

*Economics or Ethics?*

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## I. THE ECONOMIST AS PREACHER

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Economists seldom address ethical questions as they impinge on economic theory or economic behavior. They (and I) find this subject complex and elusive in comparison with the relative precision and objectivity of economic analysis. Of course the ethical questions are inescapable: one must have goals in judging policies, and these goals will certainly have ethical content, however well concealed it may be. These lectures will explore some of the problems raised by ethical questions, using the history of economics as an important vehicle in the exploration.

In this first lecture I propose to discuss how economists—primarily great English economists in the main line of development of economics—have advised men and societies on proper conduct. My interest on this occasion is not so much in the advice they have given as in the ethical basis on which this advice has been grounded. Economists have no special professional knowledge of that which is virtuous or just, and the question naturally arises as to how they are able to deliver confident and distinctive advice to a society that is already well supplied with that commodity.

## 1. HOW MUCH PREACHING?

The first, probably the most important, and possibly the most surprising thing to say about the economist-preachers is that they have done very little preaching. I suppose that it is essential to state what I mean by preaching. I mean simply a clear and reasoned recommendation (or, more often, denunciation) of a policy or form of behavior by men or societies of men. It is hardly desirable to label every non-neutral word as preaching — indeed our language is rather short of words that cannot be used in such a way as to hint of approval or disapproval. During a recent war one economist remarked that he was against “business as usual,” and a second was moved to ask whether the speaker was against “business, comma, as usual.”

I shall illustrate my loose definition of preaching and many subsequent points by quotations from famous economists, and I digress for a moment to explain their authority to any non-economists who are present. All but one of the economists I quote were highly intelligent, disciplined men whose views on subjects related to economics deserve your attention and thoughtful consideration, but no more. One, Adam Smith, is differently placed: if on first hearing a passage of his you are inclined to disagree, you are reacting inefficiently; the correct response is to say to yourself: I wonder where I went amiss?

When Adam Smith speaks of the debasement of the currency—which of course proceeds at a much more rapid pace today than it did during his lifetime—he says, “By means of those operations the princes and sovereign states which performed them were enabled, in appearance, to pay their debts and to fulfill their engagements with a smaller quantity of silver than would otherwise have been requisite. It was indeed in appearance only; for their creditors were really defrauded of a part of what was due to them.”<sup>1</sup> I consider this to be preaching since “fraud” is not

<sup>1</sup> *The Wealth of Nations*, Glasgow ed. (Oxford: Clarendon Press, 1976), I, 43-44.

merely a descriptive word. On this mild and I hope reasonable definition of a moral judgment, I have just quoted the only clear example of preaching in the first hundred pages of the *Wealth of Nations*. The preaching becomes more frequent in Smith's latter pages, but it is almost nonexistent in Ricardo's *Principles*, quite sparse in Mill's *Principles*, and virtually nonexistent in Marshall's *Principles*. Of course these admirable men expressed approval or disapproval of many things with every degree of literary subtlety. It would be easy to compile many remarks like Jevons's that the Morrill Tariff Act of 1861 was "the most retrograde piece of legislation that this (nineteenth) century has witnessed," in which disapproval is at least hinted at.<sup>2</sup> But these dicta are noteworthy for their scarcity rather than their frequency in the professional works of the economists.

The proposition that economists are not addicted to taking frequent and disputatious policy positions will appear incredible to most non-economists, and implausible to many economists. The reason, I believe, for this opinion is that in talking to a non-economist, there is hardly anything in economics except policy for the economist to talk about. The layman is unequipped to discuss with an economist the problems that concern professional economics at any time: he would find that in their professional writing the well-known columnists of *Newsweek* are quite incomprehensible. The typical article in a professional journal is unrelated to public policy — and often apparently unrelated to this world. Whether the amount of policy-advising activity of economists is rising or falling I do not know, but it is not what professional economics is about.

The great economists, then, have not been preoccupied with preaching. Indeed, none has become great because of his preaching — but perhaps I should make an exception for Marx, whom some people rank as a great economist and I rank as an immensely influential one. The fact that the world at large thinks of us as

<sup>2</sup> *The Coal Question* (London: Macmillan, 1865), p. 326

ardent enthusiasts for a hundred policies is not pure error, but it tells more about what the world likes to talk about than what economics is about. The main task of economics has always been to explain real economic phenomena in general terms, and throughout the last two centuries we have adhered to this task with considerable faithfulness, if not always with considerable success.

## 2. PREACHING TO WHOM?

It is my impression that the clergy of former times devoted their finest efforts to mending the behavior of individuals, but that in recent times they have sought rather to mend social policy. Whether this impression be right or wrong, economists have seldom spent much time exhorting individuals to higher motives or more exemplary conduct.

Again I return to Mr. Smith. The servants of great joint stock companies such as the East India Company, Smith avers, were concerned only with their own personal fortunes.

Nothing could be more completely foolish than to expect that the clerks of a great counting-house at ten thousand miles distance, and consequently almost quite out of sight, should, upon a simple order from their masters, give up at once doing any sort of business upon their own account, abandon for ever all hopes of making a fortune, of which they have the means in their hands, and content themselves with the moderate salaries which those masters allow them, and which, moderate as they are, can seldom be augmented, being commonly as large as the real profits of the company trade can afford. . . . They will employ the whole authority of government, and pervert the administration of justice, in order to harass and ruin those who interfere with them in any branch of commerce which, by means of agents, either concealed, or at least not publicly avowed, they may publicly chuse to carry on.<sup>3</sup>

After having described these wretchedly venal servants, who exploit both their masters and their victims, Smith hurries on to

<sup>3</sup> *Wealth of Nations*, II, 638-39.

say, "I mean not, however, by any thing which I have here said, to throw any odious imputation upon the general character of the servants of the East India company, and much less upon that of any particular persons. It is the system of government, the situation in which they are placed, that I mean to censure; not the character of those who have acted in it."<sup>4</sup> So it is social institutions that one should castigate: men respond to these situations in predictable, and probably unchangeable, ways. This is not to approve or disapprove of the principle of self-interest that guides men, although Smith might well have agreed with the remark of Frank H. Knight, whom we shall later meet more intimately, that anything which is inevitable is ideal!

Smith's general practice of addressing little preaching to individuals in their private behavior has continued to this day to be the practice of economists. Of course mortal man cannot wholly abstain from all instruction to the young, the inferior, and the great, and an enumeration of these acts would be amusing to you and embarrassing to me. Malthus complained that the lower classes were excessively attentive to what he termed "the passion between the sexes," and even John Stuart Mill shared with him a propensity to propose Draconian methods of dealing with the popular implementation of this passion. Alfred Marshall pointed out the un wisdom of gambling with the aid of the law of diminishing marginal utility, but later, fortunately, Milton Friedman and Jimmie Savage were able to excuse this activity with the aid of a law of increasing marginal utility. A vast number of economists have believed that the sin of myopia with respect to future needs is pervasive. We were once told that a corporation has no soul to damn or body to kick — a statement that has been emphatically and prosperously refuted by many politicians to this day. Yet surely a devil embodied in a person is a much more satisfying object of dislike and disapproval than some impersonal institution. These lapses of economists from concern with social rather

<sup>4</sup> *Ibid.*, II 641.

than individual behavior are forgivable — a concession to their membership in the human race.

But the lapses are not defensible. Social policies and institutions, not individual behavior, are the proper object of the economist–preacher's solicitude. This orientation is demanded by the very logic of economic theory: we deal with people who maximize their utility, and it would be both inconsistent and idle for us to urge people not to do so. If we could persuade a monopolist not to maximize profits, then other reformers could persuade resources not to flow to their most remunerative uses, and our theory would become irrelevant.

### 3. PREACHING EFFICIENCY

In the economists' sermons the dominant theme has been that good policy favors, and bad policy interferes with, the maximizing of income of a society. We shall find other themes, but over the last two hundred years efficiency in the sense of fuller achievement of uncontroversial goals has been the main prescription of normative economists. Let us first look at a major example before turning to an examination of the content and authority of this primary rule of good conduct.

The most sustained application of this principle by Adam Smith was in the attack on interferences with free trade and on mercantilism generally; he devoted one-fourth of his large treatise to this cause. Smith thus asserted that:

The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations; though the effect of these obstructions is always more or less either to encroach upon its freedom, or to diminish its security.<sup>5</sup>

<sup>5</sup> *Ibid.*, I, 540.

The argument for free trade was deepened some forty years later by the theory of comparative costs, but the central policy conclusion remained, in Ricardo's words, that "under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each." <sup>6</sup> This position has been almost universally accepted by economists to this day.

Many other examples, but none more important, of the economists' use of efficiency as the criterion for desirable economic policy could be given. The central element of the criticism of monopoly is that it reduces the efficiency of the use of resources. The central element of the criticism of labor market interferences, such as minimum wage laws or barriers to geographical or occupational mobility, has been their effect on the allocation of resources. An economist is a person who, reading of the confinement of Edmond Dantes in a small cell, laments his lost alternative product.

In Smith's time and for a few decades thereafter the argument for efficiency was embellished with a rhetoric of sacred and inviolable rights of natural liberty. But if the concern with natural liberty was ever strong,<sup>7</sup> it had disappeared by the mid-Victorian age.

