ethics in economics

a critical thinking approach

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PART I – MORAL FRAMEWORKS

Why should moral inquiry be a part of the economist's toolkit? The answer is simple: the subject matter of economics involves individuals making decisions within a social environment. Even the "greatest ruffian, the most hardened violator of the laws of society" is not altogether without social feelings, as noted by Adam Smith, the founder of economics.[1] Choices in economics are often framed by social relations and governed by different types of ethical norms and viewpoints.

The cases presented in this book demonstrate that while economic actors are sometimes correctly portrayed as *homo economicus*—socially isolated and morally disinterested egoists—a significant number of economic interactions are governed by expectations of ethical conduct that go far beyond enlightened self interest. Human nature may equally well be portrayed by what science writer Matt Ridley calls *homo empathicus*—a socially-embedded person who engages others. What exactly this means we will explore.

In this opening chapter we begin by reinforcing the point that ethics is an integral part of doing economics, in both its positive and normative dimensions. Subsequent chapters deal with the three main frameworks for understanding ethical behavior: through outcomes, duties and rules, and character and virtue. Any organizing typology such as this will encounter problems along the way—namely, that ethical practices blur the lines between them—which leaves us in the end to argue for a pluralistic approach to ethics.

[1] Adam Smith, *The Theory of Moral Sentiments.* D.D. Raphael and A.L. Macfie, eds. Glasgow Editions (Indianapolis, IN: Liberty Press, , 1982 [1759]).

Chapter 1

Why Ethics Matters

Economics is thought to rely on the hardheaded calculation of rational self-interest; ethics is often portrayed as mushy do-goodism. Is there any useful connection between these subjects? This book makes the central bonds between the two clearer, and shows why good economics may rely on good ethics, and vice-versa.

1.1 ETHICS IN ECONOMICS

O.J. Simpson—a flamboyant former professional football star and actor—was acquitted of double homicide in one of the 20th century's most contentious jury trials. In 2006, publisher Rupert Murdoch planned to release Simpson's quasi-autobiographical account, *If I Did It*, of how he "might" have killed his ex-wife, Nicole and Ronald Goldman. The public reacted to this news with outrage, and the book and related television show were ultimately canceled (see Figure 1.1).

Figure 1.1

Oliphant
November 21, 2006 (republished in RTD Nov 25, 2006, p. A9
http://www.gocomics.com/patoliphant/2006/11/21/

But why should there be outrage? Many people wanted to read the book! Those that did not would not be forced to buy. Standard economic logic would say that efficiency is enhanced when consumers get to buy the products they want and can afford. So what was the problem? Clearly, a majority of citizens were repulsed by the fact that Simpson and his publisher were attempting to cash-in on his celebrity status as a potential murderer. Simpson's flirtation with a blockbuster confession was morally repugnant because *moral norms were being violated.*

Moral norms change, of course, so what was considered morally outrageous in one time period (buying and selling on Sundays) is now widely accepted in the United States. And an action that was perfectly acceptable in an earlier time (buying and selling slaves) is now considered abhorrent. Markets operate within a moral ecosystem—but that environment is not well understood by economists. This book develops the notion that **ethical reasoning** is as essential for economists as it is for anyone else seeking a liberal training—that is, an education that prepares one to address complex, diverse, and changing problems in real-world settings. Economists will do a better job understanding markets and policies if they know something about ethical theory and its evolution within and outside the discipline.

Ethics Defined

There are many ways to define what is meant by **ethics**. One working definition is:

> *Ethics is the study of one's proper interactions with others: it is the analysis of right and wrong.*[2]

Ethical beliefs and practices constitute a vast and unseen institutional force. A famous example is the generous tip that a satisfied traveler leaves at a highway restaurant—an eatery to which she never intends to return. Why would anyone leave a tip in this case—when there is no expectation of future economic return?

> The typical diner shrugs and says it is customary or traditional to show generosity for good service and giving a tip is simply the "right thing to do." However, we can imagine deeper answers than this. Economic actors may leave a gratuity because they are *altruistic*; or, diners may not want to incur the social *stigma* of not tipping; or, they may believe that they have a *duty* to act in certain ways; or, they self consciously act in ways thought to be *virtuous*.

