

Ethics and the Commercial Society

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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, F. A. (1979/2011-03-21).]

I. On the Extent of Markets, A Possible Ethical Explanation.

A. To a casual reader of economic history, it should be obvious that there is no single “market.”

1. Markets change through time and vary from region to region at every given time.
2. The simplest markets are local ones, with just a few services traded, as with barter among family members, friends, and fellow tribe members for services and other favors.
3. Early markets used money and traded homemade goods indirectly for others made nearby, often in the same village or river valley.
4. A subset of these markets, but not all, were linked with others and thus inter-regional and international trading networks emerged.
5. A subset of persons, although not all, have consumed products from all over the world for several thousand years. Goods from China are, for example, found in the tombs of Egyptian kings.

B. Economic historians note that the extent of long distance trade has varied through time, and also has varied among peoples and regions.

A. Nonetheless, until the nineteenth century, most people in most parts of the world produced the necessities of life for themselves.

1. Until very recently, most persons in most places were farmers or worked on farms, as they had for thousands of years.
2. Most commercial organizations were little larger than families and served little more than their villages.
3. Only a small fraction of humanity lived in the commercial society that characterizes “normal” life for the great majority of humanity today. The commercial society that we take for granted today.

B. Technology is part of the explanation for the emergence of the commercial society.

1. As transport costs fell, it became easier to ship items from one place to another.
2. Thus, trade has normally been more extensive near bodies of water than inland.
3. However, the extent of trade also varies along a shoreline. Other organizational technologies helped increase the size of “teams” that could be used to produce and distributed goods and services.
4. New rules and monitoring methods were developed, as with invoices, double entry accounting, assembly lines.
5. However, technologies are mobile and so potentially available everywhere at a given time, so technology cannot fully account for differences in the extent or effectiveness of markets among regions or nations at a given time.

- II. An alternative explanation is differences in the quality of formal institutions.**
- A. However, formal institutions may be regarded to be technologies.**
 - B. A formal constitutional document is shorter than this book and can be carried anywhere by a single person and, in principle, enacted.**
 - C. The body of civil law is somewhat longer than a constitution, but again the formal code for such laws can be packed up and shipped as easily as a box of pottery, which have been traded for thousands of years.**
 - D. Clearly, other differences are at work.**

III. The one explored in this book might be termed informal institutions or culture, namely differences in a society's distribution of internalized moral dispositions and norms.

A. These rules are not enforced through a central agency with a monopoly of force, but are rather passed on by families and friends and enforced with a decentralized series of rewards and punishments.

B. These incentives are often simply approval or disapproval, but rise to approbation and disapprobation in more extreme cases of virtuous and unvirtuous behavior.

1. This is not to say that one people in less commercialized societies are necessarily less ethical than those with extensive commercial societies.
2. It is to say that **differences in the internalized norms**--the rules for appropriate conduct-- partly account for the variation in the extent and pace of economic development among communities. institutions and public policy.

IV. Some Illustrations from Part II

Table 7.4: Markets with Fraud and Transactions Costs

		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)

**Table 7.5: Markets with Fraud and Self Esteem
from Virtuous Behavior**

		Gordon (buyer)	
		Accept or Solicit Offer	Ignore All Offers
Richard (seller)	Fraudulent Offer	(R ,G) (3, -3)	(R , G) (-1, 0)
	Honest Offer	(2+V, 2)	(-1+V, 0)
	Do Not Make Offers	(0, -1)	(0, 0)

**Table 7.6 The Shirking Dilemma
of Team Production (in Natural Cooperatives)**

		Harold (hours of effort)		
		8 hours	6 hours	4 hours
Armen hours of effort	8 hours	(A, H) 16, 16	(A, H) 14, 17	(A, H) 12, 18
	6 hours	17, 14	15, 15	13, 16
	4 hours	18, 12	16, 13	14, 14

Table 7.7 How a Work Ethic Reduces the Shirking Dilemma				
		Harold (hours of effort)		
		8 hours	6 hours	4 hours
Armen	8 hours	(A, H) 16, 16	(A, H) 14, 17-G	(A, H) 12, 18-2G
hours of effort	6 hours	17-G, 14	15-G,15-G	13-G, 16-2G
	4 hours	18-2G, 12	16-2g, 13-G	14-2G, 14-2G

- V. The first part of the book covers major proto-liberal scholars from 1500 through to the present that speak to the role of commerce in the good life and good society, arguing that between 1500 and 1900 there is a mild upward trend in assessments of the appropriate role of commerce.
- VI. It also examines twentieth arguments over the role of the state in markets. Some of that is covered in the chapter that you have read.

Table 11.2: Market-Politics Tradeoffs

Character of Democratic Policy Decisions

	Excellent	Mediocre	Poor
Excellent	Laissez Faire	Laissez Faire	Laissez Faire
Mediocre	Mixed	Laissez Faire	Laissez Faire
Poor	Social Democracy	Mixed	Laissez Faire

VII. One of the most controversial chapters is the chapter on ethics and economic development, the concluding chapter.

A. On the Possibility of Progress

- i. Neoclassical economics and most ethical theories were developed to explain and evaluate relatively stable social and economic systems.
- ii. There is 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.
- iii. There is no use of the word progress in Rawl's theory of justice. The word innovation appears just a single time.
- iv. Principles of justice emerge from a reflective equilibrium.
- v. Ethical principles are regarded as timeless by other philosophers as well.
- vi. It was in reaction to earlier equilibrium-based economic and ethical theories that Schumpeter suggested a new model of economic progress and Spencer developed his evolutionary theory of ethics.¹

¹ 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.

