

Is economics still a branch of moral philosophy?

Paper for New Zealand Association of
Economists conference

June 2012

Geoff Bertram

- In this age of neoliberal ascendancy, mainstream economics has ceased to worry about the distribution of income and wealth and has become tolerant of monopoly, speculation, and other practices which were abhorrent to previous generations.
- Leading economists preach fiscal austerity in response to recession and unemployment and write heavy technocratic critiques of the welfare state

- History of thought has ceased to be taught in most major university economics departments, is accorded peripheral status at major economics conferences, and is not familiar to probably a majority of practising economists under the age of 35.
- The discipline today has (not for the first time) lost its moral compass and drifted into apologetics for the interests of money and power, at the expense of the welfare of ordinary people
- Postmodernist critiques, for all their general incoherence and lack of constructive content, do have an easy target

Modern economics was founded by moral philosophers

- David Hume and Adam Smith both came from philosophy to economics in the context of the Enlightenment
- Both were intrigued by the way the market system seemed to mimic natural laws and by its apparently superior power to create prosperity
- Smith's ideal market system was never the neoliberal dream of unfettered profit-seeking free from regulatory oversight

Smith saw a need for the “statesman” to

- Restrain the formation of business coalitions seeking to exercise market power at the expense of the general good
- Protect the weak and the poor against the rich and powerful
- Keep alive a clear vision of the social good – effectively a social welfare function – and be prepared to step in where markets failed to provide public goods
- Never get fixated on money values and balance sheets but keep a clear focus always on the real economy which is where the wealth of nations originates

Smith seems to me to have been surprised by the realisation of how the invisible hand operated to make self-interest useful

- His first book, *Theory of Moral Sentiments*, described and analysed the ways in which people are motivated to behave in matters involving
 - Moral values [here the impartial observer steps in]
 - Social relations with each other [here “sympathy” is the key]

The starting point for *TMS* is the empirical observation that there is more to human behaviour than just the pursuit of self interest

- “How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it....”
- Sympathy translates to social behaviour and action

So Smith's approval for *laissez faire* in the *Wealth of Nations* was pragmatic, not based on any principled appeal to the moral virtue of self-interest

- The fact that markets harness self-interest for the general good more effectively than other systems studied by Smith made self-interest instrumentally useful in the pursuit of the ultimate end: human prosperity and happiness
- But self-interest alone would perform this role reliably only under fully competitive conditions free of market power – i.e. without combinations (no limited-liability joint-stock companies, no cartels or monopolies, and definitely no business lobby groups leveraging political favours)
- And neither self interest nor profit had any moral status over and above their instrumental usefulness
- Sympathy and moral sentiments trump self-interest if we are seeking guiding principles for moral behaviour

- Sympathy raises immediately the issue of how to compare wants and feelings across individuals – interpersonal comparisons.
- Smith's approach was pre-Bentham and so not framed in terms of utility. It was bluntly commonsense:

“As we have no immediate experience of what other men [sic] feel, we can form no idea of the manner in which they are affected, but by conceiving what we ourselves should feel in the like situation. Though our brother is upon the rack, as long as we ourself are at our ease, our senses will never inform us of what he suffers. They never did, and never can, carry us beyond our own person, and it is by the imagination only that we can form any conception of what are his sensations.”

- The process by which an individual constructs in his or her own mind an emotional connection with what is going on in the mind of another Smith labels “sympathy”, and it is clear that he regards this as a faculty which individuals use to gauge the well-being of others.
- Equipped with this faculty,
 - not only can the individual be guided in meeting the demands of moral philosophy in everyday dealings with other individuals; but
 - the statesman similarly can intuitively grasp the impact of policies on the population affected by those policies, which is an essential step in applying moral principles of the public good to the art of government.

When government is captured by the interests of wealth and power, the statesman and sympathy are sidelined

- What replaces virtue and statesmanship are the “corruption of moral sentiments” and the self-aggrandisement of corrupted elites
- In the corrupted state, virtue resides at the bottom and corruption at the top:

At the bottom

- “in the middle and inferior stations of life, the road to virtue and that to fortune, at least, as men in such stations can reasonably expect to acquire, are, happily in most cases, very nearly the same. In all the middling and inferior professions, real and solid professional abilities, joined to prudent, just firm and temperate conduct, can very seldom fail of success ... The good old proverb, then, that honesty is the best policy, holds, in such situations, almost always perfectly true.” (TMS p.63).
- Thus the forces of the competitive market operate to reward and promote virtue in the mass of humanity.

