitive system must hold the appropriate belief however.

The Supply of Altruism

The final area of conflict concerns the desirability of extending commercial pressures so as to lessen the need for altruism. The clearest exposition of this view was given by Robertson (1956) who treated benevolence as a scarce resource to be economised in use. Public policy should aim to minimise occasions when the dictates of morality and profit conflict and to commercialise activities that rely on altruism at present.

The alternative approach was championed by Titmuss (1973) and Hirsch (1977) and rests upon the assumption that benevolent feelings can be augmented if relied upon and will atrophy if ignored (similar to the exercise of a muscle). Having shown that a blood donation system will work better than a fully or partially commercial one, Titmuss then made the controversial assertion that the removal of benevolence from one area of life through commercialisation will have detrimental knock-on effects elsewhere:

It is likely that a decline in the spirit of altruism in one sphere of human activities will be accompanied by similar changes in attitudes, motives and relationships elsewhere.²³

The transmission mechanism arises from the belief that people will be encouraged to act morally if they are confident that others will not free-ride or exploit them. The existence of non-commercial activities acts as an assurance mechanism:

By keeping certain important goods out of the market, we create an opportunity for citizens to confirm an optimistic theory of human nature.²⁴

When an activity is commercialised, the assumed motivation becomes one of self-interest and the expectation of benevolence is diminished. From this point of view, the competitive system and greater division of labour may bring 'efficiency' but they monetise previously altruistic relationships and make them less likely elsewhere.

Again, a firm conclusion cannot be reached. It is misleading to assume that benevolence is in fixed supply, but neither is it inexhaustible. Relying on altruism will yield more dividends in certain

²³Titmuss, R.M., 1973, *The Gift Relationship*, Harmondsworth, Pelican.

²⁴McPherson, M.S., 1984, 'Limits on Self-Seeking - The Role of Morality in Economic Life', in D.C. Colander, (ed.), *Neo-Classical Political Economy*, Cambridge, Mass., Ballinger Publishing Co, p.81.

circumstances (such as wartime) than at others when it may be foolhardy. Whilst such decisions may induce some people to be more benevolent, the effect will be limited - a Muscovite housewife is probably no more altruistic than her Western counterpart.

A definite judgement cannot be made concerning the doux-commerce and self-destruction theses. They illustrate the way the system can build up and destroy its moral basis. The survival of competition thus far suggests the tendencies may largely cancel each other out. If one looks into the future, however, pessimism becomes pre-eminent because of the corrosive side-effects that accompany the competitive process and which are likely to intensify in the future. These are now to be examined.

9. THE INDIRECT ATTACK

Thus far, the morality-threatening features of the competitive process have been intrinsic to its very existence. What have been largely ignored are the damaging by-products of a laissez-faire system. These are not just found in such a society but seem to be exacerbated by the process of competition. They each erode the conditions that that same theory predicts will encourage moral restraint - repeated transactions, social disapproval and the membership of small groups.

Anonymity

Anonymity can result from the workings of a laissez-faire system in a number of ways. Urbanisation makes it difficult to distinguish neighbours from strangers so that social disapprobism for unco-operative actions will probably not be felt. There is little incentive to be polite to strangers since repeated interactions are unlikely. The expansion of large firms increases the anonymity of individual workers whilst managers might excuse their morally unrestrained decisions upon collective decision-making. Whilst the side-effects of a laissez-faire system are not the only contributors to social anonymity, they are important and its increase will probably mean that narrow self-interest will be curbed less often.

Mobility

Similar problems arise with the stress placed upon labour mobility by the competitive system. Greater mobility is advocated for the supposed efficiency gains and yet relationships of trust and loyalty are difficult to develop if no-one can be sure where they will be living or working next year.

Rapid change of conditions, associates, acquaintances, or locations makes tradition or ethical codes less effective because rapid change... reduces the perceived gains from

*customs and honesty, makes them less certain, and/or attenuates the enforcement mechanism.*²⁵

An exchange system need not require excessive mobility but such is the likely result of multi-plant firms and free capital movements.

'Excessive' Accountability

Specialisation of function through the division of labour can lead to principal-agent problems. Occasionally, the solution to these accountability problems can work too well and be inimical to the likelihood of moral restraint. For instance, the managers of a company may wish to reduce pollution levels but to do so would damage the interests of shareholders. In their turn, pension fund managers may wish to take the 'long-term' view or invest in 'ethically-sound' companies but such acts would be detrimental to their pensioners. Paradoxically, some of the most ruthless investors appear to be the Church Commissioners!

Time Constraints

Linder (1970) has proposed that the market system has produced the scarcity of time that many now face through the expansion of the supply of goods, which require time to use. The shortage of time not only results in greater stress, but also the neglect of non-material pursuits of self-cultivation and interpersonal relationships. Linder attributed increasing loneliness and neglect in the upbringing of children to the increasing demands of material preoccupation on the fixed supply of time. Such conditions could make the cultivation of loyalty and trust increasingly difficult.

These by-products are not intrinsic to the workings of a competitive system but seem to be closely related to it. They help to erode the conditions that make moral restraint and altruistic behaviour more likely.

10. CONCLUSION

Moral restraint, when acting in accordance with the law and when interacting with others, is a vital ingredient in the successful working of an exchange-based system. If opportunism was unfettered, some markets would not exist, others would be severely hampered and investment would be deterred. Morality is a valuable economic resource and allows the present compromise between anarchy and a police state.

²⁵McKean, R.N., 1975, 'Economics of Trust, Altruism and Corporate Responsibility', in E.S. Phelps, (ed.), *Altruism, Morality and Economic Theory*, New York, Russell Sage Foundation, p.35.

The difficulty for predominantly humanistic Western society is that there is no consensus upon how to preserve and strengthen this precious resource. Hirsch (1977) proposed the re-emphasis of religious belief to promote 'as if' altruism within society. It is similar thinking that has induced some politicians, concerned about the moral threat to the market, to preach more. Such an attitude degrades Christianity into a social control mechanism and fundamentally misunderstands its message. That is, fear of God may help to restrain evil, but its power cannot be broken without the 're-birth' of individuals so that they obey not through fear but love of God.

Therefore, an exchange system based upon self-interest may be practical, given the general tendency of human nature. But such a system contains the potential to undermine its moral foundation. It would be well to inform those who eulogise competitive behaviour, in the school of Gordon Gekko, of the moral fragility of the system.

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