Of course, not everyone tips, so the simplistic account of the economic actor as *homo economicus*—a selfish miser—is correct much of the time. But the "economic actor" model cannot help us understand why O.J. Simpson's book was booed out of the market before production, nor can it help us explain generous highway restaurant tips.

The greatest distinction between humans and other animals is not our rational minds, Charles Darwin argued, but our moral capabilities which allow us to cooperate. These capabilities are honed instinctual responses. In his conclusion to *The Descent of Man* (1871), Darwin noted that:

> Any instinct, permanently stronger or more enduring than another, gives rise to a feeling which we express by saying that it ought to be obeyed.[3]

The social instincts work initially through the human capacity to sympathize with others, but are strengthened by instruction, exercise, and habit. Ethical beliefs and practices make up the formal

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[2] Some philosophers draw distinctions between the terms "ethics" and "morality." Here we use the terms interchangeably.

[3] Charles Darwin, *The Descent of Man* (New York, NY: D. Appleton and Company, 1871). Accessed at: http://books.google.com/books.

and informal rules that generate trust, promote interdependencies, and spur work productivity in a myriad of ways. In everyday economic life there is a vast grey area in which economic behavior is shaped by these social instincts and unconscious moral constructs.

The cover of this book illustrates the forces at work. Norman Rockwell painted "Freedom From Want," in 1943 as the country was pulling out of the Great Depression and fighting wars on two fronts.[4] It highlights the desire for material outcomes (the large turkey) yet also demonstrates a commitment to concepts that go beyond the individual, in the sharing of sympathies and mutual sacrifice. Everyone who sits at the table implicitly accepts the ethical mores of life in a social group, which extends to consideration of the nation and one's civic duties. People are bound together in a shared endeavor and celebrate togetherness in ritual feasts like Thanksgiving. Although people may be selfish, they restrain themselves because of ethical commitments that do not fully rely upon a calculation of gains and losses.

Adam Smith, the founder of modern economics, wrote *The Theory of Moral Sentiments* (1759) to model the process by which instinctive human nature is socialized for cooperation. Empathetic man is the one Darwin relied upon in writing about human evolution. Smith also wrote in *The Wealth of Nations* (1776) about the **invisible hand** of the market; few realize that trust and ethical norms—derived from moral sentiments—were essential components for making trade work without the heavy hand of government.[5] Chapter 10 elaborates on the psychology and ethics of sympathy.

Hidden Ethical Currents

The danger of taking too narrow an economic approach can further be illustrated by the metaphor of a sailing ship. Let us reflect: *"What moves a sailing ship?"* If you answered, "The wind"—congratulations, you got it partly right. But any savvy captain would say the real world is more complex. There are also powerful tides and currents that it would be foolhardy to ignore. Historically, tides and currents have directed trade, determined which countries were colonized, which products were traded, and determined when ships came into or out of port (see Figure 1.2). The wind is the most visible answer to the question "What moves a sailing ship," but it is by no means a complete or satisfactory answer.

Similarly, if we ask, *"What moves economic actors?"* the answer of "rational self interest" gets a definite check plus! It is a powerful answer essential for any social observer to emphasize. But that answer is incomplete—at times useless to the task. If running a complex business can be equated to sailing a ship, standard economic models rely only on one motivating force—the wind of enlightened self-interest. However, powerful social forces also act on human behavior, and many of these relate to how humans interact in groups.

The study of ethics in economics offers a complementary understanding of hidden currents and tides that also move actors on the commercial stage—workers, suppliers, managers, and

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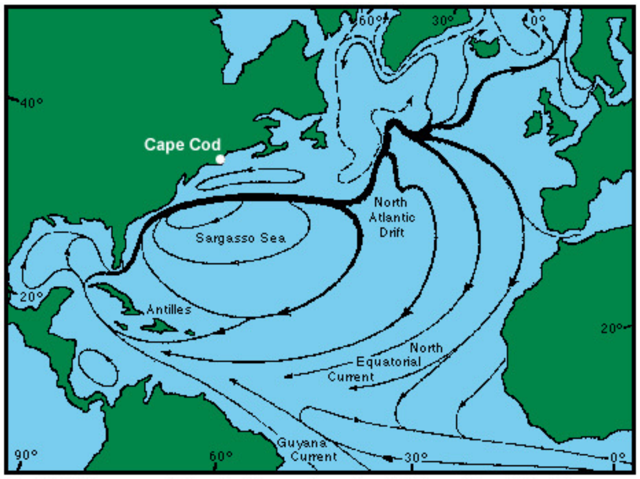
[4] The painting is part of a series published in *The Saturday Evening Post* in the early 1940s. The other paintings are "Freedom of Speech," "Freedom From Fear," and "Freedom of Religion."