At the top

“In the courts of princes, in the drawing-rooms of the great, where success and preferment depend, not upon the esteem of intelligent and well-informed equals, but upon the fanciful and foolish favour of ignorant, presumptuous, and proud superiors; flattery and falsehood too often prevail over merit and abilities. In such societies the abilities to please, are more regarded than the abilities to serve. The external graces, the frivolous accomplishments of that impertinent thing called a man of fashion, are commonly more admired than the solid and masculine [sic] virtues of a warrior, a statesman, a philosopher, or a legislator. All the great and awful virtues, all the virtues which can fit, either for the council, the senate, or the field, are, by the insolent and ignorant flatterers, who commonly figure the most in such corrupted societies, held in the utmost contempt and derision. “

Capture of government by business is bad news – especially given Smith’s critique of mercantilism in *Wealth of Nations*

“The capricious ambition of kings and ministers has not, during the present and the preceding century, been more fatal to the repose of Europe than the impertinent jealousy of merchants and manufacturers. The violence and injustice of the rulers of mankind is an ancient evil, for which, I am afraid, the nature of human affairs can scarce admit of a remedy. But the mean rapacity, the monopolizing spirit of merchants and manufacturers, who neither are, nor ought to be, the rulers of mankind, though it cannot perhaps be corrected may very easily be prevented from disturbing the tranquillity of anybody but themselves.” [emphasis added]

From Smith to the welfare state

- Smith certainly was strongly critical of actually-existing governments which failed to respect “the great and awful virtues” of the statesman
- But he was absolutely clear that “the sovereign” [implicitly Plato’s philosopher king] had duties to perform, and he produced a charter of these in *WoN Book IV Ch9*

“All systems either of preference or of restraint, therefore, being ... completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society. According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expence to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.” [emphases added]

The neoliberal [mis]reading of this passage is the minimalist state

- Defence, “law’n’order”, and some infrastructure, are all they see there.
- “Administration of justice” is stripped down to the barest minimum: protection of private property, punishment of crimes against property and persons, and enforcement of contracts.
- None of these appear in Smith as matters of fundamental principle – they are simply the institutional infrastructure without which the invisible hand and the market cannot operate effectively
- And this is not what Smith had in mind when talking of administration of justice and the “system of natural liberty”
- The words “protect every member of society from the injustice or oppression of every other member of it” extend almost inevitably to issues such as abolition of slavery, rights of women, regulation of monopoly, and redistribution of income and/or wealth.

Smith's crucial precondition for the system of natural liberty to prevail

- “All systems either of preference or of restraint” must be “taken away”
- Every person must operate within “the laws of justice”
- The sovereign is responsible for protecting every citizen against “injustice or oppression” – what more recent writers call “predation”

The welfare state is a Smithian construct

- To remove all trace of “preference”, the income distribution across classes and across individuals must be in accord with some underlying scheme of justice in distribution.
- To remove all “restraint”, it is necessary to prevent or countervail any exercise of market power which impinges upon the efficient allocation and productive use of resources, as well as to end those government interventions which are designed to benefit particular vested interests at the expense of the nation as a whole.
- Income redistribution and market regulation become preconditions for establishment of Smith’s “system of natural liberty” in any setting where the existing distribution of wealth is unjust or where monopoly imposes allocative inefficiency on markets.
- Add in the need for public goods such as health and education to be provided by the sovereign, and we are in the twentieth century

So:

- the modern subject of political economy founded by Hume and Smith combined a long tradition of western moral philosophy, inherited and adapted to a secular world view in the Enlightenment, with the application of practical reason to issues of the creation of wealth, setting of prices, and consequences of particular policy interventions, in the context of a capitalist market economy.
- The platonic concept of a public good, aligned with and defined by precepts of wisdom and virtue, and pursued by “statesmen, warriors, philosophers and legislators”, served as the benchmark against which market outcomes and individual behaviour could be evaluated.
- The defence of individual freedom, private property rights, and self-interested behaviour, relied upon the pragmatic functionalist judgment that these things were socially productive.
- The willingness to contemplate government intervention in economic matters was similarly pragmatic; Smith’s tendency to lean against such intervention in practice was not a matter of moral principle but simply a deep-rooted distrust of people in authority in the corrupted state
- Insofar as modern economists are (or seek to be) intellectual heirs of Smith, thus, their subject’s moral dimension consists in a programme of assessing economic outcomes and policy proposals against a general conception of the public good, with no preconception for or against but with a pragmatic focus on the evidence of actual behaviour and outcomes.

