

Chapter 12: Ethics and Economic Progress: Innovation and a Better Life

These revolutions periodically reshape the existing structure of industry by introducing new methods of production—the mechanized factory, the electrified factory, chemical synthesis and the like; new commodities, such as railroad service, motorcars, electrical appliances; new forms of organization—the merger movement ...

Every piece of business strategy acquires its true significance only against the background of that process and within the situation created by it. It must be seen in its role in the **perennial gale of creative destruction**; it cannot be understood irrespective of it or, in fact, on the hypothesis that there is a perennial lull (Schumpeter, J. [1942/2012], *Capitalism, Socialism, and Democracy* [KL 1519–1521, KL 1844–1847]).

I. On the Possibility of Equilibrium and the Possibility of Progress

A. Introduction

The concluding chapter explores how ethical dispositions affect assessments and rates of economic development. Insofar as progress is a series of changes that bring one closer to the good life or move one's community in the direction of the good society, ethics clearly plays a central role in personal assessments progress occurs. Insofar as those assessments affect personal decisions to innovate or not and/or public policies, they also affect rates of economic development.

A philosophical perspective that places material comfort at the center of both a good life and a good society is likely to conclude that economic development improves both life and society by increasing what economists call real income in the community of interest. A philosophical perspective that regards material comfort to be a distraction from a

good life, rather than an essential feature of one, will be inclined to regard an increase in real income as either irrelevant or a threat. Material comfort may undermine virtue or divert time and energy into activities having little to do with a good life. The turmoil introduced by innovation and other market shocks may disrupt one's pursuit of nirvana or reflective equilibrium. Among the philosophers surveyed in Part I, Jeromy Bentham, for example, might be assigned to the first category and Thomas More to the second.

In between are a variety of ideas about the good life and society that include roles for both material comfort and interests that conflict with the pursuit of material comfort or wealth. A particular development may be good or not, according to how it affects the full range of human interests or virtues. In such cases, there will be tradeoffs that need to be accounted for when determining whether a particular economic development is progress or not.

Progress, perhaps surprisingly, is essentially an ethical concept, rather than a technological one. One may say, for example, that a new machine is progress if it can do everything that its predecessors can and “more.” However, “more” must be desirable. A new production method that harmed more operators than previously ones would not be regarded as progress unless other benefits more than compensated for this new feature. Self-driving cars may be considered an instance of progress, because they make transportation easier and safer. On the other hand, it may be argued that such vehicles are not instances of progress, because they undermine the character of drivers by simultaneously removing their responsibility for actions on the road and reducing their competence at the various skills required to control their vehicles directly. If in the end, self-driving cars dominate the highways, those stressing the first vision of the good life would conclude that progress has occurred. Those stressing the latter to be important would disagree, even if they themselves use self-driving cars. When there is a conflict between pragmatic and ethical ends, one's choices may be less than ideal and recognized as such.

To say that at least some changes in society are progress is to argue that some changes improve our character, increase aggregate utility, or move us closer to the good or ideal society. That such improvements are possible has long been recognized. Aristotle, for example, considered ethics to be a method of self-improvement. He also regarded some forms of government to be better than others. Smith regarded the system of

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natural liberty to be an improvement over the medieval system that had previously characterized Great Britain. Kant regarded the Categorical Imperative to be an improvement over previous ethical theories. Bentham believed that the utility principle placed ethics on a firmer more consistent foundation.

The belief that commerce tends to improve the quality of life has been less commonplace, although part I of the present volume demonstrates that it too has long been believed by at least a subset of educated persons, from Grotius through Spencer and beyond. Pigou firmly connects that idea with utilitarian philosophy by arguing that increases in the social dividend (RGDP) tend to increase aggregate utility.

That generalized progress is possible and desirable is a more recent idea than the idea that character and knowledge can be improved over one's lifetime. That improvement is always possible is an idea that presents a number of challenges to ethical theories, public policy, and institutional design as developed in this concluding chapter.

B. On the Notion of Economic Equilibrium

Neoclassical economics and most ethical theories were initially developed to explain and evaluate relatively stable social and economic systems. There is, for example, no use of the words progress or growth in Drebeu's (1959) classic book on general equilibrium theory. Markets reach equilibrium through price adjustments that set supply equal to demand in both the short and long run. There is no use of the word progress in Rawl's theory of justice. The word innovation appears just a single time. Principles of justice emerge from a reflective equilibrium from behind a veil of ignorance. Ethical principles are regarded to be timeless by most philosophers.

Neoclassical economics provides an explanation for the existence of an equilibrium in markets, what von Mises referred to as equally rotating systems, Schumpeter as the circular flow, and Debreu as a general equilibrium. A vector of prices can generate an all-encompassing equilibrium across all markets in both production and exchange. Such an equilibrium can be shown to be a consequence of rational choice in well-known circumstances. Those choices can be used to characterize individual, firm, and market equilibria. However, no innovation occurs in Debreu's classic characterization of a commercial society. The number of goods and ser-

vices is finite and stable. In such circumstances, there is often a unique best choice for every consumer and producer.¹

It was in reaction to equilibrium-based economic and ethical theories that Schumpeter suggested a new model of economic progress and Spencer developed his evolutionary theory of ethics, but it is clear that their ideas failed disturb their fields' respective equilibria significantly.²

Neoclassical growth theory emerged in the 1950s and built on and extended the work of Robert Solo (1970), rather than that of Schumpeter. Solo's theory also neglects the possibility that innovation would affect the nature and number of the products brought to market. Growth in Solo models is generated by capital accumulation and improvements in production technologies that allowed existing goods and services to be produced with fewer resources. Equilibrium growth paths in a Solo economy are characterized by more of the same, rather than disruptions in the patterns of life and society.

C. The Nature of Social Equilibria

The term equilibrium can be regarded as a reasonable first approximation of a variety of systems at particular points in time, the orbits of the planets, the pattern of life in a stable ecosystem, the process of law making in a stable system of government, the pattern of production and exchange in a market in equilibrium, and so forth. Change may take place within such stable systems, but so gradually that it can be ignored without loss for most purposes of analysis and human life.

Within a social system, equilibrium describes a pattern of life that largely repeats itself, as with the farming cycle of a typical year, the holiday and season driven inventory cycles of grocery stores, or the cycles of

¹ Technically, Debreu's characterization of general equilibrium allows for multiple best choices among which one is indifferent. Other slightly less general textbook proofs assume that there are unique best choices for all under a given price vector.