[5] For elaboration, see Jonathan B. Wight, "The Treatment of Smith's Invisible Hand," *The Journal of Economic Education* 39(3)(2007): 341-358.

customers. Ethics provides the "institutional framework" within which economic activity unfolds. The biographies of great entrepreneurs show that they often hold complex motives and inspire others for a variety of reasons. Many technological breakthroughs of the 20th century, for example—relativity, computing, DNA, television, and the Internet—were driven by entrepreneurs with non-pecuniary motives.[6] Non pecuniary motives may relate to internal intentions or they may relate to social rewards of esteem and fame. In either case, ethical behavior is intertwined with concepts of personal meaning and social acceptance.

Figure 1.2: The Gulf Stream Currents[7]



The Gulf Stream relative to the surface circulation of the Atlantic Ocean. The Stream contains water from the equatorial current system (mostly from the Caribbean/Gulf of Mexico) and water recirculated in the North Atlantic subtropical gyre. The dashed lines denote cool currents.

Resurrecting the Link between Ethics and Economics

Like ethics, economics is also a branch of moral philosophy going back to Plato and continuing through Adam Smith in the Enlightenment. Here is a quick example of why the two philosophies are intertwined: If you were told that a child of 8 years of age could better fit into a coal mine shaft than a grown person, and working that child 14 hours per day could increase mine productivity substantially, would you support making child labor legal?

If you recoil in horror at this thought, it is because your *moral imagination* has been aroused. You can't conceive of such an inhumane policy in this time and place. Regardless of the gain to economic efficiency, other important considerations would likely outweigh it (e.g., the child's long run welfare). Even ignoring such outcomes, you might ask whether child labor violates certain fundamental human rights. In short, when considering public policies we often rely on unconscious and implicit considerations of ethics in economics. This book intends to make that practice more deliberate and less obscure.

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[6] John Kay, *Culture and Prosperity: The Truth About Markets—Why Some Nations Are Rich But Most Remain Poor* (New York: HarperBusiness, 2004).
[7] From http://www.newenglandburialsatsea.com/wp-content/uploads/2009/06/currents_route.jpg.

An economist might reply that *of course* moral norms affect the implicit rules operating in markets and public policies. But an economist might go on to say that these moral norms can be *assumed constant* when making predictions and advising on policy recommendations. For example, can't one assume the existence of child labor laws, private property rights, a democratic system, and so on? Since these "constants" rarely change there is no reason to add them into the analysis. In this view, ethical considerations may make interesting fodder for conversation but they are irrelevant in building economic models—and they can be excluded on the grounds of parsimony.

This argument falls short in several ways. First, the standard preconditions (good property rights, basic human rights, and so on) hold true only for the approximately 1 billion people living in today's developed democracies. These preconditions are tenuous or non-existent in many of the world's other societies. If economic analysis is to have scientific validity beyond the borders of developed countries, the nature of underlying institutional frameworks (including moral norms) must be uncovered.

More importantly, many developed world economists routinely provide advice to developing countries. If ethical institutions are ignored because they are thought to be irrelevant, advice can go badly awry. Economic policies themselves can change the moral norms in society. In advocating policies, economists may unwittingly also change norms.

The thesis of this book is that economics should be studied within an ethical framework. The hypotheses that underlie this view are that:

1) Science progresses better when practitioners adhere to basic ethical norms of truth-seeking and honesty.

2) Economists can understand and predict outcomes more effectively when they consider the role of ethical beliefs and commitments (e.g., can do better **positive economics**); and

3) Economists can provide sounder policy advice when analyzing a broader ethical framework (e.g., can do better **normative economics).**

In summary, economists should be careful about what we think we know about the world—and even more careful in recommending policies—if the ethical landscape is unexamined.