Smith's open-minded pragmatism harnessed to a clear moral vision is completely at odds with the dogma-based opinionising that pervades much current economic discourse

- The dramatic increase in inequality of incomes and wealth in western capitalism since the 1970s, and the accompanying rise in power of the rich over government, would fall foul of Smith's critique of the corruption of moral sentiments
- But much of our profession is [profitably] engaged in fawning upon wealth and power, despising poverty, and giving comfort to those bent upon destruction of the welfare state and slashing-back of the role of government and the statesman in human affairs
- The implicit moral position behind this, insofar as it exists, is pre-Enlightenment, rooted in doctrines of sin and redemption and unthinking respect for power and authority

The twentieth century started with the hope of a coherent moral philosophy to guide economic policy

- Classical utilitarianism had provided the basis for the neoclassical revolution
- One key result was to produce an answer to nineteenth-century socialism and Ricardo's political economy, both of which had used a class analysis featuring the power of capital over labour and the idea that labour was exploited
- The neoclassical answer was the marginal productivity theory of income distribution
- This might explain the distribution of factor incomes across land, labour and capital (allocative efficiency) – but it did not ensure utility maximisation, which was the utilitarians' guiding principle.

- Each individual's utility, in the neoclassical account, increases with income, but at a diminishing rate (diminishing marginal utility).
- If all individuals have the same utility functions, then a rich person gets less additional utility from a dollar than a poor person.
- Therefore, as Pigou pointed out in his 1920 *Economics of Welfare* (pp.89-91), the maximum utility of society as a whole will be reached when the distribution of income is completely equal.

- Wages, profits and rents might be set by the market, but the resulting distribution of the social product would not be optimal if it involved inequality across individuals, unless the rich and the poor had very different utility functions (what Pigou referred to as “temperaments”).
- So unless each individual had an equal share of society’s total land, labour, capital, and talent, and thus earned the same amount as every other individual, social welfare would be improved by taxing the rich and transferring the money to the poor until the income distribution reached full equality.

This presented an awkward policy choice

- Either capital and land would have to be redistributed so that each unit of labour had an equal share in all factor incomes (the socialist programme)
- Or income would have to be redistributed after its allocation to the factors of production
- The welfare state averted the first by undertaking the second
- The result was a mid-twentieth-century golden age of relative equality combined with prosperity and growth, from 1945 to the 1970s

This outcome was extraordinarily unwelcome to the rich.

- And, of course, for any economist inclined to admire and respect power and wealth (as distinct from wisdom and virtue) there was immediately an intellectual challenge: to restore the moral legitimacy of the possession of wealth by the rich, and of their resistance to taxation to finance a welfare state.
- Robbins and Hicks obliged: the ‘impossibility of interpersonal comparisons’ provided an alibi for the profession to abdicate from judgments on distribution and stick to the safe ground of pareto optimality
- No policymaker can with certainty undertake any redistribution of income within society in the name of raising social welfare, because there is no scientific way of measuring, and hence no way of proving, any such increase. So far as modern neoclassical economics is concerned, the rich are secure in their wealth because there is no scientifically-valid way of challenging the status quo, and no “scientific” basis for criticising transfers of wealth from poor to rich.

There's a flip side to this, of course

- Under the Robbins rule, it is impossible to prove that a revolutionary overthrow of the ruling elite, and seizure of society's wealth by the poor, involves any reduction of social welfare; it may well increase welfare. If economics cannot measure social welfare, one has to resort to other criteria to judge whether any particular income and wealth distribution is better than any other.
- But most economists from the 1930s until the 1980s (and most textbooks) adhered to the general view that judgments on matters of distribution were essentially political, to be made through the political process
- This enabled economics textbooks to dress economics up in logical-positivist clothing, in an era when that methodological position was hot.