² More recent critiques of the equilibrium view of social continued through the twentieth century, as in Schackle (1961), Kirzner (1973), Cowen and Fink (1985), Grossman and Helpman (1991), and Hanusch and Pyke (2007). It should be acknowledged, however, that these critiques and modeling extensions were minority views in economics for most of the twentieth century. Growth was acknowledged to be possible, but a tendency toward equilibrium growth paths was nearly always assumed.

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a human life. The routines of farming-based societies did not change quickly or radically for centuries at a time. They were largely determined by the seasons. Celebrations tended to be associated with each season and also with the cycles of human life. Modest improvements in crops and plows did occur, but for the most part life went on as before. The product mix of village stores and marketplaces also changed a bit from year to year. “Fashionable” and “practical” food, spices, and clothing varied, but the broad outlines of production, exchange, expectations, and life itself were more or less stable and essentially repeated.

Such stable patterns of life are supported by a stable knowledge base and collection of internalized ethical dispositions. Successive generations learn the same facts of life from their parents and teachers, who pass on the wisdom of their age to their children and students. In the absence of innovation, successive generations of scholars and intellectuals debate the same properties of nature, the divine, epistemology, and ethics and reach more or less similar conclusions. The well-plowed furrows of thought and conduct have often been thought to represent the best that could be done on earth.

Such stable patterns of life and society were arguably typical of human society before the commercial society emerged. Such equilibrium patterns allow historians and anthropologists to describe various time periods and states of development with short phrases such as with the Stone Age, the Bronze Age, the Iron Age, the medieval period, classical Greece, and so forth. The societies so described had (and in some cases continue to have) stable world views (ethical, natural and super-natural beliefs), patterns of production and consumption, and systems of government and law. Historians refer to stable periods with terms such as “age,” “era,” and “period.”

Shifts from one “age” to another are often referred to as “revolutions,” as with the shift from the Paleolithic to the Neolithic period, the shift from the Stone Age to the Bronze Age and from the Bronze to the Iron Age. These social revolutions of interest were not catalyzed by violence but by innovations that disrupted a previously stable pattern of life. The term revolution is also used to describe the changes in economic life that produced the commercial society, the Industrial Revolution.

Part of the explanation for social stability is the attraction that stable, reasonably comfortable patterns of life have for humanity. After a

perturbation or crisis, a return to the preexisting equilibrium patterns is likely when most persons prefer the certainty and comforts of the recent past to the uncertainties of radical change. This is often a sensible, indeed optimal, choice. Most of us prefer our comfortable routines to change, often quite sensibly. Many of our personal and social routines were adopted because they avoided or solved problems. They are often painfully worked out, one at a time, through a long process of trial and error.

A new world is often worse than the old. As a consequence, innovations are discouraged in stable societies. They are regarded as mistakes to be avoided, deviant behavior, or at best silliness soon to disappear, rather than new possibilities to be fully explored. Several Chinese innovations were evidently underappreciated because of such conservative dispositions, including at least two innovations that subsequently changed the world: steam propulsion and gun powder.³ Europe’s medieval period was also characterized by social conservatism.

The idea of the universe which prevailed throughout the Middle Ages, and the **general orientation of men’s thoughts were incompatible with some of the fundamental assumptions which are required by the idea of Progress**...Again, the medieval doctrine apprehends history not as a natural development but as a series of events ordered by divine intervention and revelations. If humanity had been left to go its own way it would have drifted to a highly undesirable port, and **all men would have incurred the fate of everlasting misery** (Bury, J. B. [1921/2011, *The Idea of Progress: An Inquiry into Its Origin and Growth* [KL 321–332]).

Whether evenly rotating societies are the only ones possible in the very long run is beyond the scope of this volume. Many but not all social scientists have assumed that to be the case.

³ Note that the term “underappreciated” is normative and for most persons in the West an unexceptional interpretation of these Chinese “mistakes.” This perspective itself reveals a more appreciative perspective on scientific and economic development, that is to say incorporates the idea of progress. A true conservative would regard the Chinese behavior as appropriate and unexceptional.

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To add to the cumulated understanding of the world with innovations means requires seeing possibilities previously unseen or at least ignored. That millions of intelligent men and women have previously considered such possibilities implies that relatively few innovations are obvious or anticipated. Nonetheless, that previous innovations create an augmented base of knowledge and circumstances implies that some previously neglected or ignored possibilities become less distant, more likely, and so more likely to attract attention as progress takes place.⁴

The early twentieth century assessments of Schumpeter and von Mises implied that the new more extended markets that emerged in the late nineteenth century were engines of transformation, rather than a circular flow or evenly rotating society. Constant innovation produces a spiral rather than a circular flow as new products and production methods alter patterns of consumption and production in a few families and markets at a time. Major innovations create new patterns of life that destroy or at least radically alter earlier ones, as with the indoor plumbing, steam engine, factory, automobile, jetliner, and internet. Lesser innovations may also induce significant modifications of previously existing patterns of life as with central heating, lightbulbs, wrist watches, radios, washing machines, air conditioners, micro wave ovens, and cell phones.

II. Ethics and the Meaning of Progress

The idea of progress evidently emerged in the nineteenth century. It is not entirely antithetical to social conservatism, but it implies that many changes are for the better, and that improvements are always possible. The concept of progress is necessarily evaluative and usually concerns life and society, as opposed to knowledge or machines. As a consequence, the ideas that ground the notion of progress always have an ethical dimension. Personal, civil, and social ethics provide metrics through which changes can be assessed and conclusions reached about whether a single change or sequence of changes are improvements or not.

⁴ Isaac Newton is known for this expression “If I see further it is only by standing on the shoulders of giants,” written in a letter to Robert Hooke in 1676. The possibility of progress, in effect, requires Newton’s giants to grow taller through time, revealing new possibilities previously unseen. It is likely to be this rather than increasing degrees of genius in successive generations that account for it.

Improvements in technology may appear to be relatively easy to recognize and value free, but this is rarely the case. Surely new machine that does everything that its predecessor does and more must be an improvement. However, this is true only when “more” is a desired result. A new machine that did exactly the same things that its predecessors did, but was more dangerous or more prone to break downs would not be regarded as an improvement. A metric of improvement is always necessary to determine whether a new machine is better than the old ones. The same is also true with respect to changes that affect lifestyles or society.

Ethical theories provide such metrics. The utility principle is one such a metric. Any change that increases aggregate utility is an instance of progress according to utilitarians. The dollar-denominated approximation used in welfare economics provides a similar moral metric. Whether persons find the results of a series of changes to be praiseworthy or not provides another. The “distance” to a hypothetical ideal state can also serve as such a metric.

