Moral behavior as a market phenomenon

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The object of this paper is to understand how morality and the market are related. Morality is classically regarded as the study of how men ought to behave. This study has been inextricably linked with the way in which institutions shape behavior, or in which way ethical behavior can be achieved through the design of institutions. The virtuous life for Plato and Aristotle could only be achieved in the polis, the city state. In economics this tradition is largely lost because men are posited as naturally defined maximizing creatures and talk about morality is discarded as moral philosophy. In this paper I would like to argue that to come to a good understanding of moral behavior and its relation to markets, we have to resurrect this tradition in economic thought.

Adam Smith's account is still the classic statement of the necessary and sufficient conditions for the operation of a successful market. Smith's starting point is the individual pursuit of self-interest, but contrary to a lot of contemporary economists Smith has a very broad conception of self interest. To him man is naturally able to reason, understand the market and plan with foresight. However most of all Smith's economic man is always aware of his surroundings; in that sense he was a social being. Nations could get rich if men worked together in the division of labor, that this was done out of self-interest doesn't make it less of a social process. The market was the institution that made this cooperation through exchange and division of labor, or even rational. But this social side of the market is almost completely lost in economic thought, to the point that individuals have become dispensable and replaceable consumption and production units.

If we want to understand the moral and social sides of the market we have to get back to the tradition that was largely marginalized after the classical economists. In short we have to analyze how the marketplace shapes (moral) behavior. Therefore I will argue that *moral* behavior is for a large part the outcome of the market-institutions. One of the few 20th century economists to recognize this is Frank H. Knight. In his essay 'The Ethics of competition' he claims that: "Industry and trade is a competitive game, in which men engage in part from the same motives as in other games or sports." (Knight, 1923: p. 586). Self-interest is still the governing motive. In fact the theory of pursuing self-interest is to a large extent tautological, since there seems to be a way to rationalize almost all behavior. However, the way we rationalize behavior depends on how we can make sense of the particular behavior and the way to make sense of behavior is to look at the rules, institutions and goals of the 'game', in our case the market.

Knight introduced the description of the game as a market along with a metaphor of 'good sport', this metaphor allows us to connect the moral and the economic sphere. We will look at man in his role as economic agent, and how this differentiates him from his role as say political actor. In the words of Knight we have to analyze *what kind of game* business is. There is one additional advantage of this approach; we look at the ethical outcomes of the free market, rather than attacking the scientific behavioral analysis of that market.

This is however where our ways part with Knight's thought, because Knight has developed a quite negative image of the business game. He argues for example that people in a game would rather win than continue the game, this clashes with the societal interest of continuing the economic game. This is a rather curious conception of the business game. Because what we observe in the economy can hardly be described as discontinued games, the special feature of the economic game seems to be that is in essence a game without an ending, although one can certainly gain an advantage over his fellow-players. As is often pointed out business is a game of cooperation, but at the same time it is one of competition. It is a game of cooperation within firms and most importantly in the act of exchange. It is a game of competition because as in every game, the players are competing for the victory in the game. However, victory in this game does not constitute the definitive defeat of your competitors, but instead the satisfaction of wants or the accumulation of wealth. There is no end to the game of business, although the players change from time to time. They quit upon dying, or preferably on their pension age, and may be said to enter in taking their first lessons in social behavior in elementary school. Moreover work and consumption or more general the economic sphere is very important in large parts of our life. The game of business in other words is dominant in large parts of our life and therefore it is likely to have a great influence upon our moral behavior.

Now let us look which virtues and vices the game of business promotes. The business game makes it in your self-interest to pursue education, to build a good reputation and to be trustworthy. These three hardly contested virtues seem to mainly derive of the alignment of long-term interests with short-term interests. The fact that an individual has an interest for a job until his retirement age makes him more reliable in the short term and more likely to invest in his own education. The fact that a firm has an interest in continuation of its business means that it has at the same time an incentive to deliver good quality products. It has to be noted that for such behavior to arise we have to assume the existence of basic institutions, most importantly the protection of property rights and life.