The attack on the efficiency of public policies will only be appropriate and convincing when achievement of the goals and costs of the policies are undisputed. If one policy will achieve more of a given goal than a second policy with the same cost in resources, the former policy is clearly superior, and there is no room for argument over ethics. This has indeed been the essential nature of the great majority of the economists' preachings on public policy.

<sup>6</sup> David Ricardo, *Principles of Political Economy and Taxation*, P. Sraffa ed. (Cambridge: Cambridge University Press, 1951), p. 133.

<sup>7</sup> Of which I have some doubts. Thus Smith declares that prohibiting banks from issuing small bank notes is of course a violation of natural liberty, and yet it should be undertaken for the greater good of society; see *Wealth of Nations*, I, 324.

On this reading, the economist–preacher has simply helped to straighten out the issues for a frequently muddled nation. John Stuart Mill explained the misunderstandings that supported mercantilism with his customary lucidity: how common discourse confused money and wealth; how a trader does not consider his venture successful until he has converted his goods into money; how money is *par excellence* the command over goods in general, ready on the instant to serve any desire as no other commodity can; how the state “derives comparatively little advantage from taxes unless it can collect them in money,” and so on.

“All these causes conspire to make both individuals and government, in estimating their means, attach almost exclusive importance to money. . . .”

But mark well the conclusion:

“An absurdity, however, does not cease to be an absurdity when we have discovered what are the appearances which made it plausible. . . .”<sup>8</sup>

And there we have the answer to the question of how the economist can operate so extensively and so easily as a critic of policy when he is not in possession of a persuasive ethical system. The answer is that he needs no ethical system to criticize error: he is simply a well-trained political arithmetician. He lives in a world of social *mistakes*, ancient and modern, subtle and simple, and since he is simply pointing out to the society that what it seeks, it is seeking inefficiently, he need not quarrel with what it seeks.

A world full of mistakes, and capable of producing new mistakes quite as rapidly as the economists can correct the old mistakes! Such well-meaning, incompetent societies need their economic efficiency experts, and we are their self-chosen saviors.

<sup>8</sup> *Principles of Political Economy* (Toronto: University of Toronto Press, 1965), I, 67.

Take away the linen of sophistication in which economists are nowadays dressed, and I believe that this is still the fundamental belief that underlies the large majority of the policy recommendations of our profession. There have indeed been grave income redistribution questions which are receiving increasing attention, but day in and day out for the economist the society's problems are usually problems of efficiency. We live in a mistake-prone world.

I believe that this view of society as a community with acceptable, if not always admirable, goals but possessing only a feeble understanding of efficient methods of achieving them was and is profoundly mistaken.

The mistake in this view should have been evident simply because throughout the period I am discussing there were vigorous controversies over the goals of policy. Indeed, in every literate society, even the most dictatorial, there are critics of the goals of the society. In Ricardo's day, for example, Godwin forcefully argued that the institutions of government and property were among the main causes of social misery. Perhaps Godwin is not an apposite illustration; I suppose that an anarchist is a free trader. Consider, then, Malthus, the first professor of political economy in the history of England, who was a supporter of the very protection of agriculture which was the target of Ricardo's attack.

Malthus argued that a nation specializing in manufactures and trade could easily find that its advantages were eroded by foreign or domestic competition, and in any event could be strongly dependent upon the prosperity of its trading partners. An exclusively agricultural nation could find itself locked into a stagnant feudal social system, or alternatively it could find itself unable to employ capital efficiently once its agricultural plant ceased to grow. Hence Malthus wished a mixed agricultural-commercial system.

I shall not conceal my doubt that Malthus actually demonstrated the superiority of this mixed agricultural-commercial system, but it is surely true that he raised a cloud of complications

which were only slowly dealt with by later generations of free traders. Some of these complications concern the determinants of the long-term growth and stability of economies, on which to this day economists have not found confident understanding.

There is a second, and even stronger, reason why the economist — of all people — should be reluctant to characterize a large fraction of political activity as mistaken. The discipline that assumes man to be a reasonably efficient utility maximizer is singularly ill-suited to assuming that the political activity of men bears little relationship to their desires. I have argued the theme of intelligent political behavior often enough that I must here limit myself to the barest of remarks.<sup>9</sup> The failure to analyze the political process — to leave it as a curious mixture of benevolent public interest and unintentional blunders — is most unsatisfactory.

Whether one accepts or rejects the high hopes that some of us now entertain for the economic theory of politics, the assumption that public policy has often been inefficient because it was based upon mistaken views has little to commend it. To believe, year after year, decade after decade, that the protective tariffs or usury laws to be found in most lands are due to confusion rather than purposeful action is singularly obfuscatory. Mistakes are indeed made by the best of men and the best of nations, but after a century are we not entitled to question whether the so-called “mistakes” produce only unintended results?

Alternately stated, a theory that says that a large set of persistent policies are mistaken is profoundly anti-intellectual unless it is joined to a theory of mistakes. It is the most vacuous of “explanatory” principles to dismiss inexplicable phenomena as mistakes — everything under the sun, or above the sun, can be disposed of with this label, without yielding an atom of understanding.

<sup>9</sup> See, however, “Smith’s Travels on the Ship of State,” *History of Political Economy* 3, no. 2 (Fall 1971), and “The Theory of Economic Regulation,” *The Bell Journal of Economics and Management Science* 2, no. 1 (Spring 1971), as well as the underlying literature of Anthony Downs, James Buchanan, and Gordon Tullock, and the public choice field.

We economists have traditionally made innumerable criticisms of the inefficiency of various policies, criticisms which have often been to their own (and my own) utter satisfaction. The meager success of these criticisms in changing these policies, I am convinced, stems from the fact that more than narrow efficiency has been involved in almost every case—that inexplicit or incomprehensible goals were served by these policies and served tolerably efficiently. Tariffs were redistributing income to groups with substantial political power, not simply expressing the deficient public understanding of the theory of comparative costs. We live in a world that is full of mistaken policies, but they are not mistaken for their supporters.

I wish to recur for a moment to the policy of mercantilism, which Smith attributed to the clever machinations of the merchants and traders against the simple, honorable landowners who still constituted the governing class of Great Britain in his time. Smith and his followers should have asked themselves whether simple error could persist, to the large and centuries-long cost of a class intelligent enough to hire the likes of Edmund Burke. I say, with great fear and trembling, that it is more probable that Smith, not the nobility of England, was mistaken as to the cost and benefits of the mercantile system. I say this for his sake: a world of great and permanent error would be a poor place for economics to live.

#### 4. PREACHING EQUITY

There is one large set of policies which cannot easily be judged merely as to efficiency in reaching widely accepted, comparatively uncontroversial goals: I refer to those which seek to redistribute income. If Nelson and Jones have equal incomes, and a policy takes half of Nelson's income and gives it to Jones, a question of equity will inevitably arise in the minds of everyone except Jones.

For the century from Smith to Jevons, economists were cor-

respondingly discreet in their discussions of income distribution. It may be supposed that Smith thought income distribution was a matter for markets to determine when he said, "To hurt in any degree the interest of any one order of citizens, for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all the different orders of his subjects."<sup>10</sup> I am inclined to accept this view even though one can find occasional departures such as his proposal to tax the "indolence and vanity of the rich" by having disproportionately heavy tolls on carriages of luxury (II, 246), for these departures are few and casual.<sup>11</sup>

The classical school did not depart far from Smith's practice. The evil effects of equality were held to be two: a decrease in incentives to thrift and work; and an increase in the population on Malthus' principles. Ricardo would deny the suffrage to those who would not respect the rights of property." Mill, although he was the author of the comforting thesis that the distribution of wealth, unlike its production, was socially malleable, was unprepared to support a progressive income tax — in his case, because of a fear of the effects of leveling income upon the growth of population as well as because such a tax would be insufferably inquisitorial in administration. Bentham's flirtation with notions

<sup>10</sup> *Wealth of Nations*, II, 654.

<sup>11</sup> We find complaints at window taxes as being regressive (II, 373) and at tithes for not being proportional to rents (II, 358).

<sup>12</sup> "So essential does it appear to me, to the cause of good government, that the rights of property should be held sacred, that I would agree to deprive those of the elective franchise against whom it could justly be alleged that they considered it their own interest to invade them. But in fact it can be only amongst the most needy in the community that such an opinion can be entertained. The man of a small income must be aware how little his share would be if all the large fortunes in the kingdom were equally divided among the people. He must know that the little he would obtain by such a division could be no adequate compensation for the overturning of a principle which renders the produce of his industry secure. . . . The quantity of employment in the country must depend, not only on the quantity of capital, but upon its advantageous distribution, and, above all, on the conviction of each capitalist that he will be allowed to enjoy unmolested the fruits of his capital, his skill, and his enterprise. To take from him this conviction is at once to annihilate half the productive industry of the country . . . ."

*Observations on Parliamentary Reform, in Works and Correspondence* 500-1.

of equality flowing from the utilitarian calculus left no imprint on friends, disciples, or tenants.