A society that gradually approached an ideal Spencerian state, but never reached it would be regarded as a society that progresses. As knowledge accumulated, such a society might be said to exhibit progress, a form of instability that tends toward “improvement.” If nature and society are so complex that no upper bound in knowledge exists or only one that is so distant that it not likely to bind humanity in the foreseeable future, improvements may continue into the foreseeable future under any of these metrics.

A path of transformation need not be smooth or obvious to be recognized as progress. For example, if knowledge increases in discrete steps of different and unpredictable sizes, the changes induced tend to be unpredictable and of varying magnitude. Natural and political crises may, for example, catalyze such increases in knowledge. In some cases, the required adaptations be regarded as the opposite of progress, as retrogressions. A general trend of improvement or decline in such cases would be evident only after a relatively long series of innovations and adjustments had taken place. It is such long-term series of improvements that are referred to by the generalized notion of progress.⁵

⁵ J. B. Bury (1921) provides a very nice intellectual history of the idea of progress. He notes that two broad conceptions of progress were present in the West during the nineteenth century (ch. 12). “Theories of progress are thus

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Determining whether progress is taking place is not always easy, which is one reason why in periods in which progress is slow and uneven, it might pass unnoticed. In many cases, noticing progress requires both a long-term perspective and a metric to assess the changes taking place.

Objective indices and averages such as GDP and GDP per capita can only approximate the net effect of a series of changes generated by episodes of innovation and economic development in commercial societies. As Pigou pointed out, one cannot simply assert, for example, that an increase in all goods and services always makes everyone or most persons better off. Not only are there a variety of measurement problems, but more is not always better. For example, beyond some point, increases in food and drink tend to reduce, rather than increase, both pleasure and life expectancy. Satiety sets in, our space becomes cluttered, and our bodies too heavy for pleasant exercise or long lives.

In addition, it is rarely the case that particular instances of technological change produce benefits for everyone. In economic terms, there are costs as well as benefits that need to be taken into account. The variety and quality of horse-drawn wagons, buggy whips, writing quills, and sealing wax are less than they used to be, although the variety and quality of automobiles, computers, and cell phones are greater. Determining whether progress has occurred requires an assessment of the gains and losses, and these are inherently subjective and normative. As nonmaterial aspects of life such as stress, the extent of virtue, quality of contempla-

differentiating into two distinct types, corresponding to two radically opposed political theories and appealing to two antagonistic temperaments. The one type is that of constructive idealists and socialists, who can name all the streets and towers of 'the city of gold,' which they imagine as situated just round a promontory. The development of man is a closed system; its term is known and is within reach. The other type is that of those who, surveying the gradual ascent of man, believe that by the same interplay of forces which have conducted him so far and by a further development of the liberty which he has fought to win, he will move slowly towards conditions of increasing harmony and happiness. Here the development is indefinite; its term is unknown, and lies in the remote future. Individual liberty is the motive force, and the corresponding political theory is liberalism" (p. 236). The entire book is available online from the Gutenberg project:
www.gutenberg.org/files/4557/4557-h/4557-h.htm#link2HCH0011.

tion, or quality of family life are added to the mix, it becomes increasingly difficult to assess the net benefits of change. Different ethical systems may reach different conclusions of the merits of a particular series of changes. In this respect, differences in ethical systems can lead to different notions of and conclusions about the meaning of progress.

Whether progress is generated by innovation in a commercial society is thus partly a consequence of the ethical theories used to assess them. Not all normative theories support careers in commerce or its associated research and development efforts. Not all will regard the consequences to be instances of progress. Support for commercial innovation, thus, tends to vary with the ethical disposition of the persons undertaking an assessment. When some dispositions are commonplace in particular groups, differences in support will also exist among such moral communities.

The plethora of stable societies evident in history, suggests that only a relatively small subset of humanity's ethical systems include more support for progress itself. Only a subset of moral communities thus supports innovation and experimentation. Only a subset of those theories tend to regard the changes induced by a commercial society to be progress and so lend their support to such societies. Many of these have utilitarian or contractarian foundations, although not all utilitarians or contractarians of the twentieth century were proponents of the commercial society.

III. Ethics and Economic Growth

Given that notions of progress have ethical foundations and that some ethical theories imply that a steady increase in material comforts is an instance of progress, we next examine different characterizations of commercial societies, beginning with the neoclassical growth model. Economic development can be induced in a number of ways. The least disruptive of these was the one first incorporated into economics. The early growth theorists analyzed how the accumulation of capital would affect an economy.

In a neoclassical model, the factors that generate economic growth increase the marginal product of labor and thereby labor's real income and potential to purchase material comforts and entertainment. For example, both capital and technological progress increases the marginal

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product, essentially by definition. A person can move more dirt with a shovel than his hands, with a wheelbarrow than without, and with a bulldozer than a wheelbarrow. Capital accumulation thereby increases both the output and the overall demand for goods and services. This has been known since at least the time of Adam Smith, although neoclassical growth theory is much newer.

Shortly after World War II, the first mathematical models of growth were based on that assessment, but assumed that there was just one homogenous type of capital, usually physical equipment, to avoid mathematical complications. Human capital (knowledge, training, experience, and organization) was added to the second generation of neoclassical growth models. Human capital accumulation also tends to increase the productivity of labor and so has similar effects. As human and physical capital accumulates, economic output increases because two broadly used inputs for production become more plentiful. As a consequence, consumers can obtain more of the products they are familiar with, especially those produced through capital, skill, or knowledge-intensive methods.⁶

Of course, in the real world human capital is as varied as physical capital. From the perspective of neoclassical growth theory, this book can be thought of as an effort to understand the impact of the subset of human capital that consists of internalized rules of conduct. Part II demonstrated that a subset of ethical dispositions has effects that are similar to those of other productive skills. They make markets and firms more productive by reducing a variety of agency, externality, and coordination problems. An increase in market-supporting ethical dispositions can thus produce economic growth in a standard growth model for much the same reason that increases in other forms of human capital can.

Toward the end of the twentieth century, the distribution and intensity of ethical dispositions in a given population (implicitly) came to be referred to as “social capital” or “generalized trust” and statistical evidence was developed that supported the hypothesis that increases in social capital increase income levels and growth rates.⁷ Although this term

⁶ For an overview of early growth theory grounded in capital accumulation see Solow (1970). For an early model of economic development that includes human capital accumulation, see Romer (1990).