Then came cost-benefit analysis

- After the ordinalist victory, the core theory of neoclassical economics had nothing philosophically-solid to say about the optimal distribution of income and wealth
- Yet at the same time the use of cost-benefit analysis was spreading around the world
- Most of the important policy questions of the 1960s involved winners and losers, and hence changes to the income and wealth distribution
- At this point any thought of a moral compass was set aside in favour of the measuring-rod of money.

Into the moral vacuum stepped Arnold Harberger

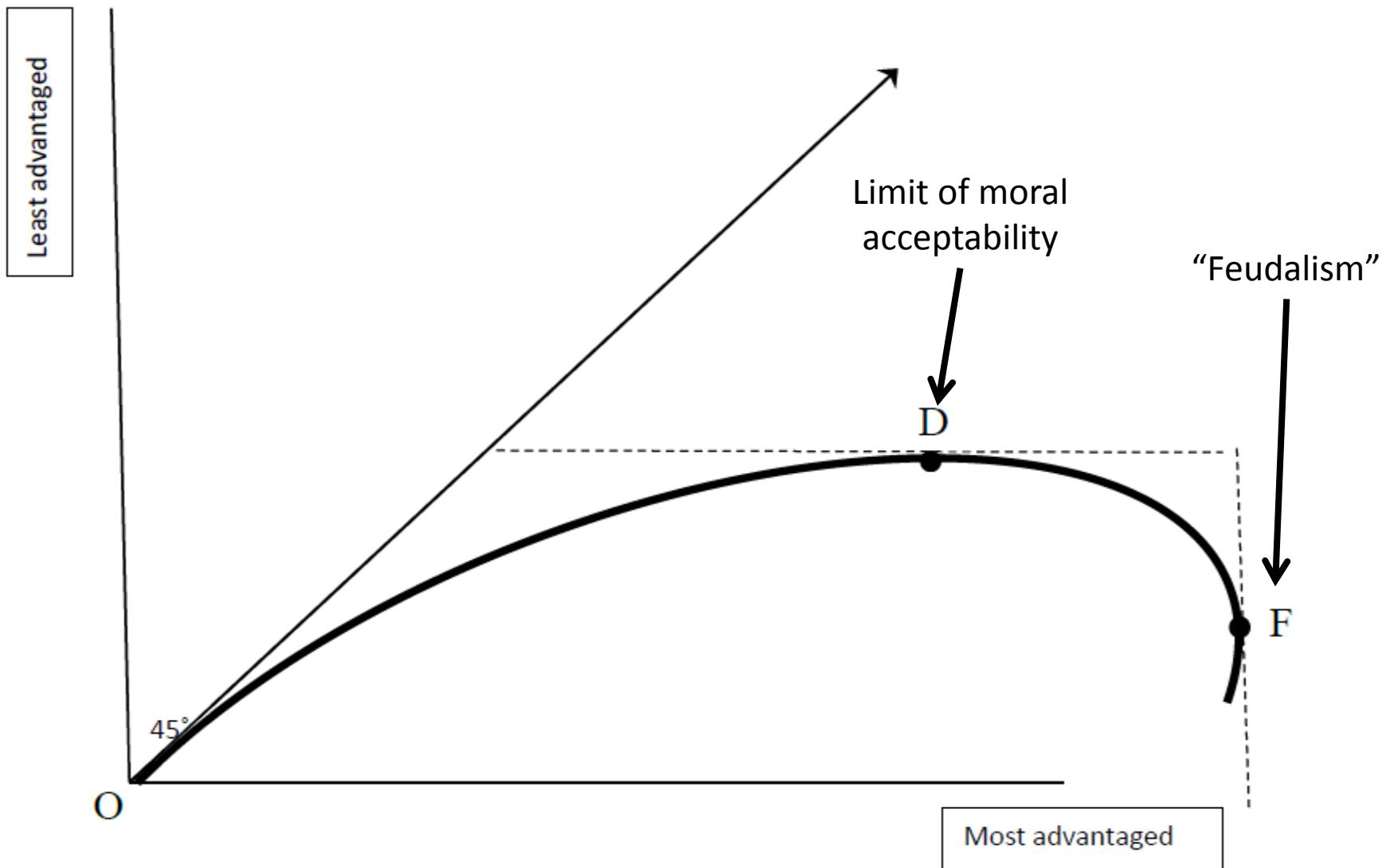
- “I have discussed only the welfare effects of resource misallocations due to monopoly. I have not analysed the redistributions of income that arise when monopoly is present. I originally planned to discuss this redistribution aspect as well, but finally decided against it.” (Harberger 1954 p.87)
- He gave no reasons for this decision, but relegated the issue of redistribution to “my more metaphysically inclined colleagues”.
- In 1971 Harberger argued directly for dropping distributional matters out of the analysis