There was one interesting near-exception to this rule of near-silence on the redistribution of income. The rent of land, the payment for the use of its “original and indestructible” properties, was by definition a nonfunctional income, so that social control over rent would not affect the use of land. Hence Mill was the ardent supporter of the nationalization of future increments of land values. But even here Mill wished to compensate present landowners fully.<sup>13</sup>

All this was to change when, but not because, the theory of utility became a centerpiece of economics. In 1881 Edgeworth published *Mathematical Psychics*, in which the utilitarian calculus was presented with magnificent subtlety, imagery, and fruitfulness. A marriage was performed between utility and natural selection, culminating in proposals such as that people below a certain level of capacity should not be allowed to have children,<sup>14</sup> and that the possible correlation of capacity to produce with capacity to enjoy might lead even to the superiority of aristocracy. This effusion was in due time replaced by the classic formulation of the utilitarian rule of taxation, minimum sacrifice. The state should tax the rich *before* the poor, not simply more heavily than the poor, subject to the unexplored dangers of the effects of aggressively progressive taxation on production.<sup>15</sup> Progression followed from the twin assumptions that the marginal utility of income falls as income rises, and there is no systematic relationship between the amount of income a person possesses and his efficiency in converting income into utility.

<sup>13</sup> Mill was mistaken only in believing that present values did not include unbiased estimates of future increments in rents. A similar problem lurks behind his support of progressive taxation of estates. The posthumous *Chapters on Socialism* pays no attention to inequality (aside from that implicit in the discussion of poverty), even in discussing Blanc, Fourier, and Owen.

<sup>14</sup> Those denied “a share of domestic pleasures” might be consoled by emigration!

<sup>15</sup> See Francis Edgeworth, “The Pure Theory of Taxation,” in *Collected Works Relating to Political Economy* (London: Macmillan, 1925), I, 111–42.

By 1912 Pigou was prepared to assert as an axiom of welfare economics that “economic welfare is likely to be augmented by anything that, leaving other things unaltered, renders the distribution of the national dividend less unequal.”<sup>16</sup> He was still reluctant to engage in extensive direct redistribution, on the ground — so characteristic of this eccentric man — that the poor would not use the funds intelligently: “Women, who cook badly or feed their children on pickles, are not bankrupted out of the profession of motherhood; fathers who invest their sons’ activities unre-meritatively are not expelled from fatherhood. . . . What has been said, however, . . . should suffice to establish the thesis . . . that the poor, as entrepreneurs of investment in themselves and their children, are abnormally incompetent.”<sup>17</sup> Fortunately the intelligence of the poor was rising at a powerful rate, so a few years later Pigou was able to write that “To charge the whole body of the poorer classes with ignorance and lack of capacity for management would, indeed, be to utter a gross libel.”<sup>18</sup> Or was Pigou getting in step with society?

I shall assert what I believe I could document, a steadily rising concern with the distribution of income among economist-preachers during the last one hundred years. Today the consequences of any policy on the distribution of income is the early subject of every appraisal, and egalitarianism is an almost uncontroverted goal of social policy. Two broad statements can be made about the ascendancy of income distribution as the subject of ethical judgments on economic policy.

The first is that the expanding concern of economists with income distribution did not come from within economics. Until recently, the professional literature on income distribution has been sparse, relatively iconoclastic (especially with reference to the possibility of interpersonal comparisons of utility), and non-

<sup>16</sup> *Wealth and Welfare* (London: Macmillan, 1912), p. 24.

<sup>17</sup> *Ibid.*, pp. 356-57, 358.

<sup>18</sup> *Economics of Welfare* (London: Macmillan, 1924), p. 709.

cumulative. It cannot be doubted that the economists have imported egalitarian values into economics from the prevailing ethos of the societies in which they live, and they have not been important contributors to the formation of that ethos. In the English tradition from which I have been drawing my examples, the Fabian socialists were immensely more influential and outspoken supporters of egalitarianism than the neoclassical economists.

The second generalization is that the wide acceptance of the ethical desirability of extensive income redistribution has inhibited the development of a positive theory of income distribution. Such a positive theory would explain how the size distribution of income affected, and was affected by, developments such as rising wealth and education, the roles of taxation and other forms of political action, the institutions of inheritance, and the changing nature of the family. Just such a positive theory is beginning to emerge, and I predict that it will have important effects upon the attitudes of economists toward policies of redistribution. The remarkable circumstance, however, that professional study of income distribution up to recent times was small and noncumulative is attributable to the fact that economists viewed the subject as primarily ethical.

## 5. CONCLUSION

I must bring this sermon on economic sermons to a close. The main lesson I draw from our experience as preachers is that we are well received in the measure that we preach what the society wishes to hear. Perhaps all preachers achieve popularity by this route.

The degree of popularity of a preacher does not necessarily measure his influence as a preacher, let alone as a scholar. In fact one could perhaps argue that unpopular sermons are the more influential — certainly if the opposite is true, and preachers simply confirm their listeners' beliefs, pulpits should be at the rear of congregations, to make clearer who is leading. Whether eco-

nostic preachers lead or follow, they need an ethical system to guide their recommendations. I shall address the nature and sources of their ethics in the next lecture.

## II. *THE ETHICS OF COMPETITION: THE FRIENDLY ECONOMISTS*

The system of organization of an economy by private decisions on the allocation of resources and the private determination of the composition and distribution of final outputs is variously known as the market system, the enterprise system, competition, laissez-faire, and by the Marxian word, monopoly-capitalism. This system has been the main method of control of economic life in the last two hundred years in the Western world, but the extent of governmental intervention has increased enormously in both its scope and depth of detail.

In this lecture I plan first to discuss the attitudes of the mainstream of English economists toward this system — the measure and content of their approval and disapproval of the enterprise system. I shall dwell only briefly on the pre-modern evolution of their attitudes and treat primarily with the modern attitudes toward the market. Thereafter, I shall address the questions of where the economists get their ethics and the effects of these ethical values on their work.

### 1. TO 1900: THE GROWTH OF CAUTION IN THE ECONOMISTS' DEFENSE

Until the mid-nineteenth century, the virtues of the enterprise system were as widely accepted as the belief in its efficiency. Private property turned sand into gold, and no one complained at the loss of the sand or the presence of the gold. The “natural system of liberty” was extended widely. It is true that considerable lists have been compiled of the public tasks which the classical economists assigned to the state to correct or reinforce private

actions, but they were not widespread or systematic *programs*, rather a spattering of Band-Aids to be put on the body economic. Malthus denounced systems of equality as part of his population essay and Ricardo ridiculed Robert Owen's parallelograms.<sup>1</sup>

John Stuart Mill was much more ambivalent on the comparative merits of private enterprise and various forms of socialism. The ambivalence was attributable to three sources: his remarkable propensity to understand and state fairly almost any view; the influence of Harriet, the *femme fatale* of the history of economics; and the astonishing and absurd deficiencies which he assigned to private enterprise. He asserted that perhaps nine-tenths of the labor force had compensation which at best was loosely related to exertion and achievement — indeed so loosely that he expressed indignation that the “produce of labour should be apportioned as we now see it, almost in an inverse ratio to the labour.”<sup>2</sup> He felt able to assert that a competitive market could not achieve a shortening of hours of work, even if all the laborers wished it.<sup>3</sup> It has been said that only a highly educated man can be highly mistaken. Mill is no refutation.

Nevertheless, while stating in explicit and implicit ways that political economy did not imply *laissez-faire*, he initiated a practice that was soon to become widely imitated. After listing several reasons for preferring *laissez-faire* — chiefly grounded on a desire for individual freedom and development, but grounded also on efficiency — Mill concludes, “few will dispute the more than sufficiency of these reasons, to throw, in every instance, the

<sup>1</sup> For those who are more familiar with the parallelograms of Euclid than those of Owen, the latter proposed a utopia composed of communities of 500 to 2,000 people, each located in a village “arranged in the form of a large Square, or Parallelogram,” with a balanced agricultural and manufacturing economy in which “a full and complete equality will prevail”; see “Constitution, Laws, and Regulations of a Community,” in *A New View of Society*, 1st American ed. (New York: Bliss and White, 1825), pp. 162-63.

<sup>2</sup> *Principles of Political Economy* (Toronto: University of Toronto Press, 1965), I, 207.

<sup>3</sup> *Ibid.*, 11,956-57.

burthen of making out a strong case, not on those who resist, but on those who recommend, government interference. *Laissez-faire*, in short, should be the general practice: every departure from it, unless required by some great good, a certain evil.”<sup>4</sup> The practice of denying *laissez-faire* as a theorem but asserting its expediency as a general rule soon became, and to this day (I shall later argue) has remained, the set-lecture of the economist. Soon Cairnes, Jevons, Sidgwick, Marshall, and J. M. Keynes confirmed the tradition.<sup>5</sup> Monopoly, externalities, ignorance, and other reasons for departing from *laissez-faire* accumulated, but as individual exceptions to a general rule.

This compromise, in which Pure Science was silent but Heavy Presumption favored *laissez-faire*, troubles me more than it has most economists. A science is successful in the measure that it explains in general terms the behavior of the phenomena within its self-imposed boundaries. Let me give an example: the science should be able to tell us the effects of a minimum wage law on the employment and compensation of all workers, the effects on consumers through price changes, and so on. The standard analysis, to be specific, predicts that a minimum wage law reduces the incomes of the least capable workers and of the community at large, and various other effects.

