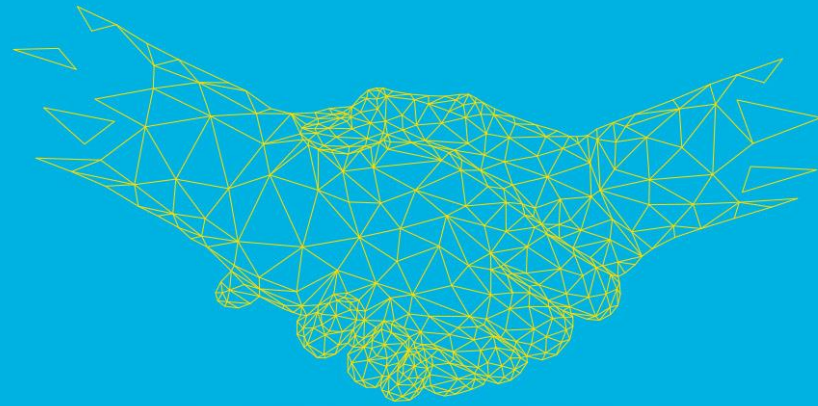


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Solving Social Dilemmas



Ethics, Politics, and Prosperity

Solving Social Dilemmas, Ethics, Politics and Prosperity

An Overview

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This exchange society and the guidance of the coordination of a far-ranging division of labor by variable market prices **was made possible by the spreading of certain gradually evolved moral beliefs** which, after they had spread, most men in the Western world learned to accept. These rules were inevitably learned by all the members of a population consisting chiefly of independent farmers, artisans, and merchants and their servants and apprentices who shared the daily experiences of their masters.

They held an ethos that esteemed the prudent man, the good husbandman and provider who looked after the future of his family and his business by building up capital, guided less by the desire to be able to consume much than by the wish to be regarded as successful by his fellows who pursued similar aims. **(Hayek 1979/2011, pp. 164–165).**