BOX 1.1: POSITIVE AND NORMATIVE ECONOMICS

Positive economics is the study of the economy as it currently exists (e.g., the discernment of facts). Positive economics is also used to make predictions about the impact of changes to the economy based on models or theories about how the world works. Positive statements of prediction take the form, "*If* this action is taken, then *this* would be the outcome."

Normative economics entails a judgment about the kinds of actions that *ought* to be taken.

As shown later in this book, the division between positive and normative economics is not precise. It is not possible to develop a science of facts and objective theories alone because value judgments play a critical role in the selection, collection, and analysis of information. In addition, the act of conducting research can change the facts producing ethical repercussions.

END BOX

The "economic way of thinking" is purported to be scientific reasoning, as espoused by many 20th century economists. George Stigler, who won the Nobel Prize in 1982, opined that: "The basic role of the *scientist* in public policy, therefore, is that of establishing the costs and benefits of alternative institutional arrangements."[8] In this statement Stigler adopts a particular moral framework (e.g, that only consequences matter) and a particular moral standard about evaluating consequences (e.g., emphasizing those that can be quantified through dollar costs and benefits). "[E]conomics is finally at the threshold of its golden age," Stigler wrote in 1965.[9]

His pronouncement was prophetic, as the methods of economists soon overran the fields of political science and sociology, and made significant inroads in law and philosophy. But in a larger sense, as economics spread across other subjects, the discipline has also drawn inwards in terms of the questions and methods considered. In short, economics became less an active participant in a liberal education.

1.2 LIBERAL EDUCATION

Virtually all public policy problems cross disciplinary boundaries and raise substantial normative questions. A liberal education requires stretching one's critical thinking skills in ways that are only partially addressed by traditional methods in economics.[10] What it means to "think like an economist," for example, contains a hefty dose of implicit ethical judgment. In a liberal arts setting, the economic worldview should be examined and debated as a way of integrating knowledge with its sister disciplines in political science, philosophy, psychology and other fields.

Shockoe Bottom site of Lumpkin's Jail—is called the "Devil's Half Acre." This is just north and east of the downtown train station, and is today a nightclubbing area.

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[8] Stigler, George. 1965. "The Economist and the State," *American Economic Review* 55(1/2)(March), p. 2 (emphasis added).

[9] Ibid., p. 17.

[10] "Liberal" is used in its classical sense, not in a modern political meaning. See Jonathan B. Wight, "Moral Reasoning in Economics," in David C. Colander and KimMarie McGoldrick, eds., *Educating Economists: The Teagle Discussion on Re-evaluating the Undergraduate Economics Major (Edward Elgar, 2009).*

In the 1840s and 1850s, slave trader Robert Lumpkin operated one of the largest auction sites for human beings in the Shockoe Bottom district of Richmond, Virginia. Hundreds of thousands of Africans were sold to bidders with prices determined by supply and demand. The slaves, forcibly separated from families, were marched in shackles over the James River and onto boats at the dock, literally "sold down the river."[11]

That practice only ended with America's Civil War (1861-65). Historical artifacts from that period such as belt-buckles and bullets are eagerly sought by collectors. During the late 19th and early 20th centuries, however, Virginians distanced themselves from those unhappy memories by pushing economic development in place of remembrance. Lumpkin's jail and other historical sites were (literally) bulldozed and concreted-over in the name of progress.

In a similar way, economists of the 20th century pushed aside the legacy of classical political economy and its conversation about policies and ethics. In doing so, the hope was to build a more scientific discipline. The result, however, in the words of Nobel laureate Amartya Sen, was that "modern economics has been substantially impoverished by the distance that has grown between economics and ethics."[12]

Today, however, a resurrection of historical memory is underway, both metaphorically in economics and quite literally in terms of Richmond's past slavery. The excavation of a slave burial site may require that coffins and artifacts be carefully revealed and other constructions moved or altered to accommodate the process of historical archeology. This raises the costs of doing business but it is generally accepted as the price paid for getting history right—for creating an accurate meaning of who we are today.