⁷ For growth models that include the accumulation of social capital, see Routledge and Ambsberg (2003). Empirical evidence of the positive effect of social capital on economic growth rates is provided by Knack and Keefer

applies most naturally to what we have termed civil ethics, social and personal ethics can also make firms, markets, and societies more productive and thereby more attractive. Insofar as markets support internalized disposition or virtues that increase productivity, and such virtues are regarded to be important nonmaterial indicators of the quality of life or society, social progress and economic growth can be mutually reinforcing, as argued by Bastiat and von Mises, and demonstrated in Part II of this book.⁸

Equilibrium models of growth have the nice property that essentially everyone benefits. More goods and services are produced, and real income rises for all. These effects are partly consequences of the equilibrium concept and party of assumptions about the nature of growth. Both tend to make economic development ethically uncontroversial, except among those holding ascetic or contemplative beliefs about the good life and good society.

IV. Innovation and Progress: The Process of Creative Destruction

Of course, increases in the production of familiar products are only one of the many forms of economic progress. Much, perhaps most, of the economic development associated with a commercial society occurs through the invention of new goods and services and refinements in the nature of goods and services previously produced, rather than production of more of the same old things. Although sailboats and container ships, horses and automobiles, sailing ships and jetliners, all provide “transportation services,” they are produced with quite different inputs, are arguably substantially different services, and support very different lifestyles.⁹

Joseph Schumpeter (1883–1950) was among the first to analyze the distinctive manner of growth characterized by commercial societies in the late nineteenth and early twentieth centuries. Writing in the early twentieth century, Schumpeter argued that innovation and disruption were essential features of economic development.

(1997), Temple and Johnson (1998), and Beugelsdijk and Van Schaik (2005) among others.

⁸ See, for example, Güth and Kliemt (1994), Landa (1994), Ingelhart (1997), Pollitt (2002), or Tabellini (2010).

⁹ Oddly enough, jet-setters have a nostalgic fondness for sailboats and horses.

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The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates (Schumpeter, Joseph [1942 / 2012-12-19]. *Capitalism, Socialism, and Democracy* [Kindle Locations 1823–1825], Routledge, Kindle Edition).

Innovation is generated by especially creative men and women who bring new production methods and products to factory floors and markets. New products obviously compete with older products for sales and inputs. Successful product introductions thus affect the equilibrium price vector and pattern of consumption and employment. Some prices rise and others fall. Some incomes increase and others are reduced. Similarly, new production methods such as the assembly line or computer-aided manufacturing reduce the cost of a subset of existing products, which either bankrupts their less efficient rivals or induces them to make new investments in plant and equipment to remain competitive.

Less costly or higher-quality products may push former producers out of businesses that they had been in for years. Products that are no longer as useful become obsolete—as with wadding, buggy whips, slide rules, photographic film, or picture tubes. Many of these products totally disappear from markets. Indeed, the words for them may disappear from common knowledge. Late in the twentieth century, a variety of Schumpeterian models of economic growth came into use, supplanting and supplementing the Solo models. In these models, innovations (productivity shocks) introduce both business cycles and economic growth.¹⁰

A. Revolutionary and Evolutionary Change in Commercial Societies

Major innovations, as with steel, the telephone, electric lighting, the automobile, the computer, and the internet, launch entirely new industries and alter patterns of life as entirely new possibilities came into existence. Such transformative products are not simply stronger boards, faster letters, better candles, horse carts, slide rules, or libraries. New in-

dustries, new cities, and new lifestyles follow on the heels of major innovations.

It bears noting that transformative innovations are very rarely single revolutionary leap of imagination, rather they stimulate a variety of new ideas that generate innovation cascades. For example, as the cost of steel fell, secondary innovations in the possible uses of what previously had been an extraordinarily expensive “high tech” metal rapidly emerged. New applications were developed for construction of building and bridges, military equipment, railroads, household appliances, and subsequently the automobile. Tertiary innovation in all of these new product areas also followed. Contemporary automobiles are still steered with a wheel, ride on rubber tires, and propelled (for the most part) by gasoline engines with cylinders and spark plugs. Nonetheless, modern mass-produced automobiles differ from Henry Ford’s old model T in hundreds of respects. Contemporary radios, heating and cooling systems, mapping programs, Internet connections, and energy-saving shapes were beyond the imagination and ability of the most creative engineers of 1908. Contemporary automobiles allow one to go farther on less fuel, carrying more stuff, with far greater comfort than possible with Ford’s pioneering tin lizzy.

Other transformative innovations have occurred in many other “ordinary” product areas during what might be called the commercial era. For example, the telephone of the late 19th century made instantaneous voice communication possible. During the past half century, innovations have created telephones using technologies that Graham Bell would be amazed by. Indeed, users of telephones in the mid-twentieth century might not recognize cell-phones as telephones. Contemporary telephones lack bells, rotary dials, and cords. In effect, they have become voice transmitting and receiving radio-computers that also play music, take photos, answer Internet queries, plot location and routes, and so forth. These transformations occurred at the same time that the quality of sound associated with long distance conversations radically improved, partly as digital encoding replaced analog encoding.

B. The Ethics of Innovation

Readers of this book are likely to regard the course of innovation and market developments over the past century or two to be evidence of progress. However, many of the innovations were not obviously so at the

¹⁰ This is by now a very large literature. See, for example, Mueller (2005) or Van Der Berg and Lewer (2007).

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time that the new products and lifestyles were introduced. Transformative innovations disrupt standing patterns of life, making many persons worse off at the same time that benefits are provided for the innovators themselves and their customers and input providers. Schumpeterian innovation does not simply add another layer or more icing to a preexisting cake shared in fixed proportions by all.

As a consequence, the process of innovation raises a variety of ethical issues that do not exist in stationary or smoothly expanding economies. Changes in market conditions associated with innovation impose costs as well as benefits on the individuals living within commercial societies.

Generally, however, in the capitalist system, with its rapid strides in improving human welfare, progress takes place too swiftly to spare individuals the necessity of adapting themselves to it. **When, two hundred years or more ago, a young lad learned a craft, he could count on practicing it his whole life long in the way he had learned it, without any fear of being injured by his conservatism. Things are different today** (von Mises, Ludwig [1927/2012]. *Liberalism* [p. 81]).

For those who lose their jobs or businesses as a consequence of innovation, the effects can be as devastating as a major earthquake or fire.

As a consequence, many of the economic and social effects of innovation conflict with both traditional norms and others more liberal in their orientation. For example, Mills argued that:

[T]he fact of living in society **renders it indispensable that each should be bound to observe a certain line of conduct** toward the rest. **This conduct consists, first, in not injuring the interests of one another** (Mill, J. S. [2013-08-16], *On Liberty* [KL 41041-41043]).

