Part IV

Ethical Voids and Social Pathologies

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Teaching Economics as if Ethics Mattered

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I have spent the past thirty-five years as a professor of economics. Over the course of my tenure at The American University, in Washington, D. C. (1965–75) and the University of Notre Dame (1975–present), however, I became ever more disenchanted with the capacity of traditional economic theory to enable people to lead a good life. I found myself unable to accept the values embedded in economic theory, particularly the elevation of self-interest, the neglect of income distribution, and the attempts to export these values into studies of the family, the role of the state and so on. As a result I started researching and writing on the nature of economics and the role of ethics in economic theory.

This work has led me to three important conclusions. First is the conviction that economic theory is not value-free as is so often claimed. Rather, it presupposes a set of value judgments upon which economic analysis is erected. Second is the realization that the economy itself requires that the self-interest of economic actors be morally constrained. Third is the recognition that economic institutions and policies impact people's lives requiring that both efficiency and equity be assessed. Teachers of economics need to make use of these insights.

ECONOMISTS, VALUE JUDGMENTS AND ECONOMIC THEORY

Many economists argue that while values might have a place in what is termed normative economics, they should be kept out of the everyday scientific business of the profession-the development and testing of falsifiable propositions – which is often referred to as positive economics. This separation, however, is problematic. Economists, as persons, necessarily work from a viewpoint that structures the questions asked, the methods, the evidence, the answers deemed acceptable. Because there is no direct access to the 'real' world, an economist is forced to see that world through the lenses of theory. Does that mean 'facts' are theory-laden? And if theory-laden, value-laden? What would this mean for economic theory? Ultimately, the question becomes: how does one do economics in a world where facts and values cannot be conveniently disentangled?

In looking for an answer to this question, economics students find to their surprise that they have much to learn from Adam Smith. Smith's economic theory was closely related to his moral thought. For example, while Smith often used the metaphor of the watch in describing how the self-interested actions of individuals worked for the good of the whole, he saw the 'machine' itself as the product of a beneficent God, which moreover depended on the virtues of individual actors to operate smoothly. Smith's *Theory of Moral Sentiments*,[1] written before the *Wealth of Nations*,[2] offers a rich moral vision of society that contrasts with the thin gruel of 'rational economic man.

Modern economics has selectively adapted Adam Smith's invisible hand metaphor, focusing on the economically wondrous effects of the butcher and baker trading out of their own respective interests and ignoring the prior description of the same deistic hand propelling the creation of a virtuous society. In Smith is a forgotten lesson that the foundation of success in creating a constructive classical liberal society lies in the individuals' adherence to a common social ethics. According to Smith, virtue serves as 'the fine polish to the wheels of society' while vice is 'like the vile rust, which makes them jar and grate upon one another.' Indeed, Smith sought to distance his thesis from that of Mandeville and the implication that individual greed could be the basis for social good. Smith's deistic universe might not sit well with those of post-enlightenment sensibilities, but his understanding that virtue is a prerequisite for a desirable market society remains an important lesson. For Smith ethics is the hero-not self-interest or greed-for it is ethics that defend social intercourse from the Hobbesian chaos.

Since the work of Thomas Kuhn and other historians of science, it has been increasingly recognized that scientists cannot be neutral in matters of value. In an article co-authored with Roland Hoksbergen,[3] I survey what others have had to say about value neutrality in economics, showing that there has been a lively debate on the subject in the years since 1970. One group argues that economists can successfully separate values from facts, which are 'out there' in the world, by adhering to a positivist methodology. According to this group, a failure to maintain this distinction will lead to a disastrous slide into relativism.

Critics of value neutrality, on the other hand, marshal a wide variety of arguments to make their case. It is argued, for example, that there is no access to objective reality except through the lenses of a theory and, therefore, the values shared by the community of economists color their judgment in determining just what the relevant 'facts' are. For example, years of schooling are important facts because they are proxies for human capital, and human capital in turn is important because neoclassical theory says that it is what explains a major portion of income differences. In another theory years of schooling might be replaced by labor-market discrimination and family wealth as more important facts.