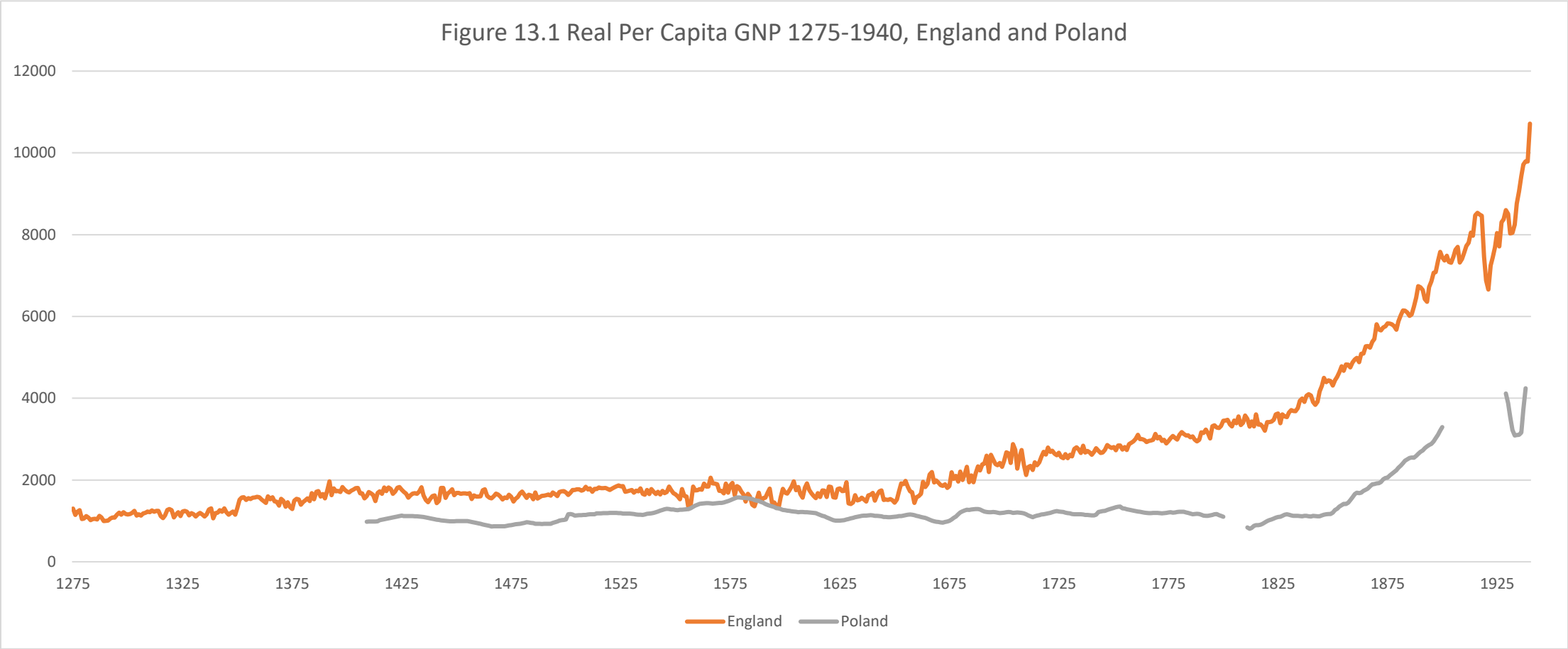
Introduction: The Project

- Hayek, Buchanan, Weber, and many others have argued that internalized rules of conduct play a role in economic development.
- And there has been a bit of work along these lines that explore instances where the dispositions created by such rules may play a role in economic efficiency, as with various papers on the economic contributions of a work ethic.
- However, even though many economists—but obviously not all—have argued that internalized norms can promote economic development, there has not been a full-fledged analysis of this that I am aware of
- This book provides such an analysis using a multi-disciplinary approach.

The Book in a Nutshell: Some Big Questions and Simple Answers

- This book attempts to provide answers to several big questions.
- (1) Why do all societies have internalized systems of norms?
- (2) Why do humans have extensive trading networks and not other mammals?
- (3) Why did commerce suddenly take off in the West during the nineteenth century”
- **The answer suggested in this book has two parts:**
 - (1) There are a huge number of social dilemmas that have to be solved or ameliorated for economic and other forms of progress to emerge.
 - (2) Given this, the ability to devise and internalize rules of conduct provides the most plausible explanation for all three questions.

The Great Acceleration



Other Incomplete explanations

- *It is not technology, per se, that accounts for the great acceleration.*
 - Technology is completely portable and so not regionally specific
- *It is not urbanization, per se.*
 - Few if any of the great urban centers of the past directly participated in the great acceleration of the 19th century.
- Although both these processes played important roles in the great acceleration, neither by itself provides a complete explanation.

Main Theme

- **If the root problem focused on in this book (social dilemmas) and its solution (internalized rules) are correct, then prosperity has ethical or normative foundations.**
 - That a variety of social dilemmas can impede economic and other forms of human development is illustrated with a series of one-shot games.
 - That internalized ethical rules can ameliorate or solve those social dilemmas developed is illustrated with those same games.
 - Governments cannot be relied on for solutions to those problems because the too are riddled with social dilemmas.
- This hypothesis can account for the great acceleration as well as the great stagnation that occurred before it. To demonstrate this, one should be able to observe **productive shifts in the ethical evaluations of markets and careers in commerce (in the West)** during the run up to the great acceleration of commerce in Europe and America in the 19th century. Part III of the book suggests that this did in fact happen.
- This talk provides the gist of several of the main points in theory developed in the 400 pages of *Solving Social Dilemmas*.

What this book does not argue

- **The book does not argue** that ethical behavior, per se, is the root of economic and other social and economic progress.
 - All societies have ethical/normative systems that solve or ameliorate the worst Hobbesian and Commons Problems.
 - And many people in most societies have internalized those systems and act substantially in accord with them.
- **It is only the subset of ethical dispositions that solve or ameliorate important social dilemmas that ultimately support social, political and economic progress.**
 - This implies that not all societies have—or have had—an ethos that solves the dilemmas associated with prosperity.
- The (social) evolutionary process associated with “rule innovation” resembles biological evolution in that it tends to be a series of punctuated equilibria as new problems are confronted, but not resolved.