Mill's first duty is violated every time a new product is successfully introduced, because such products nearly always reduce the income of persons producing rival products. New products that bankrupt rival companies may cause thousands to lose their jobs, many of whom face lower

wages as their skills become obsolete, and lower wealth as their house near their place of work falls in value.

Mill also argues that utilitarian principles implies that government interventions may be appropriate in cases in which one person's actions harm another:

As soon as any part of a person's conduct affects prejudicially the interests of others, society has jurisdiction over it, and the question whether the general welfare will or will not be promoted by interfering with it, becomes open to discussion. (Mill, J. S. [2013-08-16], *On Liberty* [KL 41047–41049]).

Rawls draws a similar conclusion when he states that

Of course, **liberties not on the list**, for example, the right to own certain kinds of property...and freedom of contract as understood by the doctrine of laissez-faire are not basic; and so **they are not protected by the priority of the first [equal liberty] principle** (Rawls, J. [2003], *A Theory of Justice* [p. 52]).

From these perspectives, innovation is simply one of many activities that a community might properly regulate. One cannot simply assert, as many economic text books do, that “pecuniary externalities” do not count. Such claims run counter to the utilitarian foundations of mainstream welfare economics.

Cases in which one restaurant owner is driven into bankruptcy by an innovative competitor with better food or service has to be distinguished from cases in which a rival simply burns down his competition's place of business. If innovation is to take place, inventions must be exempt from both criminal law and the civil proceedings of tort laws. Clearly, the opposite conclusion might also be reached based on what economists call pecuniary externalities. Without a long series of obvious welfare-improving innovations, most consequentialist ethical theories would have a difficult time distinguishing between such cases.

And, of course, historically many communities have not done so. Many Medieval European communities had restrictions on entering new markets that protected existing firms and town centers. Even innovations

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in food and clothing have been regulated as with the various dietary and sumptuary regulations of medieval societies.

Given the unavoidable negative effects of entry and innovations on the welfare of other firms and their employees, in what sense can it be moral to innovate?

Both utilitarian and contractarian theories of social ethics provide affirmative answers to that question. First, they note that the benefits that consumers of new higher quality or less expensive or new products have to be taken into account. Their utility (or net benefits) must increase if they purchase the new over the old products. Second, they note that firm owners and employees damaged by one innovation benefit from many others. People are both consumers and producers, and even production methods often are improved via innovation. Moreover, both utilitarian and contractarian analysis of rules supporting or discouraging innovation imply that matters is the long term consequences of a series of innovations, rather than those associated with a single innovation. If the benefits realized from other innovations exceed those lost in a particular instance, innovation itself may be deemed a moral activity from both these perspectives, one worthy of support.

The moral issue for utilitarians is whether aggregate utility tends to be increased by a series of innovations, or not? From a contractarian perspective, the ethical issue is whether essentially all persons anticipate being better off as a consequence of a long series of innovation or not? If so, establishing a right to innovate would be appropriate policy and innovation generally a virtuous and praiseworthy activity. If not, the status quo ante should be protected and innovations banned.¹¹

In areas in which most innovations produce progress, research and development would be essentially unrestricted. Innovations in such areas generate essentially universal benefits for members of the community of interest. This tends to be true of innovations in the character of and methods of production for consumer goods and services and also most areas of academic research. In some areas, however, both utilitarians and contractarians are likely to favor restrictions on innovation, as with re-

spect to innovations that make fraud, theft, or murder easier to do or less likely to be detected. Similar restrictions might also be applied to the development of computer virus and methods for identity theft.

Other moral perspectives can also justify innovation on procedural grounds, even when others are harmed. For example, if civil law has the character of Kantian universal rules, and civil law permits innovation in a particular area, then behavior consistent with those rules is, by definition, moral or at least not immoral. Others may stress voluntariness rather than civil law, noting that the use of innovations in markets is voluntary and evidence of mutual gains from trade. All such rule and procedural-based arguments distinguish between the damages imposed on others by innovations and the damages imposed on others by thieves, arsonists, and murderers.

C. Ethics and the Laws Governing Innovation

Whatever conclusions are reached about the morality of innovation by policy makers—whether by voters, aristocrats, or kings—is likely to affect a community's laws. For example, if only innovations that harm no other persons are allowed, then only relatively minor innovations would be deemed legal or worthy of political support. A farmer might invent a new method of planting or harvesting his or her crops, which arguably would increase his profits without harming any other, as long as it was not widely adopted. However, a major innovation that affects the farming practices of the entire industry would affect broad patterns of demands for labor, capital, and land. The new relative prices for the various inputs changes the distribution of income and wealth. There are many losers from major innovations, and so these would be banned, because of the damages generated.

Similar conclusions would be drawn for innovations in non-economic spheres of life as well. Major new ethical, scientific, and religious theories also disrupt patterns of life, as they attract the time and interest of large numbers of persons in a given society. New dietary ideas may affect the demand for corn, wheat, beef, and fish. New religious ideas or interpretations may produce new organizations (sects) whose political influence may induce new laws and legal reforms harming those with different beliefs. In a truly conservative society, only conventional ideas

¹¹ Rawls (2003), for example, notes that inequalities induced by innovation are acceptable under his difference principle if the entrepreneur's "better prospects act as incentives so that the economic process is more efficient, innovation proceeds at a faster pace, and so on" (p. 66).

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and behavior would be deemed praiseworthy or worthy of political support.

However, if some harms are regarded to be unavoidable, but progress widely is believed to be possible, then policies would support rather than suppress major innovations improve life or society. For example, if the good life is an active creative life—a life of becoming rather than being—innovation will be praised rather than disapproved of. If material comforts and entertainment are regarded as essential to a good life, then commercial innovations will likewise be praised rather than disapproved. Laws in such communities will support the development and adoption of new ideas, technologies, and products.

Civil and criminal law would allow innovators to damage others in particular ways, as with the various price and wealth effects that economists refer to as pecuniary externalities. Innovations that destroy other businesses in a manner analogous to arson would be exempt from the criminal punishments associated with arson. They would also be exempt from liability for pecuniary damages that an accidental fire would entail. The persons damaged by innovations would not be able to sue innovators for compensation in court. Other policies such as patents and copyright production thought to increase rate of innovation might also be adopted. Support for public education (especially in areas where innovations seems likely and beneficial), and subsidies for research and development might also be provided to further accelerate the pace of innovation.

Differences in ethical systems can thus partially account for differences in the both the degree of economic development that has taken place in the past two centuries and for differences in innovation rates among contemporary societies. Far less innovation and industrialization would take place in conservative societies where equilibrium rather than growth is the aim of a good life and good society. In societies where widely held normative theories support the idea of progress and commerce, more would take place as innovators are freed to pursue new ideas, technologies, and products to replace the old.