B. This chapter explores how ethical dispositions affect economic development.

- i. Ethics plays many roles in dynamic economic and social systems.
- ii. Ethics can provide an impulse for economic development insofar as innovations in ethical theories create new opportunities for exchange and team production.
- iii. Personal ethics may support innovation and experimentation.
- iv. Civil ethics may support laws and political institutions that allow or promote economic development or may attempt to retard them.

C. It bears noting that the notion of progress itself is partly an ethical concept.

- i. To say that change occurs is not to say that the results are good; many are not.
- ii. To say that at least some changes are good is to argue that such changes improve our character, or move us closer to the good or ideal society.
- iii. That such improvements are possible has long been recognized. Aristotle, for example, considers ethics to be a method of self-improvement.
- iv. Smith regarded the system of natural liberty to be an improvement over the medieval system that had previously characterized Great Britain.

D. The belief that commerce tends to improve the quality of life has been less commonplace, although part I of the present volume demonstrates that that too has long been held by at least a subset of educated persons.

E. That continual improvement is possible has been less commonplace.

- i. That innovation in a commercial society produces progress rather than degradation is partly a matter of one's conception of the good life.
- ii. If the good life is an active creative life, innovation will be praised and the stimulus provided by new opportunities enjoyed.
- iii. Innovators will be praised by such persons and innovation considered a praiseworthy activity.
- iv. However, if the good life is a life of stable patterns of life and thought, innovation may be regarded as a threat to the good life, rather than a complement to it.
- v. Challenges to one's private equilibrium in such cases will be unwelcome and innovators and innovators subject to disapprobation, rather than praise.

F. It also bears noting that Schumpeter's term "creative destruction" can be used to describe either the path to material comfort and longer lives associated with economic progress or a death spiral back to the short brutish and nasty lives of the Hobbesian Jungle.

Either can be consequences of innovation.

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]).

G. The Ethics of Innovation

- i. Both major and minor innovations routinely disrupt standing patterns of life, making many worse off at the same time that benefits are provided for the innovators themselves and their customers and input providers.
- ii. Innovations do not simply add another layer or more icing to a preexisting cake.
- iii. 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]).

- iv. This norm is violated every time a new product is successfully introduced, because such products nearly always reduce the income of persons producing rival products.
- v. 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.

VIII. For Innovations to be a praiseworthy, indeed legal activity, special rules have to apply to innovation that do not apply to other areas of conduct.

IX. Both utilitarian and contractarian theories of civil ethics provide possible answers to that question.

A. From the perspective of both utilitarian and contractarian analysis, what matters are the long term consequences of a series of innovations, rather than those associated with a single innovation.

- i. Is aggregate utility generally increased by a series of innovations, or not?
- ii. From a contractarian perspective, the issue is whether essentially all persons anticipate being better off as a consequence of a long series of innovation or not?
- iii. If so, establishing considerable liberty to innovate would be appropriate policy and innovation generally a virtuous and praiseworthy activity.
- iv. If not, the status quo ante should be protected and innovations banned.²
- v. Utilitarians and contractarians require that innovations generate essentially universal benefits for members of the community of interest.

² 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).

B. Other moral perspectives can also justify the process of innovation on procedural grounds.

- i. For example, if the essential features of civil law are accepted as Kantian universal rules, then behavior consistent with those rules is, by definition, moral or at least not immoral.
- ii. One may also stress procedural notions of proper behavior noting that both innovations the individual persons adopting them have engaged in voluntary, lawful behavior.
- iii. Such rule and procedural-based arguments, however, need to somehow distinguish between the damages imposed by innovators and those caused by thieves, arsonists, and murderers.

C. Ethics and the Politics of Innovation

- i. Either moral conclusion tends to affect the politics of regulation to the degree that such conclusions are taken into account by policy makers.
- ii. For example, if only innovations that harm no other person are allowed, as is the case for fires, then only relatively minor innovations would be deemed moral or worthy of political support.
- iii. 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.
- iv. However, a major innovation would affect the farming practices of the entire industry, which would affect demands for labor, capital, and land, changing prices and the distribution of wealth.
- v. There would be many losers from such innovations, and these might be banned.

D. Far less innovation and industrialization would take place in conservative societies in which internalized norms tend oppose either change itself or all conduct that harms others.

E. More would take place in societies where widely held normative theories favored change or creativity,

- i. This tends to be true in societies where utilitarian and contractarian theories are widely accepted
- ii. And, historical evidence of progress is clear.

X. Reducing Uncertainty: Innovations in Risk Management

A. Partly because of the uncertainties associated with innovation, a variety of public and private innovations created new methods of risk management and radical extensions of older ones.

- B. These reduced but did not, and cannot, eliminate the uncertainties of life in a commercial society.**
- C. That so many persons (but not all) around the world seek out commercial societies over more traditional societies, suggests that the uncertainties and other costs of a commercial society are far smaller than their benefits for many persons.**
- D. That some societies have more extensive markets than others is very likely to reflect differences in culture, especially those with respect to personal and civil ethics, both insofar as these directly affect actors in markets and insofar as they indirectly affect public policies and the institutional frames within which commerce takes place.**

Thank you for your attention.