(1) A More General Foundation for Rational-Choice-Based Analysis: *Homo Constitutionalis*

- Most the analytical part assumes that humans have the capacity to create and internalize **three kinds of “rules” or “if-then” relationships**.
 - A. Rules that describe the world’s unchangeable elements (Science)
 - If then descriptions of an apple
 - B. Rules that describe the effects of an individual’s (or a group’s) conduct on the future course of the world (Technology)
 - If then descriptions of the offering an apple to other people in various ways
 - C. Rules that can be used to assess the effects of possible actions (Ranking Rules).
 - If then evaluations of various ways to offer apples: adam and eve example
 - Ethics and other norms are one kind of type C rules—they are ranking rules—they describe what one should do to be “good” or to have “good” effects through one’s actions.
 - It is this relatively “small” aspect of culture that is focused on in the book.

(1) A More General Foundation for Rational-Choice-Based Analysis: *Homo Constitutionalus*

- An implication of the *Homo Constitutionalus model* is that rules of various kinds are internalized by individuals, and as this takes place their world view becomes shaped by those systems of rules. These systems of rules affect their behavior.
- Insofar as the rules include ethical rules and other guides for making decisions, norms affect—although they do not fully determine--individual behavior.
- Thus, a rational-choice-based analysis grounded in *Homo Constitutionalus* must incorporate the effects of ethical and similar rules into the “utility functions” used to characterize individual and group choices.
- **Ordinary idealists** are populate this book. They are motivated partly by ethical and similar rules and partly by practical or pragmatic interests.
- The relative influence of these two types of ranking rules reflect the degree to which a rule has been internalized and the practical rewards of a given choice setting.

(2) Social Dilemmas: The Perennial Problem of Humanity

A social dilemma occurs when an outcome is determined by the independent choices of two or more individuals (or two or more groups of individuals), and the outcome is one that is disadvantageous for all the persons or groups involved, despite the intention of each to achieve the best possible result for themselves (as determined by their ranking rules). Table 1.1 illustrates such a dilemma.

Although the game matrix makes the problem—what ever it may be—look obvious. In a setting with dozens, hundreds, thousands, or more individuals, the problems are rarely so obvious.

The dilemmas involve completely different circumstances, strategies, and people, and so rarely resemble others confronted in the past.

Yet, in another sense they are all fundamentally similar.

Table 1.1: A Simple Social Dilemma		
	Player Z Chooses Strategy A	Player Z Chooses Strategy B
Player Y Chooses Strategy A	(Y,Z) 3, 3	(Y,Z) 1, 4
Player Y Chooses Strategy B	4, 1	2, 2

(2) Social Dilemmas: A Plausible Solution

In the long periods of human history without productive governments, the most likely way that problems associated with social dilemmas—such as excessive conflict (Hobbes), excessive use of local natural resources (Hardin), under supplying local public goods such as village defense (Samuelson), and so on—**were solve was through the development of rules of conduct** (many of which would be regarded as parts of ethical systems) that ameliorated the problems confronted. This did not always require the groups affected to recognize the exact nature of the social dilemma in which they were trapped.

As a rule of conduct becomes internalized, individuals may feel virtuous when following the rule or feel guilty when they violate it.

When the sum of these effects is large enough (strongly internalized enough) they may dominate the pragmatic interests that generated the social dilemma.

If $v+g > 1$, the dilemma of 1.1 is solved, or at least ameliorated in cases like the one modeled. .