V. Risk Management: Innovation, Uncertainty, and Ethics

In societies that accept and support the notion of progress, the future course of life and society is not entirely knowable or certain. Rather

than an evenly rotating society, such societies are constantly being disrupted by innovations of various kinds. The result is not turmoil, because innovation and adjusting one's life and society to take account of those innovations are difficult tasks and so relatively small innovations and adjustments tend to be more common than major ones. What might be called dynamic tranquility is also increased through various public and private innovations in risk management.

New ideas and inventions may occur at any time and many will induce individuals and communities to change their standing routines for life, and not always for the better. As uncertainties and downside risks become recognized, methods for coping with them will naturally be incorporated into both private and public routines. This is true at the levels of individuals, families, organizations, and governments. Uncertainty is the price of progress, and when that price can be reduced, innovation will be more strongly supported.¹²

A. Market and Political Innovations in Risk Management

As commercial societies emerged throughout the West in the late nineteenth and early twentieth centuries, economists began to carefully analyze the effects of uncertainty on the organization of commerce. Frank Knight (1921) was among the first to fully integrate risk and uncertainty into microeconomic analysis. He noted, for example, that markets tend to produce specialization in various risk- and uncertainty-bearing services.

Uncertainty thus exerts a fourfold tendency to select men and specialize functions: (1) an adaptation of men to occupations on the basis of kind of knowledge and judgment; (2) a similar selection on the basis of degree of foresight, for some lines of activity call for this endowment in a very different degree from others; (3) a specialization within productive groups, the individuals with superior managerial ability (fore-

¹² That innovation produces uncertainty is self-evident within microeconomics. That it generates macroeconomic uncertainty is nearly so, as developed in Schumpeter's research on business cycles. Towards the end of the twentieth century, a new school of macroeconomics emerged that argues that many if not all business cycles are generated by "productivity shocks," which is simply another name for innovations affect manufacturing methods. See for example Greenwood, Hercowitz, and Hoffman (1988) or McCallum (1988).

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sight and capacity of ruling others) being placed in control of the group and the others working under their direction; and (4) those with confidence in their judgment and disposition to “back it up” in action specialize in risk-taking (Knight, F. [1921/2009-02-05], *Risk, Uncertainty, and Profit* [KL 3154-3159]).

The effect of specialization in risk bearing and risk pooling is to reduce uncertainty for most persons and thereby to make life in a commercial society more attractive. Such risk management services and products do not reduce risks by reducing innovation, but reduce the indirect downside risks of innovation and other unpredictable events such as weather that affect prices, salaries, and wealth. Innovations in risk and crisis management thus tend to reduce, rather than increase, uncertainties.

In the early twentieth century, several innovations in public policies were also adopted to reduce risks associated with commercial societies and thereby make such societies more attractive. Examples include both unemployment insurance and efforts to manage the business cycle. These new policies took the merits of the commercial society for granted and simply attempted to moderate or pool the risks associated with life in such societies.

Many were formally risk pooling efforts analogous to private insurance. This is evident in their official names, which often include the term insurance; in their method of funding, often through earmarked taxes collected from labor income; and in the terms of eligibility for payouts, being temporarily unemployed or ill. Such insurance-like policies did not interfere with the core processes of the commercial society, but made them more broadly acceptable for the risk-averse persons living within them.

However, other more radical policies were also considered during the twentieth century that might have eliminated the commercial society. Debates over such radical reform proposals included both ethical and economic arguments.

B. Reducing Uncertainty: On the Merits of Central Planning

Mid-twentieth century utilitarians moved beyond Pigou's welfare economics to argue that an economy could, at least in principle, be directed by a utilitarian central planner who would produce a more attrac-

tive pattern of life by eliminating commerce while increasing aggregate utility, much as More's magistrates did in his imagined utopia. It was argued that such a planner could increase aggregate utility by reducing uncertainty, improving the distribution of income, and eliminating externality problems. Such conclusions were consistent with mainstream economic models of the twentieth century, which implied that a perfectly informed, all-powerful, utilitarian ruler analogous to Plato's philosopher king could improve on the commercial society by replacing it entirely or by administering a broad subsection of it.

The equilibrium models of neoclassical economists provided support for this new strand of utilitarian reasoning. Indeed, Russia and its Soviet Union maintained that such a system was successfully being implemented in Northern Asia.¹³ This was a radical challenge to mainstream utilitarians, who had long favored commercial societies. This debate involved many technical economic issues, so it is unsurprising that the central planning debate took place largely among economists. What might be surprising is that much of the debate over central planning relied upon utilitarian reasoning.¹⁴

Those who challenged the analysis of the proponents of central planning used several lines of attack. First, critics argued that using neoclassical models as the foundation of their analysis generated several misleading conclusions. The commercial society was far more innovative and dynamic than those models implied. Moreover, the implicit informational assumptions of neoclassical models implied that planners and market

¹³ Note that such a society, without markets but with ideal production and distribution, resembles Thomas More's *Utopia*, with its sharing of labor and distribution squares. It seems clear that such a society could not exist without ethical foundations, insofar as shirking rather than working tends to be more prevalent when work is unrelated to salary than when it is. The ethical foundations for such a society are beyond the scope of the present volume.

¹⁴ A useful collection of essays on the original central planning debate was assembled by Hayek (1935), which has been reprinted several times. Interest in somewhat more limited forms of central planning continued after World War II, as in Tinbergen (1964). The arguments were not often conducted in terms of utility per se but, with respect to economic output and growth, more or less in the manner pioneered by Pigou. Late twentieth century commentary and critiques of central planning include Lavoie (1985) and Boettke (2002).

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participants had far more information at their disposal than they were likely to have in reality. Second, they argued that the “first best” outcomes of utilitarian planning were not feasible. This was partly for the same reasons. Planners would not be able to produce an innovative society, nor would they have sufficient information to replicate the equilibrium allocation of resources generated by markets in the short term. Moreover, it was also argued that the persons that become central planners were not likely to be utilitarians. Thus, the outcomes associated with even perfectly informed planning are not likely to maximize aggregate utility or attempt to do so. As a consequence of all these factors, the result of central planning would far lower aggregate utility (as proxied by economic output) than generated by a dynamic commercial society.

For example, Friedrich Hayek (1899–1992) reminded proponents of central planning that information is not freely available at a central depository but remains disaggregated in the minds of individuals. This, in combination with the heterogeneity of the knowledge that we each possess (and our ignorance), implies that planners would not know all that was necessary to coordinate the behavior of market participants as well as market prices do.