The best arguments for the market institution are not surprisingly to be found in a time in which the free market was not yet a common institution. The arguments employed in 18^{th}-century thought in favor of the market are beautifully analyzed in Hirschman's 'Passions and the Interests'. These 18^{th}-century authors do not seek for a way to limit our passions or our self-interest, but rather to design institutions that will guide our passions and self-interest in a way that is beneficial to society. A perfect example of such an argument is one that Hamilton employs in the Federalist for the possibility of re-election of a president. The possibility of re-election would temper his passions to abuse his position during his current term:

> "the same man, probably with a different prospect before him, might content himself with the regular prerequisites of his situation, and might even be unwilling to risk the consequences of an abuse of his opportunities. His avarice might be a guard upon his avarice". (Hamilton, quoted in Hirschman, 1977: p. 29).

While this argument is not directly about the market-institution, we can easily extend it by an analogy. If we do so, we come to a true understanding of the value of the market-institution. It is a way to guard us against some undesirable outcomes of our passions. Self-interest as is sometimes cynically noted would lead us to robbery of weak persons, but the market institution provides a way to regulate our self-interest in a way to make it advantageous to all; voluntary exchange with well-established property rights. And to expand the analogy with the political actor, the economic actor has an interest in keeping up a good reputation during his entire life. Moreover with the emergence of firms, the interest in keeping up a good reputation within the market has been extended beyond the duration of human life into possible infinity.

A lot of current literature on problems like adverse selection and moral hazard can be understood from this perspective, and the solutions offered are exemplary of the perspective just laid down. The solutions to these problems can easily be divided in two categories: control and new rewarding schemes. The economist has a natural bias towards the latter solution, and rightly so. The control of passions, as the 18^{th}-century authors already understood, by other agents will be hugely inefficient. Firstly the supervising agent himself has to be supervised leading to an ever-expanding control-system and secondly the self-interests of the agent will find new ways to manifest itself. The second solution will try to bring the self-interest of the agent in an organization in line with the interest of the company, by redirecting the interests of the agent through new rewarding systems. In this way there is no need to control the passions but only to redirect them in a way that is beneficial to all, just like in voluntary exchange and the division of labor.

There seems to remain one tension that needs further attention, the tension between competition and cooperation. We have seen how the market aligns the self-interest of the individual for the social good, but how do we value the motive for competition in the wider society? There seems to be an intuitive appeal in the Olympic motto, that taking part is more important than winning. Or as Frank Knight put it: "It is in fact much easier to argue that the introduction of the contest motive into economic life has made it more efficient than that it has made it more pleasurable." (Knight, 1922: p. 613). To this day this remains largely an open question, but some preliminary things can be made. If we morally value the fact that things get done and more in general value industriousness, then the contest motive seems to be morally good. If on the other hand we think that things should be done for their intrinsic value the contest motive might direct us to unworthy activities. In a pluralist society however, in which an objective or shared conception of the good is lacking, we seem to be inclined to embrace the former more subjective conception of the good. In this conception there is more freedom for the individuals themselves to judge what activities they think are worthwhile. There has to remain however a concern that the contest motive does not lead to an arbitrary selection of only some activities, while for example more creative activities that fit rather difficult into the competition framework remain underdeveloped. More work in this framework might lead us to a better understanding of the contest motive in the broader society.

Let us finish with some concluding remarks with regard to Knight's criticisms of the business game. His most important argument against the business game was that the people playing it are not interested in continuing the game, but in winning the game. I hope to have shown that with the right institutions, we can redirect the natural passion to wealth and goods in a way that is beneficial for all. Often this takes the form of bringing the long-term interest of society in line with the relative short-term interest of the current players. Appeals to morality, religion or central control of behavior are all aimed in some sense at repressing personal interests. However, these appeals seem to be largely ineffective and as the 19th-century Frenchmen Paul d'Holbach beautifully expressed: "Reason […] is nothing but the act of choosing those passions which we must follow for the sake of our happiness."

Bibliography:

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