Table 1.2: A Simple Social Dilemma with Ethical Players

	Player Z Chooses Strategy A	Player Z Chooses Strategy B
Player Y Chooses Strategy A	(Y,Z) 3+v, 3+v	(Y,Z) 1+v, 4-g
Player Y Chooses Strategy B	4-g, 1+v	2-g, 2-g

(3) Social Dilemmas and Social Evolution

- (1) Not all ethical rules of conduct solve social dilemmas, but a subset do.
- (2) Those that do are more likely to be passed on from one generation to the next because such rules enhance a community's prospects for survival
- (3) In terms of political theory, this process provides a "mechanism" through which humanity can transition from a Hobbesian environment without rules (at the level of individuals and tribes) to a Lockean environment in which rules of conduct are internalized to some degree by all community members.
- At this point, the path to prosperity may open up. A bit of trade may take place, and customary laws may become routinized (albeit not always followed).

Steps to Prosperity Each Have Dilemmas

- The **first** step to prosperity is escaping from the Hobbesian Jungle.
- The **second** is solving the problems required for attractive settled communities to emerge,
- The **third** is for markets to emerge so that specialization which requires norms to incentivized and support the activities of voluntary exchange.
- The **fourth** is the creation of productive governments rather than extractive governments.
- The **fifth** is the accumulation and use of capital goods and human capital.
- The **sixth** is the encouragement of useful innovations.

- The book suggests that each of these steps requires solving a variety of new social dilemmas and sometimes revisiting old ones that had previously been solved.

Evidence

- The first two thirds of the book (Parts 1 and 2) explore the variety of social dilemmas that have to be overcome for trade to emerge and expand, including dilemmas associated with non-extractive governance.
- The last third (part 3) provides some evidence that norms changed in the seventeenth and eighteenth centuries in ways that would tend to promote economic development. (It uses quotes from philosopher-economists whose views of ethical conduct were mostly empirical to do so. In general, reservations about markets diminished and support increased during this period.)
- It also includes a bit of statistical evidence that democracies work best when they are supported by a subset of norms.

Medieval and Modern perspectives on trade

- From *Erasmus on the Nature of Merchants*
- But **the most foolish and basest of all others are our merchants**, to wit **such as venture** on everything be it never so dishonest, and manage it no better; who though **they lie by no allowance, swear and forswear, steal, cozen, and cheat, yet shuffle themselves into the first rank**, and all because they have gold rings on their fingers.
- Nor are they without their flattering friars that admire them **and give them openly the title of honorable, in hopes, no doubt, to get some small snip of it themselves**. (Erasmus 1532/1993, *The Praise of Folly*, KL 733–37).
- By 1920, the scope of commerce (rgdp) was widely used as an index of the goodness of societies.

Realizing Gains From Trade (w. transactions costs)

Table 3.2: Exchange Game with Transactions Costs, but without a Supporting Culture or Ethos			
		Ronald (Buyer)	
		Make offer	Do not
Douglas (Seller)	Accept Offer	(D, R) (2, 2)	(D, R) (-1, 0)
	Do not	(0, -1)	(0, 0)

Realizing Gains From Trade (with ethical or social support)

Table 3.3: Gains from Trade with Transactions Costs in a Trade-Supporting Culture or **with a Supporting Ethos**

		Friedrich (Buyer)	
		Make offer	Do not
Adam (Seller)	Accept Offer	(A , F) (2+V, 2+V)	(A , F) (-1 + V, 0)
	Do not	(0, -1 + V)	(0, 0)

Realizing Gains From Trade (fraud)

**Table 3.4: The Dilemma of Fraud with Pragmatic Sellers
(Erasmus' Dilemma? Akerlof Lemons Problem?)**

		Gordon (buyer)	
		Accept or solicit offer	Ignore all offers
Richard (seller)	Fraudulent offer	(R , G) (3, -3)	(R , G) (-1, 0)
	Honest offer	(2, 2)	(-1, 0)
	Do not make offers	(0, -1)	(0, 0)

Realizing Gains From Trade (avoiding fraud)

Table 3.5: Markets with Fraud but with Guilt from Fraudulent Behavior			
		Gordon (buyer)	
		Accept or solicit offer	Ignore all offers
Richard (seller)	Fraudulent offer	(R, G) $(3-G, -3)$	(R, G) $(-1-G, 0)$
	Honest offer	$(2, 2)$	$(-1, 0)$
	Do not make offer	$(0, -1)$	$(0, 0)$

Government and the Reinforcement of Norms

- Another possible solution to the problem of fraud and other crimes (e.g. immoral behaviors) would be to create an organization with coercive authority to impose penalties on those violating community norms.
- If such law-enforcing organizations were ever founded to “enforce the law” it was most likely to be customary (informal) law that was to be enforced.
 - Note that if law punishes “wrongful” conduct, there must be preexisting norms that characterize “wrongful.”
- **However, it is not easy to induce a law enforcing agency to actually enforce the law! To do so, various corruption dilemmas have to be solved.**

Government reinforcement of norms?