It is useful to recall at this point that all economic decisions are made necessary by unanticipated changes, and that **the justification for using the price mechanism is solely that it shows individuals that what they have previously done, or can do now, has become more or less important**, for reasons with which they have nothing to do (Hayek, F. A. [1968/2002], “Competition as a Discovery Process,” *Quarterly Journal of Austrian Economics* 5: 9–23).

Hayek also argued that markets take account of far more information than a real benevolent central planner could.

[T]he **two advantages of a spontaneous market order or catallaxy: it can use the knowledge of all participants, and the objectives it serves are the particular objectives of all its participants in all their diversity and polarity.** The fact that catallaxy serves no uniform system of objectives gives rise to all the familiar difficulties that disturb not only socialists, but all economists endeavoring to evaluate

the performance of the market order (Friedrich Hayek [1968/2002], “Competition as a Discovery Process,” *Quarterly Journal of Austrian Economics* 5: 9–23).

In Hayek’s view, this ignorance extends to the common understanding of markets themselves.

Even today the **overwhelming majority of people**, including, I am afraid, a good many supposed economists, **do not yet understand that this extensive social division of labor, based on widely dispersed information, has been made possible entirely by the use of those impersonal signals** which emerge from the market process and tell people what to do in order to adapt their activities to events of which they have no direct knowledge.

That in an economic order involving a far-ranging division of labor it can no longer be the pursuit of perceived common ends but only **abstract rules of conduct**—and the **whole relationship between such rules of individual conduct and the formation of an order** which I have tried to make clear in earlier volumes of this work (Hayek, F. A. [1979], *Law, Legislation and Liberty, Volume 3: The Political Order of a Free People* [p. 162]).

Another crucial issue was whether the central planner would tend to be benevolent or not (utilitarian or not), an issue that goes back at least as far as Plato’s and Aristotle’s analyses of ideal governments. Post-war public choice analysis suggested that the persons most likely to rise to positions of authority are unlikely to be utilitarians or altruists.

The rapidly accumulating developments in the theory of public choice, ranging from sophisticated analyses of schemes for amalgamating individual preferences into consistent collective outcomes, through the many **models that demonstrate with convincing logic how political rules and institutions fail to work as their idealizations might promise**, and finally to the array of empirical studies that corroborate the basic economic model of politics—these

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have all been influential in modifying the way that modern man views government and political process.

The romance is gone, perhaps never to be regained. The socialist paradise is lost. **Politicians and bureaucrats are seen as ordinary persons much like the rest of us, and politics is viewed as a set of arrangements, a game if you will, in which many players with quite disparate objectives interact** so as to generate a set of outcomes that may not be either internally consistent or efficient by any standards (Buchanan, J. M [1984], "Politics Without Romance," *The Theory of Public Choice II*).

What Hayek, Buchanan, and many other economists suggest is that feasibility cannot always be deduced from economic models, because the models necessarily abstract from many details in order to facilitate theoretical developments. Unfortunately, those details cannot always be ignored in practice. The disintegration of the Soviet Union in 1992 affirmed most of their conclusions. It revealed that Soviet planners had not been able to replicate the production efficiency or the material comforts of Western commercial societies after more than a half century of active central management. Moreover, that economy generated very few innovations.

In the centralization debate, differences in normative theories were arguably less important than differences in the expected implications of central planning, because the debate was largely among utilitarians or persons who had accepted the neo-utilitarian approach of Pigou. Nonetheless, assumptions about the ethical dispositions of persons in the societies to be centrally managed were also central to the argument.

A central planner that had internalized utilitarian theory would do better at maximizing aggregate utility--to the extent this can be discerned--than a pragmatist interested in maximizing his own income and authority. Economic incentives matter less if all persons have internalized a strong work ethic and a rule following norm.¹⁵ The argument in favor of

¹⁵ It is interesting to note that markets tend to reward these core ethical beliefs insofar as they tend to increase firm profits, individual incomes, and consumer satisfaction. Without such market rewards, it is clear that the distribution of internalized norms in centrally planned societies would be different than those of

central planning thus implicitly assumed a very complementary normative foundation for their society. Without that ethical foundation, it was behaviorally infeasible, regardless of whether it was economically feasible or not.

Life in the former Soviet Union would doubtless have been far more attractive had their leaders been utilitarians rather than pragmatists seeking personal authority and its citizens ascetic idealists without interests in material comforts and leisure. Central planners would still have been limited by the information at their disposal, but the results are likely to have been far better than they were.

In the end, both economic analysis, ethics, and social evolution favored commerce over central planning, and attention returned to improving the commercial society rather than replacing it.

VI. Conclusions: Ethics and Economic Development

The innovation and progress characterized by a commercial society raises ethical issues beyond those associated with a static or evenly rotating society. Innovations nearly always disrupt the status quo ante and impose a variety of damages on persons throughout society. As such, innovation tends to conflict with many of the norms of civilized society. Nonetheless, innovation may come to be morally supported. The good life may be regarded not as a stationary state but as a life of growth and development, propelled by one's own creativity and stimulated by others. The good society may similarly be regarded as one in which progress continually takes place, in both the domain of ideas and material comforts.

Competition for the favor of consumers in commercial societies tends to provide innovation in goods, services, and production methods that advance those interests. The dynamic, unpredictable character of a commercial society may thus gain approval from a variety of moral perspectives, although not all of them. Both rising income and the introduction of new goods and services provide an ever expanding domain of opportunities for personal development and comfort.

market-based societies. Market rewards for a work ethic and for rule following behavior tend to cause such ethical dispositions to be more commonplace and strongly internalized, as demonstrated in part II.

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All the above imply that shifts in the extent of ethical support for commerce and domains of innovation tend to affect the course of economic development. When internalized ethical dispositions support commerce and innovation, economic growth accelerates as both are supported ethically, culturally, and through public policies. Such an acceleration is evident in the seventeenth and nineteenth centuries in societies where ethical support increased. When it diminishes, the course of economic development slows, individuals spend less time and energy on commerce, innovation slows, and public policies may impede rather than support development, as was true of Medieval Europe.

The extent of commerce and the trajectory of commerce are affected by conclusions about the good life and society. At the individual level, these affect career choices and work effort. At the social level, these affect public policies and other laws that provide the “rules of the game” for both commerce and innovation.