I come down on this side of the issue, arguing that neoclassical economists share a 'world view'-a notion of the good, which shapes their analysis of the economy. This world view includes three main elements:

1. People are rational and self-interested.
2. The purpose of life is to pursue happiness as people define it.
3. The ideal world is one in which people are free to compete to achieve their ends and in which market forces lead to optimal equilibrium outcomes.

This is certainly a set of value judgments, in need of justification like any other. If these judgments indeed correctly characterize economics, they should be openly debated, rather than tacitly assumed.

Thus, economists bring certain values to their interpretation of the facts, for example, by imposing a neoclassical template on the world they observe. In an article by Robert Frank and others, they take the argument a step further.[4] They experimentally demonstrate that economists' values can affect the 'real world' itself-and not just economists' interpretations of it. This happens when economists 'export' values into the classroom by teaching the economic theory of rationality. The authors report several experiments, in one of which they put students in a prisoner's dilemma situation, with actual cash at stake. In a regression model of the resulting data, with the decision to defect as the dependent variable, an economics major variable was significantly positive; those who had studied economics the most were more likely to take the most self-interested action. If this kind of effect is common, then even clearly self-interested behavior may not constitute an independent verification of the theory of rational self-interest, but instead may be a *product* of that theory.

An introductory course in economics should provide students with several different approaches to the relationship between facts and values in economics, demonstrating that the role in economics of ideals such as objectivity are unsettled. The debate is a longstanding one, and it continues.

Rationality, Ethics and the Behavior of Economic Agents

After teaching the fundamentals of microeconomics-scarcity, choice, opportunity cost, supply and demand, it is important to discuss the limitations of the microeconomic way of thinking. Basically, economic theory posits that wants are always greater than resources, therefore, scarcity is *the* economic problem. Since by assumption everyone wants to get the most for the least the logic of the model follows. The extensions are particularly troubling-couples choose between a new car and a new baby; elected representatives act so as to maximize the possibility of re-election. Even altruistic behavior is seen as self-interested; people are seen to give money to charity because it makes them feel good or it brings them social approval.

However, all evidence indicates that economic actors (consumers, workers, firms) act out of more than calculated self-interest. Thus the assumption of rationality used in economics may be insufficient in some cases and inappropriate in others. In fact, people's behavior is influenced by many things including ethical norms. Economists have several reasons to be concerned. First, to the extent that economics is based on a faulty theory of human behavior, it will be unable to predict and control. For example, how should government encourage people to behave in socially beneficial ways, say, to donate blood? If people are rational maximizers, government can best achieve its ends by providing a proper set of economic incentives for such behavior. But if economics misconceives the way people are motivated, such incentives might fail to work. In fact, there is evidence that blood donations decline when a system of cash payments is introduced. How can this be?

It is not clear how to account for the decline in contributions, but one possible answer relates to a second, *generative,* role for economic theory. By this is meant its role in generating behavior as opposed to merely predicting or controlling it. Economics can play this role in several possible ways. First, as mentioned earlier, economics can become a sort of philosophy of life for those who study it, leading them to behave in economically rational ways. Second, and more appropriate for the blood-donation case, economically rational ways of behavior can be taught by exposure to social policies and practices that presuppose economic rationality. Thus, even those who initially behave according to social norms about giving blood may come to view blood donation as just another economic transaction, once they see people being paid for their donations. What they once saw as a 'priceless' gift, they now see as a $50 gift. Thus, their non-economic motives are undercut by an economic policy based solely on self-interest.

Another reason to be skeptical regarding the assumption of economic rationality has to do with its normative role. Earlier I noted that the practice of neoclassical economics, despite claims of a positive-normative distinction, commits one to certain moral beliefs. For example, when economics merely identifies and describes certain behaviors as 'rational,' the label of rationality carries a positive connotation that may lead some to see such behavior as desirable or even morally good. Another normative role for the theory of economic rationality is as a benchmark of economic success. Economists measure the success of the economic system by its satisfaction of individual preferences, as opposed to some other measure such as reductions in infant mortality or the elimination of demeaning working conditions. In this 'benchmark' role, the economic theory of rationality is normative because it dictates how policies and behaviors are to be judged.