Understanding the world we live in requires dealing with the messy and often unpleasant implications of slavery. In a similar way, a liberal education requires understanding the moral frameworks that lie beneath the surface of modern economic theory. Excavating the history of economics and ethics is one way to start. As an example, five Nobel laureates in economics recently pushed for a more nuanced approach to dealing with human welfare.[13]

1.3 LOOKING AHEAD

Economists implicitly use ethical frameworks and theories in doing research whether they are conscious of it or not (Chapter 2). At the most basic level, science requires shared moral norms and the acceptance of ethical duties and ideals, such as honesty (Chapter 3). Moreover, economists often unconsciously accept the ethical assumptions and worldview upon which the discipline is built.[14]

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[11] David Zucchino, "With Unearthing of Infamous Jail, Richmond Confronts its Slave Past," *Los Angeles Times* (December 18, 2008).
[12] Amartya Sen, *On Ethics and Economics* (Oxford: Blackwell Publishing, 1988), p. 7.
[13] Joseph E Stiglitz, Amartya Sen, and Jean-Paul Fitoussi. *Report by the Commission on the Measurement of Economic Performance and Social Progress,* 2009.
[14] Thomas Kuhn, *The Structure of Scientific Revolutions* (Chicago, IL: Univ. of Chicago, 1962.

Economists, for example, adopt a particular ethical viewpoint when arguing that the economic system should be evaluated on the basis of the *outcomes* produced (Chapter 4). Going further, economists often identify a *single* desired outcome, **economic welfare**—which consists in maximizing the net economic value created through trade (Chapter 5). Economic **efficiency** is the measure of how well this goal has been achieved. Many economists are blissfully unaware that this approach, and the cost-benefit analyses that rely on it, use highly controversial ethical precepts (Chapters 6 and 7). Indeed, many economists maintain that they don't rely on ethics at all! This last point is most troublesome, because if efficiency is viewed simply as a "fact" instead of as an evaluative measure, it creates wide intellectual blinders for anyone doing public policy work. Further chapters bring out these points through examples and cases.

In contrast, many economists subscribe to the view that "economics isn't defined by its subject matter but by its way of thinking."[15] This is only partially true. By defining economic efficiency and social welfare to mean a *particular* thing, economists are explicitly choosing a subject matter and a related moral philosophy. The baggage of implicit moral judgments in economics must be subject to scrutiny. You would not let someone on a plane without checking the contents of their carry-on, and economics education should be no different. We should unpack and examine the ethical framework that informs the standard economic approach. The argument that "everyone does it" and therefore the standard view has legitimacy for that reason, seems weak to any questioning mind.

One purpose of this book is therefore to demonstrate that standard economics relies on a set of normative values. It is important to bring these unconscious norms to light. Ethical considerations are often avoided by economists who are concerned about introducing ambiguity into the seemingly objective predictions and recommendations of economics. But again in the words of Amartya Sen:

> An economic analyst ultimately has to juggle many balls, even if a little clumsily, rather than giving a superb display of virtuosity with one little ball [e.g., efficiency].[16]

The complexities of ethics in markets cannot be introduced all at once. Rather, teaching about ethics in economics is analogous to making a sandwich (Bain, p. 126). Supply and demand are the bread that builds the foundation. Self interest provides the meat. Human sociability, which gives rise to considerations of fairness and morals, is the mayonnaise that holds everything together. A dry sandwich without the spread is hard to swallow.

Integrating ethics into economics enhances the critical thinking process and can presumably better prepare students for the complex world of life. Hence, even as company CEOs strive to maximize profits (mandated by the fiduciary duty to shareholders), they must also conform their actions to the "basic rules of the society, both those embodied in law and those embodied in

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[15] Diane Coyle, *The Soulful Science: What Economists Really Do and Why It Matters* (Princeton, NJ: Princeton University Press, 2007): 232.
[16] Amartya Sen, in Arjo Klamer, "A Conversation with Amartya Sen," Journal of Economic Perspectives 3(1)(1989): 141.

ethical custom."[17] This is a tall order, but one that economists are increasingly taking an interest in studying.

In the next chapter we turn our attention to a case in which using economic logic without understanding its ethical foundations proves to be an expensive lesson for General Motors.

[17] Milton Friedman, "The Social Responsibility of Business Is To Increase Its Profits," *New York Times Sunday Magazine*, September 13, 1970, at p. 32.