One could say that the theory does not lead to an unambiguous rejection of minimum wage laws because of limitations imposed by the economist’s framework: for example, monopsony in the labor market or ignorance of workers leads to inefficient market results. Then, however, the economist should analyze the effects

<sup>4</sup> *Ibid.*, 11, 944-45. The argument is presented fully in book V, chapter XI.

<sup>5</sup> J. E. Cairnes, “Political Economy and Laissez-Faire,” in *Essays in Political Economy* (London: Macmillan, 1873): “Economic science has no more connection with our present industrial system than the science of mechanics has with our present system of railways” (p. 257); W. S. Jevons, *The State in Relations to Labour* (London: Macmillan, 1882); H. Sidgwick, *Principles of Political Economy*, 3d ed. (London: Macmillan, 1901), bk. 111, ch. 11; A. Marshall, “Social Possibilities of Economic Chivalry,” in *Memorials of Alfred Marshall*, ed. A. C. Pigou (London: Macmillan, 1925); and J. M. Keynes, *Scope and Method of Political Economy*, 4th ed. (London: Macmillan, 1930), ch. 11.

reached under (say) minimum wage laws and laissez-faire with monopsony, and reach a definite result or no result. In either event, no *presumption* is established.

Alternatively, the theory may be deemed inconclusive for reasons lying outside the economists' domain; in particular, social values not recognized by the theory may reverse the conclusion.<sup>6</sup> For example, a desired income redistribution (or some other social value) may be achieved by the minimum wage law. Thus the apparent beneficiaries of a minimum wage law are the workers above the minimum wage, and indeed that is the reason the AFL-CIO supports the law. Or the workers in a high-wage area may be protected from the competition of a low-wage area, preserving a desired distribution of population.

Very well, let these or other reasons be sufficient to explain the informed passage and continuance of the minimum wage law by the community. Is it not then a fair request of economic theory that it include these results in its study of the minimum wage law? Why shouldn't the full range of consequences important to the society be important to the economist? Unless we invoke consequences outside the scope of rational inquiry — say, that the law favors believers in the true God, without further identification — it is not easy to live with both a pure science of economic phenomena and a set of nonderivative presumptions about practice. Of course the neglect of values other than efficiency may be defended on grounds of scientific division of labor, even though no other science seems inclined to study the neglected share. In any event, one wonders again where the presumption comes from.

I suspect the answer to these questions is that the economists have decided, possibly implicitly and silently, that the other values that might overcome the efficiency presumption are usually weak or conflicting, or even reinforce the conclusion based upon the studied effects. I am in no position to quarrel with this as a work-

<sup>6</sup> In Mill's view, the freedom from compulsion was the chief value justifying the presumption of laissez-faire; book V, chapter XI of the *Principles* is a preview of *On Liberty*.

ing philosophy: no matter how full the explanation of why we have minimum wages — and it is a study we should broaden — I predict that we economists will not like the law. But the working philosophy should not parade as science.

## 2. MARGINAL PRODUCTIVITY ETHICS

The decline in open, unconditional praise of the enterprise system by economists suffered one important interruption at the end of the nineteenth century. The occasion was the discovery and widespread adoption of the marginal productivity theory.

The marginal productivity theory states that in competitive equilibrium each productive factor receives a rate of compensation equal to the value of its marginal or additional contribution to the enterprise that employs it. If the productive factor is a laborer, and he works as (say) a service worker with negligible capital equipment, in equilibrium his wage will equal simply the amount of revenue his services add to the enterprise. If, as is usually the case, the product of all factors is commingled, the marginal product may be manifested as a slightly larger crop or a more reliable machine or some other salable attribute.

If you declare to a layman that a certain individual is paid his marginal product, after explaining perhaps more clearly than I have what a marginal product is, and then add, "Isn't that simply outrageous?," I predict that this layman will be amazed by your comment. In any event, several economists who were among the founders and disseminators of the marginal productivity theory did take exactly the view that the value of the marginal product of a person was the just rate of his remuneration.

The most famous exponent of this view was John Bates Clark. In his magnum opus, *The Distribution of Wealth* (1899), he stated:

The welfare of the laboring classes depends on whether they get much or little; but their attitude toward other classes — and

therefore the stability of the social state — depends chiefly on the question, whether the amount they get, be it large or small, is what they produce. If they create a small amount of wealth and get the whole of it, they may not seek to revolutionize society; but if it were to appear that they produce an ample amount and get only a part of it, many of them would become revolutionists, and all would have the right to do so. . . .

Having first tested the honesty of the social state, by determining whether it gives to every man his own {product}, we have next to test its beneficence, by ascertaining whether that which is his own is becoming greater or smaller.<sup>7</sup>

T. N. Carver of Harvard was also an exponent of productivity ethics:

But if the number of a particular kind of laborers is so small and the other factors are so abundant that one more laborer of this particular kind would add greatly to the product of the combination, then it is not inaccurate to say that his physical product is very high. That being the case, his value is very high. This, therefore, is the principle which determines how much a man is worth, and consequently, according to our criterion of justice, how much he ought to have as a reward for his work.<sup>8</sup>

I have not sought to discover how many economists joined in this ethical justification of competition. I believe that many economists did so, not so often by explicit avowal as by the implicit acceptance of the propriety of marginal productivity as the basis for remuneration. Pigou, for example, wished to define an exploitive wage, and he chose as his definition a wage which fell below the value of the marginal product of the worker.<sup>9</sup>

This literature is usually referred to as “naive productivity ethics,” with the adjective serving not to distinguish it from some other more sophisticated ethical system but to express disapproval.

<sup>7</sup> (New York: Macmillan Co., 1899), pp. 4–5.

<sup>8</sup> *Essays in Social Justice* (Cambridge: Harvard University Press, 1915), p. 201.

<sup>9</sup> *The Economics of Welfare*, 2d ed. (London: Macmillan, 1924), p. 754.

The classic statement of this disapproval is the famous essay by Frank Knight, “The Ethics of Competition” (1923).<sup>10</sup> Four charges are made against the claims of the competitive system to be just:

1. An economic system molds the tastes of its members, so the system cannot be defended on the ground that it satisfies demands efficiently.<sup>11</sup>
2. The economic system is not *perfectly* efficient: there are indivisibilities, imperfect knowledge, monopoly, externalities, etc.<sup>12</sup>
3. The paramount defect of the competitive system is that it distributes income largely on the basis of inheritance and luck (with some minor influence of effort). The inequality of income increases cumulatively under competition.<sup>13</sup>
4. Viewed (alternatively) as a game, competition is poorly fashioned to meet acceptable standards of fairness, such as giving everyone an even start and allowing a diversity of types of rivalries.

When I first read this essay a vast number of years ago, as a student writing his dissertation under Professor Knight’s supervision, you should not be surprised to hear that I thought his was a conclusiverefutation of “productivity ethics.” When I reread

<sup>10</sup> *Quarterly Journal of Economics*; reprinted in *The Ethics of Competition* (Chicago: University of Chicago Press, 1976).

<sup>11</sup> “. . . the social order largely forms as well as gratifies the wants of its members, and the natural consequence [is] that it must be judged ethically rather by the wants which it generates . . .” (ibid., p. 51).

<sup>12</sup> Hence, “in conditions of real life no possible social order based upon a *laissez-faire* policy can justify the familiar ethical conclusions of apologetic economics” (ibid., p. 49).

<sup>13</sup> “The ownership of personal or material productive capacity is based upon a complex mixture of inheritance, luck, and effort, probably in that order of relative importance” (ibid., p. 56). “The luck element is so large . . . that capacity and effort may count for nothing [in business]. And this luck element works cumulatively, as in gambling games generally” (ibid., p. 64).

it a year or so ago, I was shocked by the argumentation. Knight made a series of the most sweeping and confident empirical judgments (such as those underlying the first and third charges) for which he could not have even a cupful of supporting evidence. Moreover, why was it even relevant, with respect to his second charge, that real-world markets are not perfectly competitive in his special sense: one can define a perfect standard to judge imperfect performance, and assuredly real-world performance under any form of economic organization will be less than perfect by any general criterion. Knight kept referring to the objections to competitive results under any "acceptable ethical system" but never told us what such a system contained in the way of ethical content. His own specific judgments do not seem compelling, as when he asserted that "no one contends that a bottle of old wine is ethically worth as much as a barrel of flour." Dear Professor Knight, please forgive your renegade student, but I do so contend, if it was a splendid year for claret.

I shall have more to say about acceptable ethical positions shortly, but for the moment I wish only to assert that the appeal of productivity ethics for income distribution commands wide support not only from the public but also from the economists when they are watching their sentiments rather than their words. Ethical values cannot be counted by a secret ballot referendum, but the support for a productivity ethic is indeed widespread. Even Marx, like Pigou, defined surplus value as the part of a worker's product that he was not paid. The fact that more than skill and effort go into remuneration — that in Knight's example bearded women get good circus jobs simply by not shaving — is not enough to dismiss productivity ethics.

### 3. THE ETHICS OF ECONOMISTS

I have postponed as long as possible the question: where do economists get their ethical systems? My answer is: wherever they can find one.