Thus, there are a number of reasons why one should be concerned about whether the economic theory of rationality is a good one. How would one begin to determine the answer to that question? Certainly it is relevant to ask whether people actually behave according to the theory. One article does just that, using experimental evidence.[5] However, keeping in mind the generative role that theory potentially plays, one must also ask what the *consequences* are of adopting the neoclassical theory of value. In an article I suggest among other things that a society constructed on the basis of pure economic rationality might face overwhelming problems of moral hazard, resulting in a kind of crisis of the moral environment.[6] I examine the problems of organizing society, and, in particular of organizing work, in conditions of imperfect information. In those conditions, as economists have demonstrated, the problem of *moral hazard* can arise. The problem arises when the payoff to one party of a contract depends upon the performance of the other party, and the performance cannot be monitored. For example, there may be a tendency to avoid work when the boss is not looking. Such problems are surely pervasive in our complex society. I argue that ethics can be part of the remedy, diminishing the tendency to 'shirk' in such situations. I argue further that alternative forms of work organization, such as cooperatives, might be effective in eliciting moral behavior under conditions of imperfect information.

Several themes emerge from a study of rationality, ethics, and the behavior of economic agents. As has been seen, one of the crucial issues is the empirical validity of the neoclassical theory. Another issue is the potential consequences of adopting the theory as society's operative theory of human nature. A third issue is the question of exactly *how* people might deviate from the rational model. If people are moral agents in addition to rational maximizers, how *do* they care about the world? For example, do they simply care about the utility of other agents, or do they obey certain moral strictures – like those against lying – regardless of their effect on others' happiness?

What studies make clear is that there is no one form of behavior, whether self-interested or moral, that is dictated by human nature. There is abundant evidence for this. The question then becomes how the various aspects of human nature-economically rational and otherwise-can be elicited so as to create an efficient and just society.

ETHICAL THEORIES

We have examined how the relationship between ethics and economics is important both for the construction of theory and for understanding the behavior of economic agents. We now begin the examination of the third question-how to assess the differential impact of economic institutions and policies. That is, to answer the question of whether outcomes are desirable, ethical evaluations must be applied in addition to economic evaluations. This requires some understanding of available moral theories. A moral theory is needed to provide a framework for responding to the ethical questions that arise in the course of economic activity. For example, if one decides that value-free economics is impossible, which moral values should inform the discipline? If people do not behave simply as rational maximizers, what moral theories might guide their actions? What moral theory should be used to answer applied policy questions? And finally, if individual preference sovereignty is rejected as the overriding goal of the economic system, what moral benchmarks or objectives should take its place? All of these issues cannot be even understood, much less resolved, without some sort of a moral theory as a guide.

There are three main types of moral theory: consequentialist, deontological, and virtue ethics. Consequentialism holds that the right action is the one that results in the best outcomes. One type of consequentialism, utilitarianism, is dominant in economic theory and asserts that the outcomes that matter are utility or preference satisfaction.

Implementing utilitarianism presents certain problems. How does one measure welfare or preference satisfaction, particularly when different individuals must be compared? Do consequences count if they are not expected in advance? Does the welfare of future generations matter? What of animals? How does one compare two different states of affairs in which population levels differ? How does an individual make ethical decisions when quantifying utility is difficult if not impossible? Despite these difficulties, it is argued by many that utility is the only intrinsically good thing. Others argue that utilitarianism is justified on the basis of equal respect among persons. There has been a recent resurgence in the popularity of consequentialism and many economists find it appealing because of its apparent compatibility with neoclassical economic theory.

In deontological ethics by contrast, moral duties or rights sometimes take precedence over outcomes, because those duties or rights are morally valuable in themselves. The deontological position is intuitively appealing as can be seen by means of an example: assume a situation in which you must choose between killing one innocent person yourself and allowing two others to be murdered by another person. The consequences, in terms of the number of lives lost, are not as bad if you commit the murder. But to do so violates the moral obligation not to kill.

Virtue theory traces its roots to Aristotle. Happiness plays a central role in virtue theory, just as in utilitarianism, but virtue theorists mean something different when they refer to happiness. Aristotle used the term to refer to activity in accordance with virtue. Virtues, in turn, are the personal qualities that enable us to do the things that good people do. Of course, the qualities of a good person are complicated and require some kind of agreement on the proper ends of humankind. Unfortunately, an important feature of modern societies is their inability to reach agreement on such matters. But most people will agree that the human virtues include truthfulness, courage, and so on.