- Consider the problem of penalizing firm for making fraudulent offers.
- **A pragmatic law enforce would use his or her authority to extract “profits” from his or her position.**
 - He or she would take payments or profit sharing from those selling fraudulent products.
 - And, worse, he or she would tend to use threats of penalties to extort payments from honest merchants.
- **Why doesn't the law enforce simply accept a fraction of the profits as bribes (supplemental income) rather than enforce the law?**
- **The law and econ solution would be to add an anti-corruption level to the law enforcing organization, but this does not really solve the problem.**

Government Enforcement of Norms?

Table 6.3 The Enforcement Dilemma:
(Not) Enforcing Laws Against Fraud and Corruption (Bribery)

		Gordon (enforces anti-corruption law)	
		Enforce law	Accept bribe
Andrei (enforces anti-fraud law)	Enforces law	(A, G) S, S	(A, G) S, S
	Accepts bribe	$S + B - F, S$	$S+B/2, S+B/2$

Normative Solutions to Governance?

Table 6.4 An Ethical Solution to the Enforcement Dilemma:

Enforcing Laws Against Bribery and Fraud

		Gordon (now with virtuous law enforcing disposition) (enforces anti-bribery law)	
		Enforce Law	Accept Bribe
Andrei (enforces anti-fraud law)	Enforce law	(A, G) S, S+V	(A, G) S, S
	Accept bribe	S+B-F, S+V	S+B/2, S+B/2

Choosing among Political Economy Systems

- When one attempts to evaluate the relative merits of alternative political economic systems, the distribution of ethical persons in governments and markets should affect preferences over political economy systems.
- **The more trustworthy are governments, other things being equal, the more authority it should be delegated.**
- **The more trustworthy are markets, other things being equal, the less governments should regulate or interfere with normal market activities.**
- Ethical personnel are arguably more important in governments than in markets because one can substitute among firms far more easily than among governments. (On this **both Von Mises and Rawles agree.**) This leads to a table of “typical voter preferences” over institutions something like the following.

Choosing among Political Economy Systems

Table 8.2: Trustworthiness and the Ideal Political Economy System

		Moral Character of Governmental Policy Makers		
		Excellent	Mediocre	Poor
Moral Character of Market Participants	Excellent	Laissez-Faire	Laissez-Faire	Laissez-Faire
	Mediocre	Mixed	Laissez-Faire	Laissez-Faire
	Poor	Social Democracy	Mixed	Laissez-Faire

A Few Conclusions

- **The book argues that moral dispositions that solve social dilemmas can and do emerge, although not quickly, and that both markets and governments benefit from those dispositions.**
- Markets become more productive sources of material comfort, entertainment, and also more innovative, because of various norms that support specialization, capital accumulation, and innovation.
- Government employees become more trustworthy, and democratic governments may become less extractive and more productive.
- There are many dilemmas that have to be solved for this to occur, which explains why it took so long for economic progress to emerge.
- Some ethical systems do so better than others, which at least partially accounts for differences in the quality of governance and markets among countries at a given time and within particular territories through time.

Much more is in the book

- This concludes the talk.
- There is much more to the argument than sketched out here, and the book also provides a couple of kinds of empirical evidence.
- Some of that is of the traditional quantitative variety.
- The rest is based on evidence concerning changes in ideas about markets that occurred during the run up to the great acceleration of commerce in the 19th century in Europe, the US, and Japan.
- The latter suggests that capitalism—believe it or not—has moral foundations.