One occasional source has been a widely acceptable philosophical system. The most important such system in the history of economics has been utilitarianism, which was strongly influential on Bentham's circle, Sidgwick, Marshall, Pigou, and above all Edgeworth. I have already referred to Edgeworth's *Mathematical Psychics* (1881), which is in good part a reproduction of his earlier monograph, *New and Old Methods of Ethics* (1877). Edgeworth presents the utilitarian ethic in full grandeur:

'Mecanique Sociale' may one day take her place along with 'Mecanique Celeste,' throned each upon the double-sided height of one maximum principle, the supreme pinnacle of moral as of physical science. As the movements of each particle, constrained or loose, in a material cosmos are continually subordinated to one maximum sum-total of accumulated energy, so the movements of each soul, whether selfishly isolated or linked sympathetically, may continually be realizing the maximum energy of pleasure, the Divine love of the universe.<sup>14</sup>

Edgeworth's calculus and Sidgwick's *Methods of Ethics* represent the high point of the utilitarian ethics in neoclassical economics.

It proved to be a major obstacle to the explicit use of the utilitarian ethic that it required additional information, particularly about the efficiency of different persons in producing utility, that admitted of no objective determination. Recall that Edgeworth was led to recognize the possibility that an aristocracy might be the best of all societies.

Even when the difficulty of comparing utilities could be overcome, and it was generally overcome by consensus rather than by argument or evidence, the systematic ethic led to an embarrassing consequence. Let me explain by example.

When one traces out the applications of a general ethical system one encounters problems such as one that Alfred Marshall faced. He examined the properties of good excise taxes in a chapter suitably entitled "Theories of Changes in Normal De-

<sup>14</sup> *Mathematical Psychics*, p. 12.

mand and Supply in Relation to the Doctrine of Maximum Satisfaction.”<sup>15</sup> According to the utilitarian theory, it is more desirable, Marshall stated, to tax necessities rather than luxuries because the demand for necessities is less elastic and therefore an excise tax will occasion a smaller loss of consumer utility (surplus).<sup>16</sup> Of course he rejected this recommendation of regressive taxation because it ignored ability to pay taxes.

It might be argued that if Marshall had properly weighted the marginal utility of income of the poor as greater than that of the rich, he would be freed of embarrassment. Possibly, although he would then have needed to compare the magnitudes of utilities with taxation of luxuries and taxation of necessities. In any event, other embarrassing implications are readily found, for example, that the utilitarian goal would imply cosmopolitan income redistribution.

And that is the trouble with a comprehensive ethical system: it leads to conclusions which are unpopular with the community and therefore unpopular with the economists. I believe, although I have not undertaken the substantial task of verifying, the proposition that wherever an ethical system has clashed with widespread social values, the economists have abandoned the implications of the ethical system. If that is indeed the case, it strongly argues for the acceptance of the community's values with whatever inconsistencies they contain.

John Rawls once proposed a way out of this impasse—a method of deriving general ethical values that were both inductive and capable of consistent application. His proposal was as follows. Select a set of competent judges and ask them to decide many and varied specific conflicts that arise between individuals in the society. Given their decisions, seek an explication or principle that correctly predicts these decisions on average and call that principle the ethical principle. Any implicit ethical principles

<sup>15</sup> *Principles of Economics* (1920), bk. V, ch. XIII.

<sup>16</sup> *Ibid.*, p. 467 n.

that had been followed by the competent judges would be recovered by this procedure. One might complain at the elitist nature of the procedure, and a fundamental question is of course whether any principles would be found to exist.<sup>17</sup> Rawls's later and influential presentation of a modified utilitarian theory of justice has no such inductive basis, which suggests that he also found an inductive ethics difficult to systematize, and possibly difficult to accept.<sup>18</sup>

If economists have been content to base their goals upon the ruling views of the educated classes, as I believe to be the case, that is not quite the same thing as saying that they have simply taken an implicit opinion poll on ethical values and either accepted the majority view or distributed themselves in proportion to the frequencies of views held by these classes. Their own discipline has had its own influence.

Members of other social sciences often remark, in fact I must say complain, at the peculiar fascination that the logic of rational decision-making exerts upon economists. It is such an interesting logic: it has answers to so many and varied questions, often answers that are simultaneously reasonable to economists and absurd to others. The paradoxes are not diminished by the delight with which economists present them. How pleased Longfield must have been when he showed that if, in periods of acute shortage, the rich bought grain and sold it at half price to the poor, the poor were not helped. How annoyed the ecclesiastical readers of Smith must have been to learn that the heavy subsidization of clerical training served only to lower the income of curates. How outraged even some economists are with Becker's "rotten kid theorem," which demonstrates that altruistic treatment of a selfish person forces him to behave as an unselfish person would.

Economic logic centers on utility-maximizing behavior by

<sup>17</sup> See "Outline of a Decision Procedure for Ethics," *The Philoiphiral Review* 60 (1951): 177-97.

<sup>18</sup> See *A Theory of Justice* (Cambridge: Harvard University Press, 1971).

individuals. Such behavior may be found in every area of human behavior — and my just-mentioned colleague, Gary Becker, has analyzed it with striking results in areas such as crime, marriage and divorce, fertility, and altruistic behavior — but the central application of economic theory has been in explicit markets. The power of self-interest, and its almost unbelievable delicacy and subtlety in complex decision areas, has led economists to seek a large role for explicit or implicit prices in the solution of many social problems.

As a result, in a period of rapid and extensive movement away from reliance on competitive markets to allocate resources and to distribute income, economists have not led the trend but rather followed it at substantial distance. They have sought persistently to employ prices to abate pollution or to ration energy or to incite safety conditions. They have been at the forefront of what presently appears to be a modest policy of deregulation of certain areas of economic behavior.

It would take a wiser person than I to determine which shares of this market orientation of economists are due to professional training, to attachment to a demonstrably efficient machinery for allocating resources that is largely (but not completely) independent of the goals being sought, and to ethical values in the market organization of economic activity. But this last component, the ethical attractiveness of voluntary exchange, plays at least some part in our attitudes, and I shall give an example of its role.

Market transactions are voluntary and repetitive. These traits are much less marked in political transactions, or military transactions, although perhaps not in religious transactions. Because the market transactions are voluntary, they must benefit at least one party and not injure the other. Because they are repetitive, they (usually) make deceit and nonfulfillment of promises unprofitable. A reputation for candor and responsibility is a commercial asset — on the enterprise's balance sheet it may be called good will.

Nothing in rational behavior precludes the formation of habits which economize on decision-making costs. One such habit according to Marshall is probity: "The opportunities for knavery are certainly more numerous than they were; but there is no reason for thinking that men avail themselves of a larger proportion of such opportunities than they used to do. On the contrary, modern methods of trade imply habits of trustfulness on the one side and power of resisting temptation to dishonesty on the other, which do not exist among a backward people."<sup>19</sup> A still stronger, and much earlier, extension of the same argument was made by Smith:

Whenever commerce is introduced into any country, probity and punctuality always accompany it. These virtues in a rude and barbarous country are almost unknown. Of all the nations in Europe, the Dutch, the most commercial, are the most faithful to their word. The English are more so than the Scotch, but much inferior to the Dutch, and in the remote parts of this country they (are) far less so than in the commercial parts of it. This is not at all to be imputed to national character, as some pretend. There is no natural reason why an Englishman or a Scotchman should not be as punctual in performing agreements as a Dutchman. It is far more reducible to self interest, that general principle which regulates the actions of every man, and which leads men to act in a certain manner from views of advantage, and is as deeply implanted in an Englishman as a Dutchman. A dealer is afraid of losing his character, and is scrupulous in observing every engagement. When a person makes perhaps 20 contracts in a day, he cannot gain so much by endeavouring to impose on his neighbours, as the very appearance of a cheat would make him lose. Where people seldom deal with one another, we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they can lose by the injury which it does their character. They whom we call politicians are not the most remarkable men in the world for probity and punctuality. Ambassadors from different nations are still less so: they are praised for any little

<sup>19</sup> *Principles of Economics*, 8th ed. (London: Macmillan, 1920), p. 7.

advantage they can take, and pique themselves a good deal on this degree of refinement. The reason of this is that nations treat with one another not above twice or thrice in a century, and they may gain more by one piece of fraud than (lose) by having a bad character. France has had this character with us ever since the reign of Lewis XIV<sup>th</sup>, yet it has never in the least hurt either its interest or splendour.<sup>20</sup>

I do not know whether in actual fact the participants in economic transactions behave more honestly than those in diplomatic exchanges or in primitive barter, and I am reasonably confident that Marshall and Smith also did not know when they wrote these passages, whatever they have learned since. But I do believe that they, and most modern economists, accept the substance of their position on commercial morality.

This belief is based not upon some poll of opinion but on our daily practice. Modern economists almost invariably postulate transactions free of fraud or coercion. This postulate is partially presented in mathematical versions as the budget equation, which states that for each economic agent the sum of values received equals the sum of values given up. No transaction therefore leaves anyone worse off, *ex ante*, than he was before he entered it — almost a definition of a noncoercive transaction.

There is no inherent reason for us to make this assumption, and two good reasons for not doing so. The first reason for including fraud and coercion in economics is that they are probably impossible to distinguish from honorable dealing. Assume that I take a shortcut home through a park each night, and once a week on average I am robbed of my trousers — I have learned not to carry money. Is this not a voluntary transaction in which I pay a toll of one-fifth of a pair of trousers per day for access to the shortcut? Assume that I sell to you a plot of land which you erroneously believe to cover an oil pool, and I know the truth.