Virtue theory might have much to teach modern business people. Businesses might perform better if they concentrated on developing virtues or excellences like quality, rather than focusing exclusively on the bottom line.

Deontological considerations might be used to augment neoclassical economics. The essence of the deontological approach is that while the utilitarian views the person as a unified bundle of preferences, the former sees the self as bifurcated. Each person has a set of desires as well as a separate aspect of the self that judges those preferences in light of moral considerations. The ultimate choices of the individual are the product of both aspects of the self. This notion is consistent with the work of those economists who have introduced 'meta-preferences,' a secondary set of preferences over the domain of all possible preferences. For example, I like grapes but my moral commitment to the United Farm Workers strike kept me from buying them in the 1960s. In addition to the fact that preferences have this dual nature, they respond to experience, and thus are endogenous in an important way. That is, our preferences are not inborn but are learned.

Morality interpenetrates all of economic life; its implications are sweeping and do not apply only to certain areas. For example, in considering work life, the moral value of work, and not just preferences must be taken into account. Moreover, moral behavior undergirds all of the economy, which would quickly disintegrate if large numbers of people attempted to cheat one another or failed to honor their contracts. Thus, moral considerations demand a radical rethinking of all of economics.

Virginia Held[7] addresses another approach to ethics: Is there such a thing as a feminist ethics? Carol Gilligan was one of the first to study this issue. Her work was framed as a criticism of Lawrence Kohlberg, who apparently had found that moral development among girls was less advanced than among boys. Gilligan tried to document that what appears to be a lack of moral development is rather a distinctively 'female' form of moral thought, which is shared by many girls and women, as well as some young boys. Men tend to have what Held calls a 'justice perspective' on morality. This form of morality emphasizes rules and individual conscience. In contrast, women have a 'care perspective,' which centers on meeting others' needs and maintaining relationships, rather than rigid adherence to moral rules.

Following the general lines of Gilligan's approach, Held argues that women tend to share certain ways of thinking, acting and feeling about moral problems. These distinctive forms of female moral experience are in part the product of the activities that women have historically been involved in, especially mothering. To the extent that moral theory is based upon moral experience, Held argues women's distinctive experiences should be included. Held believes that this is especially the case because the experience of mothering is so central and important to human life, compared with the realm of public affairs, which provides the inspiration for many 'male' forms of moral thinking.

Held enumerates several aspects of women's morality. First, it is attentive to the needs of 'particular others,' in contrast to all other people in general. That is, it emphasizes the special obligations we have to those who are close to us, as opposed to all others. Second, a feminist morality de-emphasizes, but does not discard, moral rules and principles. Third, there is more to morality than just knowledge; equally important are the associated feelings and motivations. Fourth, one of the most important female experiences providing inspiration for feminist morality is the process of giving birth; the pain of bearing a child inspires the commitment of the mother, who does not want her suffering to have been in vain. Fifth, a feminist morality emphasizes the survival of children and relations of care and concern. Finally, Held argues that while much of what feminists say about morality has been said before, as some critics have alleged, the important thing is that many problems and experiences specific to women have been largely ignored.

ECONOMIC INSTITUTIONS AND ETHICS

Institutions, such as markets and property rights, impact people's welfare and those impacts need to be evaluated both in economic and ethical terms. Some economists may believe that the market is to be judged only on its efficiency in meeting wants, but Elizabeth Anderson[8] shows that moral concerns should play a part in our evaluations of the market. It is often proposed that markets should be used to allocate goods and services wherever possible because they are more efficient than the alternatives.

How can one evaluate such proposals? Anderson, in 'The Ethical Limitations of the Market,' suggests an answer. She argues that when we allocate a good or service through a certain institution such as the market, we treat it in accordance with the norms of that institution. Those norms may allow us to realize some values, but fail to realize – or even undermine – others. Thus, a good is properly traded on the market if its value is successfully realized by the norms of the market. Also, an institution like the market, together with its associated norms, embodies certain interpretations of ideals, while possibly denying or ignoring other ideals. To determine whether a good is appropriately distributed by the market, one can examine the rival ideals at stake. The way people value things when they are allocated through the market is what Anderson calls *use*. When we *use* something, we treat it in accordance with certain norms of the market:

> First, market relations are impersonal ones. Second, the market is understood to be a sphere in which one is free, within the bounds of the law, to pursue one's personal advantage unrestrained by any consideration of the advantage of others. Third, the goods traded on the market are exclusive and rivals in consumption. Fourth, the market is purely want-regarding: from its standpoint all matters of value are simply matters of personal taste. Finally, dissatisfaction with a commodity or market relation is expressed primarily by 'exit,' not 'voice.' (p. 182)

To determine whether a good should be traded on the market one should consult this list of market norms to see if they are compatible with the full realization of its values.