- “when evaluating the net benefits or costs of a given action (project, program, or policy), the costs and benefits accruing to each member of the relevant group (e.g. a nation) should normally be added without regard to the individual(s) to whom they accrue”.
- Harberger’s aim here was pragmatic: to encourage economic analysts to press ahead with the task of estimating empirically the consequences of various alternatives, setting aside difficult and complex issues such as distribution which might otherwise bog the analysis down.
- This involved abandoning any claim that economics could answer moral dilemmas.
- Harberger’s fundamental line of argument for setting income redistribution aside was that economists have nothing to say on distributional matters: “the economist as such is not professionally qualified to pronounce, and ... one economist is not professionally qualified to check the opinion of another”
- So even though redistributive effects might well dominate the final policy decision, economists had nothing to contribute professionally to that aspect of the decision

- Harberger nowhere suggested that economists should press upon policymakers a professional view that distributive effects are unimportant, or that policymakers ought to ignore distributive matters simply because economists had no means of reaching a professional consensus.
- He just thought that “giving equal weight to all dollars of income is mathematically the simplest rule.” (1971 p.787) and that economists should stand back and allow others to reach informed judgments on matters of redistribution.
- Adam Smith could have lived with this.
- But many economists have ignored or forgotten Harberger’s point.

- The failure of the original neoclassical welfare-economics project to build a basis for normative policy judgments from the ground up, on the basis of utility theory, should have forced economists
 - either to come up with something better,
 - or to return to the ground occupied by Adam Smith two hundred years before, taking moral principles from the philosophers and juxtaposing them against observed economic behaviour, thereby enabling the policymaker (assuming he or she is a Smithian “statesman”) to determine when the outcomes of market forces are morally unacceptable, and to seek advice on how those outcomes can most effectively be modified by policy (whether legislation or regulation).
- Instead the profession has dug itself into a moral hole and now is busy “defending the indefensible”
- The inheritor of Smith’s mantle in the late twentieth century was not an economist but the philosopher John Rawls, with his theory of justice

Rawls' Diagram



The Rawlsian perspective does give the “statesman” some ground on which to stand

- The maximin test is a valuable piece of the toolkit but still requires sympathy to be exercised in tune with the precepts of moral philosophy
- But Rawls’ position is arguably too sweeping in its claim to uncover a universally-valid “just society”
- Sen has recently argued that there is more to be gained from exercising sympathy at the margin to identify which changes are for the good and which are not, than from trying to get clear, cross-culturally valid answers from behind the “veil of ignorance”
- But Sen and Rawls would agree that moving from D down to F – the descent into feudalism – is morally a mistake
- Adam Smith would agree
- Neoliberal economics and its total surplus standard has no ground to stand on that would pass muster in a moral philosophy debate

Conclusion

- Economists have no special advantage over other human beings in forming moral judgments. But that is no excuse for philosophical and ethical illiteracy, or for ignorance of the discipline's past efforts to resolve its moral dilemmas.
- Good economics always requires a dialectical interplay between the “scientific” and the moral dimensions. Technical and mathematical brilliance cannot give satisfactory answers to moral questions. The concept of “efficiency” is not an adequate smokescreen for abdicating from moral discourse while subverting the efforts of others to bring moral intuitions to bear on policy matters.

Smith (1776), Marshall (1890) and Sen (2010) all harnessed their economic analysis to aspirations from moral philosophy

- Marshall: “No doubt men, even now, are capable of much more unselfish service than they generally render: and the supreme aim of the economist is to discover how this latent social asset can be developed most quickly, and turned to account most wisely. ”
- Sen: “what moves us, reasonably enough, is not the realization that the world falls short of being completely just – which few of us expect – but that there are clearly remediable injustices around us which we want to eliminate.... The identification of remediable injustice is not only what animates us to think about justice and injustice, it is also central ... to the theory of justice.”