<sup>20</sup> *Lectures on Justice, Property, and the Distribution of Resources* (Cambridge: Cambridge University Press, 1978), pp. 538–39.

Am I being fraudulent? If so, modify the circumstances so that you know there is oil and I don't. Clearly we can find situations in which the presence of fraud is rejected by half the population.

Second, even when fraud or coercion is unambiguous in the eyes of the society, that is no reason to believe that ordinary economic analysis is inapplicable. Fraudulent securities will be supplied in such quantity that their marginal costs, including selling costs, equal their marginal revenue. One would not expect criminals to earn more than they could obtain in legitimate callings, proper allowance being made for all costs of doing business. The ordinary propositions of economics hold for crime.

I conclude that we economists have customarily excluded fraud and coercion because we have thought that they are not empirically significant elements in the ordinary economic transactions of an enterprise economy.

Although economists have displayed a larger affection for the system of private enterprise than has the remainder of the educated public, this is not to say that prevalent social views have no influence on technical economic writing. Consider the enormous attention that is devoted to monopoly in modern economic theory, an attention so vast that it has virtually taken possession of the literature on industrial organization. The evidence that monopoly is important is negligible, and the evidence that it is a quite minor influence on the workings of the economy is large. I have slowly been approaching the view of Schumpeter, that the eminent role of monopoly in economic literature is due to the influence of general social views.<sup>21</sup>

#### 4. WHAT IS ETHICS?

Economists, I have just said, believe that economic transactions are usually conducted on a high level of candor and responsibility,

<sup>21</sup> The recent attention economists have paid to conservation of resources and to all varieties of pollution also represents a response to popular discussion of these matters rather than the result of autonomous professional economic research.

because it is in the interest of the parties to behave honorably in repetitive transactions. Hence honesty pays.

Against this view we may set that of Archbishop Richard Whately, himself something of an economist as well as a noted logician and divine. The man who acts on the principle that honesty is the best policy, said his Grace, is a man who is not honest.<sup>22</sup> He did not elaborate, but the meaning is clear: he who behaves honestly because it is remunerative is simply an amoral calculator; an honest man is one whose principles of right conduct are adopted independently of their consequences for him.

If every person in a society shared the utilitarian goal of maximum utility for the society, all would presumably behave honestly because there is a large deadweight loss to society in erecting defenses against dishonesty and punishing its manifestations. If even one person did not share this ethic, it might well pay him to engage in acts of dishonesty — indeed it would hardly pay the society to take defensive steps against him or her. One may therefore conclude that honesty would be a utilitarian ethic for the society as a whole, even though honesty did not pay (was not utilitarian) for an individual.

Do people possess ethical beliefs which influence their behavior in ways not dictated by, and hence in conflict with, their own long-run utility-maximizing behavior? This question is not free of ambiguity: if we allow unlimited altruism in the individual's utility function, we are back to social utilitarianism. Less to avoid this result than to attain a position that seems empirically defensible, I shall assume that the altruism is strong within the family and toward close friends and diminishes with the social distance of the person — very much the position Adam Smith advanced in his *Moral Sentiments*.<sup>23</sup> This interpretation does not determine the answer to the question whether people act

<sup>22</sup> Nassau W. Senior, *Journals, Conversations and Essays Relating to Ireland* (London: Longmans Green, 1868), 11, 271.

<sup>23</sup> See Ronald H. Coase, "Adam Smith's View of Man," *Journal of Law and Economics* 19 (1976): 529–46.

on ethical principles. Indeed it eliminates the easy answer, “of course, they give to charity.”

The question of the existence of effective ethical values is of course an empirical question, and in principle it should be directly testable. I recall reading of an experiment in which stamped and addressed but unsealed envelopes with small sums of money were scattered in the streets, and records were compiled of which envelopes were mailed to the designated recipient. My faint recollection is that more envelopes were mailed when the designated recipient was a charity, but that most sums were appropriated by the finders.

One could quarrel at the design of this test, as I recall it, for it gave no information on the finders: perhaps those who were conversing with their clergymen when the envelope was found behaved differently from those who were conversing with their bookies. Still, it is an interesting line of inquiry, one that would be a better employment of the recent doctorates in philosophy than the employments which are reported.

Let me predict the outcome of the systematic and comprehensive testing of behavior in situations where self-interest and ethical values with wide verbal allegiance are in conflict. Much of the time, most of the time in fact, the self-interest theory (as I interpreted it on Smithian lines) will win. In a set of cases that is not negligible and perhaps not random with respect to social characteristics of the actors, the self-interest hypothesis will fail — at least without a subtle and unpredictable interpretation of self-interest.

I predict this result because it is the prevalent one found by economists not only within a wide variety of economic phenomena, but in their investigations of marital, child-bearing, criminal, religious, and other social behavior as well. We believe that man is a utility-maximizing animal — apparently pigeons and rats are also — and to date we have not found it informative to carve out a section of his life in which he invokes a different goal of behavior.

In fact, the test I have just proposed has very little potential scope, I shall argue, because most ethical values do not conflict with individual utility-maximizing behavior.

I pursue this dangerous line of thought in my final lecture.

### III. THE ETHICS OF COMPETITION: THE UNFRIENDLY CRITICS

In the century following the appearance of the *Wealth of Nations*, the pace of economic progress accelerated to levels never before achieved on so continuous and comprehensive a scale. The technology, the economy, the lives, and even the politics of the Western world underwent profound and lasting changes. The standard of living reached continually higher levels, longevity increased, and education spread over the entire society.

It was to be expected that the radical changes accompanying this astonishing economic development would arouse deep opposition and bitter criticism from some groups. Important figures in the cultural circles of Great Britain were soon nostalgic for a romantic past. Robert Southey, the poet laureate, viewed the earlier cottage system and the factory system through bifocal spectacles with rose and black tints, respectively:

... we remained awhile in silence, looking upon the assemblage of dwellings below. Here, and in the adjoining hamlet of Millbeck, the effects of manufactures and of agriculture may be seen and compared. The old cottages are such as the poet and the painter equally delight in beholding. Substantially built of the native stone without mortar, dirtied with no white-lime, and their long low roofs covered with slate, if they had been raised by the magic of some indigenous Amphion's music, the materials could not have adjusted themselves more beautifully in accord with the surrounding scene; and time has still further harmonized them with weather-stains, lichens and moss, short grasses and short fern, and stone-plants of various kinds. The ornamented chimneys, round or square, less adorned than those which, like little turrets,

crest the houses of the Portuguese peasantry; and yet not less happily suited to their place, the hedge of clipt box beneath the windows, the rose bushes beside the door, the little patch of flower ground, with its tall holly-hocks in front; the garden beside, the beehives, and the orchard with its bank of daffodils and snow-drops (the earliest and the profusest in these parts), indicate in the owners some portion of ease and leisure, some regard to neatness and comfort, some sense of natural and innocent and healthful enjoyment. The new cottages of the manufacturers are . . . upon the manufacturing pattern . . . naked, and in a row.

How is it, said I, that everything which is connected with manufactures presents such features of unqualified deformity? From the largest of Mammon's temples down to the poorest hovel in which his helotry are stalled, these edifices have all one character. Time cannot mellow them; nature will neither clothe nor conceal them; and they remain always as offensive to the eye as to the mind !

Of the innumerable voices that joined in this swelling chorus, I shall briefly notice two.

Thomas Carlyle, who gave the dismal science this name, wrote with his customary passion:

And yet I will venture to believe that in no time, since the beginnings of Society, was the lot of those same dumb millions of toilers so entirely unbearable as it is even in the days now passing over us. It is not to die, or even to die of hunger, that makes a man wretched; many men have died; all men must die, — the last exit of us all is in a Fire-Chariot of Pain. But it is to live miserable we know not why; to work sore and yet gain nothing; to be heart-worn, weary, yet isolated, unrelated, girt in with a cold universal Laissez-faire: it is to die slowly all our life long, imprisoned in a deaf, dead, Infinite Injustice, as in the accursed iron belly of a Phalaris' Bull! This is and remains forever intolerable to all men whom God has made. Do we wonder at French Revolutions,

<sup>1</sup> *Sir Thomas More; Or Colloquies on the Progress and Prospects of Society* (London: John Murray, 1829), I, 173-74.

Chartisms, Revolts of Three Days? The Times, if we will consider them, are really unexampled.<sup>2</sup>

Finally, John Ruskin's immense Victorian audience was repeatedly instructed in the vices of industrialism. He was prepared to sum up his entire message in the declaration: "Government and cooperation are in all things the Laws of Life; Anarchy and competition the Laws of Death."<sup>3</sup> A more explicit version runs: "It being the privilege of the fishes as it is of rats and wolves, to live by the laws of demand and supply; but the distinction of humanity, to live by those of right."<sup>4</sup>

A full tour through the modern critics of the competitive organization of society would be a truly exhausting trip. It would include the drama, the novel, the churches, the academies, the lesser intellectual establishments, the socialists and communists and Fabians and a swarm of other dissenters. One is reminded of Schumpeter's remark that the Japanese earthquake of 1924 had a remarkable aspect: it was not blamed on capitalism. Suddenly one realizes how impoverished our society would be in its indignation, as well as in its food, without capitalism.