To illustrate the application of this theory, consider the good of personal relationships. The practice of modern relationships is informed by the ideals of intimacy and commitment, as opposed to the ideal of market freedom embodied in the market. This means that the goods of personal relationships are, to a significant extent, shared ones. So, each partner enjoys those goods and knows that the other also enjoys them. And the goods at stake must be provided in the spirit of a gift, rather than out of narrow self-interest, meaning that they must express a cognizance of and appreciation for the personal characteristics of the recipient.

All of this conflicts with the market norm of *impersonality*, which requires that goods be provided without regard to any characteristics of the buyer other than his or her willingness to pay. Also, the goods of personal relationships cannot be attained if they are given for base motives, like economic gain. Thus, Anderson argues, we can see that sexuality is not appropriately traded on the market. For a prostitute is motivated by monetary gain and, in providing her sexual 'services,' does not respond to the personal qualities of his or her customer. Furthermore, the goods of personal relationships can be seen as 'higher' than those of the market. By implicitly equating the personal goods of the prostitute with the money of the client, a lower good, prostitution, degrades the prostitute. For these and other reasons cited by Anderson, prostitution does not realize the goods of love; thus, sex should not be distributed on the market.

ECONOMIC POLICIES AND ETHICS

Rational actor theory is more than an empirical theory of behavior. This is perhaps most clearly evident when economists assess the relative efficiency of alternative economic arrangements, and, therefore, the desirability of policies. Since the definition of welfare used is preference satisfaction, the utility function becomes a normative benchmark. In practice economists use the more crude standard – cost-benefit analysis (CBA). In this practice, the merit of projects or policies is determined by adding up their costs and benefits. The benefits are usually measured in terms of the willingness of the affected parties to pay for them; with willingness-to-pay the normatively relevant piece of data because it reflects preferences. Thus, both in theory and in practice, economists rely on the notion that welfare amounts to the satisfaction of observed individual preferences.

Tyler Cowen[9] is critical of the use of preference-satisfaction as a yardstick for policy choice, arguing not that it necessarily always gives the wrong policy recommendations, but that in some cases it fails to issue in any coherent recommendations at all. Cowen's argument is based on the paradox that preferences shift in response to policy. Thus, there is a source of circularity in the use of preferences to guide policy. An example will serve to illustrate the point. Suppose that liberal education instills in students liberal values and a tendency to favor government support for liberal education; while at the same time, those educated in a more authoritarian system tend to support authoritarian educational policies. In this situation, the preference sovereignty standard fails to provide any consistent advice to the policy maker. Which policy satisfies preferences best depends upon which policy is implemented in the first place. Thus, 'preference sovereignty' as a criterion for policy selection is not only incorrect, it is incoherent.

These problems are compounded when considering the problem of how to count the welfare of future generations. The shape (and existence!) of future individuals' preferences are determined in part by the policies adopted today, so again one is faced with the question of which preferences to count.

A related problem arises when dealing with the problem of imperfectly informed preferences. It has been empirically documented that in the real world, preferences are affected by all kinds of irrational influences. How, then can one justify relying on those preferences to guide policy? For example, A person reveals a preference to smoke when buying a pack of cigarettes. At the same time that person wants to quit smoking.

CONCLUSION

In this chapter I have focused on the interaction between ethics and economics, both in economic theory and economic policy. I have examined the three ways in which ethics are important in economics: 1. Economists have ethical values that help shape the way they do economics. 2. Economic actors have ethical values that help shape their behavior. 3. Economic institutions and policies impact people differentially and thus ethical evaluations must supplement economic evaluations. Economics would be greatly enriched if it recognized that there is no alternative to working from a world view. Making explicit the ethical values embodied in that world view would help keep economics more honest and useful.