Two recent books have argued that the rate of economic growth in the West has diminished since approximately 1970, Cowen (2011), and Gordon (2016). Gordon provides copious data and analysis that point out the slowdown and Cowen explains that slowdown by pointing to the unusual technological opportunities of the previous century. An alternative explanation for that slowdown has been provided in this chapter.

Ideological shifts in the second half of the twentieth century have led voters and policymakers to be increasingly concerned about the income distribution generated by commercial societies. Such concerns were not new, but became increasingly mainstream during the century. To address such concerns, the modern welfare state, with its higher taxes and lower rewards for innovation, emerged in the period between 1960 and 1985 (Congleton and Bose, 2010). Another significant ideological shift was generated by the environmental movement which challenged the moral and material basis for industrialization and the commercial society. The impact of green arguments are also evident in public policy, which like the welfare state tend to discourage economic development, although in this case by increasing costs rather than diminishing benefits.

When shifts in internalized norms concerning the good life and good society reduce moral and cultural support for lives and societies grounded in commerce, the theory developed in this book predicts a gradual slowdown in the both rate of growth and innovation.

B. A Short Recapitulation of the Analysis: Ethics and Economics

Ethics and economics are not entirely separate subjects. Part I of this book demonstrated that many of the most influential philosophers in the West wrote on both ethical and economic topics, and many believed that commerce should play a role in a good life. How great a role varied. Most of those surveyed provided at least limited support for careers in commerce and rules of conduct that tend to increase the productivity of individuals in commercial enterprises. To the extent that the authors surveyed in Part I were or became mainstream during the period between 1500 and 1900, their theories and illustrations reveal a gradual increase in support for commerce and economic growth in the West gradually accelerated during that period.

Prior to 1900, economics was undertaken by private individuals and persons holding positions in philosophy rather than economics. It was rarely their main interest. Economics as a specialty had not yet emerged. Among the economist professors of moral philosophy were Adam Smith and Alfred Marshall, who had major impacts on the course of economic theory. After 1900, specialization increased, and fewer persons wrote on both ethical and economic issues. As a consequence, ethics largely disappeared from economic texts, except insofar as Pigou's utilitarian ideas continued to provide the foundation for welfare economics. Ethics has indirectly returned to economics through the trust and social capital literatures of the past twenty years, but the term “ethics” and “virtue” are rarely used or a focus of economic analysis. McCloskey (2006) and Rose (2011) are rare exceptions to this rule.

This book is partly an effort to explicitly bring ethics back into economics. It does so by reminding readers of the long history of remarks by ethicists on the role of commerce in a good life and good society. It also demonstrates how ethics can be incorporated into mainstream economic theory. It is unnecessary to abandon economics as it has been taught for a century to bring ethics into it. Part II showed that taking account of the personal rewards of ethical conduct can shed light on a variety of economic phenomena.

Internalized ethical dispositions can reduce a number of problems associated with life in communities and in markets. In principle, as point-

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ed out by Spencer, ethics can solve all of such problems, although in practice it does less than it could. By reducing agency costs in organizations, it allows all organizations to work more effectively, both private and governmental organizations. By reducing the risk of fraud and breach of contract, it allows more extended trading networks to emerge. By supporting laws and policies that further reduce transactions costs and barriers to entry, it increases competition and rates of innovation. The analysis of part II thus implies that the circular flow tends to increase whenever market-supporting ethical dispositions become more commonplace or deeply held. The analysis of chapter 12 implies that economic development tends to accelerate when moral support for markets includes support for innovation.

With respect to commerce, Pigou demonstrated that average income can be used as a rough measure of aggregate utility (welfare). Taken at face value, this implies that the extent of a commercial society is an indicator of the attractiveness of a society from the utilitarian perspective. This is not to say that a commercial society cannot be improved, but implies that, other things being equal, a more extensive and inclusive commercial society is morally superior to a less extensive and inclusive commercial society. Pigou was evidently more interested in how a commercial society could be improved than in praising the remarkable society that had emerged in the late nineteenth and early twentieth century throughout the West.

His analysis was extremely influential in the nineteenth century, presaging both the emergence of the welfare state and environmental regulations. However, that his famous book begins with a ringing utilitarian endorsement of commerce and the commercial society should not be forgotten.

C. Causality

All this is not to say that causality runs entirely from the pen of philosophers to the minds of individuals. Philosophers base their arguments partly on the work of previous generations of philosophers and partly on the internalized ethical dispositions of their time. Their theories have to account for both to be taken seriously. Thus, philosophers and other normative theorists are also influenced the ethical dispositions of their readers, which provide the maxims and illustrations that are taken to be

self-evident and the data that their proposed new or modified theory has to take into account. That which is already in the minds of their readers reflects what they have learned from their parents, friends, and teachers, and their own creativity and experience. What parents and teachers pass on to their children and students partly reflects their own moral dispositions, especially those with respect to what should be taught. Insofar as parents want their children to have good life, they will encourage internalized ethical dispositions that tend to promote that end. What the readers learn from a single book is not likely to induce them to radically adjust their theories of the good life or good society, but may influence them and alter exactly what they decide to pass on to their friends and children.

The same logic applies to markets. Firms affect the ethical dispositions of their current and future employees by rewarding a subset of ethical dispositions that reduce production costs. This induces current employees to develop such dispositions or at least pretend that they have done so. Parents who observe that higher salaries or more pleasant careers are associated with particular ethical dispositions and skills will tend to encourage their children to develop such dispositions and skills, especially if they regard material comfort to be an important part of a good life. In this manner, a supportive culture for commerce and creativity may gradually emerge, if it requires ethical dispositions other than ones that are routinely encouraged in children. A supportive culture takes many generations to emerge and also several generations to disappear.¹⁶

In general, the ethical theories transmitted and the extent to which they are internalized within a community is largely determined by non-economic factors. Parents, philosophers and theologians rarely use material comfort as the primary aim of their ethical and theological theories, although many find it useful to use commonplace economic activities to illustrate their theories. As internalized norms that are supportive of commerce become more commonplace and more strongly internalized, new market opportunities emerge along with pressures for political re-

¹⁶ This partially accounts for the fact that following the collapse of the Soviet empire in the early 1990s, the societies that had been most supportive of commerce prior to being absorbed in to that empire returned to prosperity more rapidly than parts of the empire that had cultures that were less supportive of commerce.

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forms that support economic development. Markets forces play a non-trivial role in this process, but can influence culture only in the long run.

Without ethical support, markets would exist in every civil society, but they would be much smaller and much less productive as they were two centuries ago. In that sense at least, the commercial society may be said to have moral foundations. Normative ideas largely determine the extent of commercial networks, the level and mode of production, and rate of innovation.

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