It is no part of my present purpose to sketch this opposition, and still less to attempt to refute it. Many excellent replies have been penned: Southey's passage with which I began called forth the full scorn — and that is truly a vast scorn — of Macaulay:

Mr. Southey has found out a way, he tells us, in which the effects of manufactures and agriculture may be compared. And what is this way? To stand on a hill, to look at a cottage and a factory, and to see which is the prettier. Does Mr. Southey think that the body of the English peasantry live, or ever lived, in substantial or ornamented cottages, with box-hedges, flower-gardens,

<sup>2</sup> *Past and Present* (Chicago: Henneberry, n.d.), p. 296.

<sup>3</sup> *The Complete Works of John Ruskin* (New York: Thomas Crowell, n.d.).

<sup>4</sup> *The Communism of John Ruskin* (New York: Humboldt, 1891), edited by W. P. B. Bliss, p. 52 n.

beehives, and orchards? If not, what is his parallel worth? We despise those mock philosophers who think that they serve the cause of science by depreciating literature and the fine arts. But if anything could excuse their narrowness of mind, it would be such a book as this.<sup>5</sup>

Macaulay in fact would give Southey credit for only “two faculties which were never, we believe, vouchsafed in measure so copious to any human being — the faculty of believing without a reason, and the faculty of hating without a provocation.”<sup>6</sup>

Later, and usually lesser, defenders of laissez-faire have proved that the critics behaved as critics usually do: inventing some abuses in the system they attacked; denouncing some of its virtues as abuses; exaggerating the real shortcomings; and being singularly blind to the difficulties of any alternative economic system, when they faced this problem at all. But these characteristics are not unique to the critics of private enterprise and may well be inherent in criticisms of any existing order.

I begin with this smattering of early critics only to suggest that important leaders of public opinion have long been opposed to a competitive economic system. There is a natural temptation to credit to them and their numerous present-day progeny the decline that has occurred in the public esteem for private enterprise and the large expansion of state control over economic life. I urge you to resist that temptation. After a preliminary look at the so-called followers of opinion, I shall return to the leaders and seek to explain their attitudes and to question their importance. If my interpretation is correct, it raises interesting questions on the future of private enterprise.

## 1. HAVE ATTITUDES CHANGED?: THE LOWER CLASSES

History is written by and for the educated classes. We know

<sup>5</sup> “Southey’s Colloquies on Society,” in Thomas Babington Macaulay, *Critical, Historical, and Miscellaneous Essays* (New York: Mason, Baker & Pratt, 1873), II 148–49.

<sup>6</sup> *Ibid.*, p. 132.

more about the thoughts and actions of an eighteenth-century lord than about 100,000 members of the classes which were at or near the bottom of the income and educational scales. No one can deduce, from documentary evidence, the attitudes of these lower classes toward economic philosophies, whereas the noble lord's words are enshrined in Hansard and several fat volumes of published correspondence. Hence we cannot determine from direct documentary sources what the attitudes toward *laissez-faire* of these lower classes have been.

Nevertheless, it is an hypothesis that is plausible to me and I hope tenable to you that these lower classes — who have increased immensely in wealth and formal education in the last several hundred years — have been strongly attracted to the economic regime of *laissez-faire* capitalism. One highly persuasive evidence of this is the major spontaneous migrations of modern history: the armies of Europeans that came to the United States, until barriers were created at both ends; the millions of Chinese who have sought entrance to Hong Kong, Shanghai, and other open Asian economies; the millions of Mexicans who these days defy American laws designed to keep them home. These have not been simply migrations from poorer to richer societies, although even that would carry its message, but primarily migrations of lower classes of the home populations. An open, decentralized economy is still the land of opportunity for the lower classes.

The stake of the lower classes in the system of competition is based upon the fact that a competitive productive system is remarkably indifferent to status. An employer finds two unskilled workers receiving \$3.00 per hour an excellent substitute for a semiskilled worker receiving \$8.00 per hour. A merchant finds ten one-dollar purchases by the poor more profitable than a seven-dollar purchase by a prosperous buyer. This merchant is much less interested in the color of a customer than in the color of his money.

If it is true that a large share of the population of modern

societies (and many other societies as well) eagerly migrates to competitive economies when given the opportunity, why have these people supported the vast expansion of governmental controls over economic life in the many democratic societies in which they constitute an important part of the electorate?

I shall postulate now, and argue the case later, that the lower classes have not supported regulatory policies and socialism because they were duped or led by intellectuals with different goals. Instead, these classes have shared the general propensity to vote their own interests. Once the unskilled workers enter an open society, they will oppose further free immigration. The most poorly paid workers are aware of the adverse effects of minimum wage laws, and their representatives vote against such laws.<sup>7</sup> It would be feasible to devise numerous tests of this rational interpretation of lower-class political behavior: as examples, have they been supporters of heavy governmental expenditures on higher education, or of the pollution control programs?

Studies such as I call for will demonstrate, I believe, that the lower classes have been quite selective and parsimonious in their desired interventions in the workings of the competitive economy, simply because not many regulatory policies work to their benefit. These classes will seek and accept all the transfer payments the political system allows, but they have little to gain from regulatory policies that reduce the income of society.

But these lower classes do not dominate our political system. In the long run they have more votes in the marketplace than they have at the ballot box, despite appearances to the contrary. They do not have in full measure the necessary or useful attributes of successful political coalitions, such as common economic and social origins and interests, nor are they localized in space or cohesive in age and social background. They have access to the press or the electromagnetic spectrum only as receivers. They do

<sup>7</sup>See J. B. Kau and P. H. Rubin, "Voting on Minimum Wages: A Time-Series Analysis," *Journal of Political Economy* 86 (1978): 337-42.

not directly control the flow of information. These characteristics do not imply that they are the victims of some conspiracy or that they have no influence on political events. It does mean that the marketplace measures their preferences more finely and more promptly than the literature or the politics of the society, even if that society is as democratic as Great Britain or the United States.

This premium placed by politics on certain educational and social characteristics of the voting population is, I believe, the first of two reasons for the failure of the lower classes to play a larger role in modern regulatory policy. The second and more fundamental reason is that the lower classes are by no means a majority: the very efficiency of the competitive economic system has depleted the ranks of the poor and the ill-educated! The productivity of the economy has moved the children of immigrants or poor farm families into the middle classes. A fair fraction of the best economists in the United States are one or two generations away from the garment trades.

When private enterprise elevates many of its lower-class supporters to the middle classes, they find a much larger agenda of desirable state action. The restrictions on entrance into skilled crafts and learned occupations will serve as an important example of the large number of profitable uses of political power that are open to the various groups in the middle classes. If Groucho Marx would not join a country club that would admit the likes of him, private enterprise has reversed the paradox and expells those who learned to play the game well.

## 2. HAVE ATTITUDES CHANGED?: THE INTELLECTUALS

The intellectual has been contemptuous of commercial activity for several thousand years, so it is not surprising that he has made no exception for the competitive economy. Yet the larger part of the present-day class that lives by words and ideas rather than by commodity processing owes its existence to the productiveness of

modern economic systems. Only economies that are highly productive by historical standards can send their populations to schools for twelve to eighteen years, thus providing employment to a large class of educators. Only such a rich society can have a vast communications industry and pervasive social services — other large areas of employment of the intellectual classes. So it is at least a superficial puzzle why these intellectuals maintain much of the traditional hostility of their class to business enterprise — contemptuous of its motives, critical of its achievements, supportive at least of extensive regulation and often of outright socialization.

An answer that many will give is that the competitiveness of economic relationships, the emphasis on profit as a measure of achievement, the difficulties encountered by those cultural activities that do not meet the market test — are precisely the source of opposition: materialism is hostile to the ethical values cherished by the intellectual classes.

A second, and almost opposite, explanation is that these upper classes find their chief patrons and their main employment in government and its activities. Even though the growth of government relative to private economic activity is conditional on the productivity of the private economy, the self-interest of the intellectuals is in the expansion of the government economy.

I believe that this is true in the short run, and the short run is at least a generation or two. The extensive regulatory activities of the modern state are, both directly and in their influence on the private sector, the source of much of the large demand for the intellectual classes. For example, if higher education in America were private, so its costs were paid directly by students rather than so largely by public subventions, the education sector would shrink substantially, not because of increases in efficiency, although such increases would surely occur, but because for large numbers of older students, school attendance would no longer be a sensible investment of their time. The state has greatly reduced the rela-

tive cost of higher education for the individual student, although it has raised the relative cost for society. Similarly, the immense panoply of regulatory policies has generated a public employment of perhaps half a million persons, with an even larger number of people occupied in complying with or evading the policies the first group are prescribing.

In short, the intellectuals are the beneficiaries of the expansion of the economic role of government. Their support is, on this reading, available to the highest bidder, just as other resources in our society are allocated. Have not the intellectuals always been respectful of their patrons?

I am not striving for paradox or righteousness, so I would emphasize, like Adam Smith, that no insinuations are intended as to the deficient integrity of the intellectuals, which I naturally believe to be as high as the market in ideas allows. No large number of intellectuals change positions after wetting a finger and holding it in the wind: they cultivate those of their ideas which find a market. Ideas without demands are simply as hard to sell as other products without demands. If anyone in this audience wishes to become an apostle of the single tax after the scripture of Henry George, for example, I recommend that he or she acquire and cherish a wealthy, indulgent spouse.

### 3. IDEOLOGY AND THE INTELLECTUALS

A self-interest theory of the support for and opposition to private enterprise will shock many people, and not simply because the theory I propose is so elementary and undeveloped (although these are admitted defects). Many and perhaps most intellectuals will assert that the opposition of intellectuals to private enterprise is based upon ethical and cultural values divorced from self-interest, and that the intellectuals' opposition has played an important leader role in forming the critical attitude of the society as a whole.

An invariably interesting scholar who urged the powerful influence of the intellectuals on social trends was Joseph Schumpeter. Schumpeter's full argument for the prospective collapse of capitalism contains an elusive metaphysical view of the need for legitimacy of a social system, and a charismatic role for its leading classes, that was, he felt, incompatible with the rational calculus of the capitalist mind. The intellectuals were playing their customary role of critics of social order:

On the one hand, freedom of public discussion involving freedom to nibble at the foundations of capitalist society is inevitable in the long run. On the other hand, the intellectual group cannot help nibbling, because it lives on criticism and its whole position depends on criticism that stings; and criticism of persons and of current events will, in a situation in which nothing is sacrosanct, fatally issue in criticism of classes and institutions.<sup>8</sup>

The intellectuals are credited in particular with radicalizing the labor movement.

That intellectuals should believe that intellectuals are important in determining the course of history is not difficult to understand. The position is less easy for even an intellectual economist to understand since it sets one class of laborers aside and attributes special motives to them. On the traditional economic theory of occupational choice, intellectuals distribute themselves among occupations and among artistic, ethical, cultural, and political positions in such numbers as to maximize their incomes, where incomes include amenities such as prestige and apparent influence. On the traditional economic view, a Galbraith could not do better working for Ronald Reagan and a Friedman could not do better working for Carter or Kennedy, and I could not do better telling you that intellectuals are terribly important.<sup>9</sup>

<sup>8</sup> *Capitalism, Socialism and Democracy*, 3d ed. (New York: Harper Torchbooks, 1950), p.151.

<sup>9</sup> Please recall the statement that concludes the last section, that the allocation system works, usually *not* by individuals choosing merchantable ideas, but by only certain of their ideas finding markets.

It is worth noticing that Schumpeter partially accepted this position in pointing out that the declining market prospects of the intellectual class were one basis for their criticism of the market.<sup>10</sup>

Please do not read into my low valuation of the importance of professional preaching a similarly low valuation of scientific work. Once a general relationship in economic phenomena is discovered and verified, it becomes a part of the working knowledge of everyone. A newly established scientific relationship shifts the arena of discourse and is fully adopted by all informed parties, whatever their policy stands. Whether a person likes the price system or dislikes it and prefers a form of non-price rationing of some good, he must accept the fact of a negatively sloping demand curve and take account of its workings. The most influential economist, even in the area of public policy, is the economist who makes the most important scientific contributions.

On the self-interest theory, applied not only to intellectuals but to all of the society, we should look for all to support rationally the positions that are compatible with their long-run interests. Often these interests are subtle or remote, and often the policies that advance these interests are complex and even experimental. For example, it would require a deeper and more comprehensive analysis than has yet been made of the effects of the vast paraphernalia of recent regulation of the energy field to identify and measure the costs and benefits of these policies. But at least in principle, and to a growing degree in practice, we can determine the effects of public policies and therefore whose interests they serve.

The case is rather different with respect to the role of ideology, if that ambiguous word is appropriated to denote a set of beliefs which are not directed to an enlarged, long-run view of self-interest. If an anti-market ideology is postulated, and postulated to be independent of self-interest, then what is its origin and what is its content? Do we not face an inherently arbitrary choice if we

<sup>10</sup> *Capitalism, Socialism and Democracy*, pp. 152–53.

follow this route?: anti-market values are then some humanistic instinct for personal solidarity rather than arms-length dealings, or a search for simplicity and stability in a world where competitive technology is the sorcerer's apprentice, or a wish for a deliberately inefficient egalitarianism, or something else. Choices in this direction are surely as numerous and arbitrary as choices of ethical systems, and indeed that is what they are. Perhaps no one, and certainly no economist, has the right to disparage such non-utility-maximizing systems, but even an economist is entitled to express skepticism about the coherence and content, and above all the actual acceptance on a wide scale, of any such ideology.

In the event, ideology is beginning to make fugitive appearances in the quantitative studies of the origins of public policies. Thus, if one wishes to know why some states lean to income taxes and others to sales taxes, the most popular measure of the higher values (or of intellectual confusion?) entertained by a state is the percentage of its vote cast for McGovern in 1972! At this level, ideology is only a name for a bundle of undefined notions one refuses to discuss.

The simplest way to test the role of ideology as a nonutility-maximizing goal is to ascertain whether the supporters of such an ideology incur costs in supporting it. If on average and over substantial periods of time we find (say) that the proponents of "small is beautiful" earn less than comparable talents devoted to urging the National Association of Manufacturers to new glories, I will accept the evidence. But first let us see it.

#### 4. THE CALCULUS OF MORALS

I arrive by the devious route you observe at the thesis that flows naturally and even irresistibly from the theory of economics. Man is eternally a utility-maximizer, in his home, in his office—be it public or private—in his church, in his scientific work, in short, everywhere. He can and often does err: perhaps the calcu-

lation is too difficult, but more often his information is incomplete. He learns to correct these errors, although sometimes at heavy cost.

What we call ethics, on this approach, is a set of rules with respect to dealings with other persons, rules which in general prohibit behavior which is only myopically self-serving, or which imposes large costs on others with small gains to oneself. General observance of these rules makes not only for long-term gains to the actor but also yields some outside benefits (“externalities”), and the social approval of the ethics is a mild form of enforcement of the rules to achieve the general benefits.<sup>11</sup> Of course some people will gain by violating the rules. More precisely, everyone violates some rule or other occasionally, and a few people violate important rules often.

Two difficulties with enlarging and elaborating this approach to ethical codes are worth mentioning. The first is the constant temptation to define the utility of the individual in such a way that the hypothesis is tautological. That difficulty is serious because there is no accepted content to the utility function — I gave my interpretation at the end of the second lecture, and it made a person’s utility depend upon the welfare of the actor, his family, plus a narrow circle of associates. Still, the difficulties in using utility theory can be exaggerated. A rational person learns from experience, so it is a contradiction of the utility-maximizing hypothesis if we observe systematically biased error in predictions: thus one cannot surreptitiously introduce the theory of mistakes. The development of a content-rich theory of utility-maximizing is a never-ending task.

A second difficulty with the utility-maximizing hypothesis is that it is difficult to test, less because of its own ambiguities than because there is no accepted body of ethical beliefs which can

<sup>11</sup> The expression of this social approval by an individual is itself enforced by the approval of other individuals and therefore constitutes a system of informal law. Clearly this line of argument takes us (as Michael McPherson pointed out) into political (i.e., not purely individualistic) theory.

be tested for consistency with the hypothesis. In the absence of such a well-defined set of beliefs, any ad hoc ethical value can be presented, and of course no respectable theory can cope with this degree of arbitrariness of test.

In particular, a system of ethics of individual behavior is all that one can ask a theory of individual utility-maximizing behavior to explain. Political values — values that the society compels its members to observe by recourse to political sanctions — include such popular contemporary policies as income redistribution and prohibition of the use of characteristics such as race and age and sex in certain areas of behavior (but not yet in other areas such as marriage). It requires a political theory rather than an individualistic ethical theory to account for policies and goals whose chief commendation to a substantial minority of people is that their acceptance spares them a term in jail.

With these disclaimers, I believe that it is a feasible and even an orthodox scientific problem to ascertain a set of widely and anciently accepted precepts of ethical personal behavior, and to test their concordance with utility-maximizing behavior for the preponderance of individuals. In fact Rawls's proposal of a method of constructing an inductive ethical system, which I briefly described earlier, is exactly the procedure that would show that the ethical system was based on utility-maximizing behavior. My confidence that the test would yield this result will be disputed by many people of distinction, and that argues all the more for making the test.

## 5. CONCLUSION

I have presented the hypothesis that we live in a world of reasonably well-informed people acting intelligently in pursuit of their self-interests. In this world leaders play only a modest role, acting much more as agents than as instructors or guides of the classes they appear to lead.

The main aspects of social development all have discoverable purposes and should run predictable courses. It is precisely the great virtue — and the great vulnerability — of a comprehensive theory of human behavior that it should account for all persistent and widespread phenomena within its wide domain.

If the hypothesis proves to be as fertile and prescient in political and social affairs as it has been in economic affairs, we can look forward to major advances in our understanding of issues as grave as the kinds of economic and political systems toward which we are evolving. Even if it does not achieve this imperial status, I am wholly confident that it will become a powerful theme guiding much work in the social sciences in the next generation. I would give much to learn what it will teach us of the prospects of my friend, the competitive economy.