Chapter 2

Three Ethical Frameworks

Economists routinely posit that decisions should be decided by comparing costs and benefits at the margin. Following this blindly can produce problems unless the wider ethical landscape is well-understood. To illustrate, this chapter uses a case study of automobile safety to introduce three different ethical approaches.

2.1 THE CHEVY MALIBU CASE

In July 1999, a jury assessed $4.9 *billion* in damages against General Motors for selling the Chevrolet Malibu, a car with a dangerous fuel tank placement that was implicated in a number of fiery crashes. The reason the award was so large is that the jury discovered that General Motors managers had *known* about the problem and had done nothing to correct it. This case provides an informative window into the world of ethics and its intermingling with economics. Let us first start by laying out the economic way of thinking; we will then overlay some useful ethical concepts.

Here are the facts: A GM engineer's secret memorandum calculated that fixing the known fuel-tank problem would cost General Motors $8.59 per car. But leaving the car as it was would cost General Motors even less, only $2.40 per car (based on settling the product liability lawsuits, with an average expected payout of $200,000 per life). Every car *not* fixed earned GM an expected additional profit of $6.19 per car. In considering the costs and benefits for the company, GM managers decided not fix the fuel tank. Nor did they inform consumers about the issue.

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Chevy Malibu
Source: http://www.safetyforum.com/gmft/.

Economic Thinking

The engineer's memorandum represents a standard way of thinking at the margin about economic costs and benefits. The premise for this viewpoint is that people make voluntary trades that improve their own individual welfares. Hence, people evaluate what they will gain, and what they will lose, and they choose the outcome that maximizes their own individual gain or minimizes their individual loss. In this mindset it is rational and desirable to take an action as long as the *incremental benefits* of that action exceed the *incremental costs*. It is not only GM engineers who make such economic calculations: consumers do also.

> *Hence, some consumers do not want the safest car possible, because that might make the car prohibitively expensive. The "correct" amount of safety in cars can be discovered by finding the point at which the marginal private cost (MC) of safety equals the marginal private benefit (MB) of safety.*

From the perspective of General Motors, the $8.59 cost per car to fix the fuel tank represents the "opportunity cost" to the company of fixing the tank. The value of lives saved by fixing the tank represent the benefit. Economists measure the dollar value of saving lives by what the person *would* have earned had he or she remained alive or working for a normal time period, which is usually how a court decides on wrongful death settlements.

Hence, not all lives are valued the same in economics and law. If the Malibu is built for middle to low-income consumers, the death or disability earnings are lower than if the car were built for someone with higher income potential. The economic analysis of whether to fix the fuel tank thus relies on a theory that some low income people would rather be able to afford an inexpensive car—even if it is more dangerous—than no car at all. Since there are many cars to choose from, consumers that prefer a safer car can choose that option.

The Implicit Moral Argument

Let us examine the structure of the moral argument used by General Motors managers:

- Only outcomes matter to ethical decision making.
- An action is morally justified if it produces the best outcomes specifically for this company.
- The best outcome for this company is measured by dollar profits in the short run.

Considering the consequences for the company itself is certainly not wrong, but it is incomplete as an approach to decision making. That is, applying a simplistic notion of ethical egoism to the corporation probably misses some big points that most humans would say need to be considered. What are those big things? To see, let us step back to examine a wider scope of ethical inquiry.

2.2 BUILDING AN ETHICAL FRAMEWORK

There are three main ethical frameworks in modern Western thought. Briefly, these focus on outcome-based ethics, duty- and rule-based ethics, and character-based ethics. The three approaches are related and intermingled, illustrated in the schema below:[18]

An economic agent takes an action that produces certain outcomes:

(1) Economic Agent → (2) Action → (3) Outcomes

[18] David W. Solomon, "Normative Ethical Theories," in: Charles K. Wilber (ed.), *Economics, Ethics, and Public Policy* (Lanham, MD: Rowman & Littlefield, 1998): pp. 119–38.

Orthodox economics puts its focus on step (3), which is an analysis of outcomes or consequences. Above all, economists analyze a particular outcome—economic welfare:

> By comparing costs against benefits, economists try to answer the question: What action or policy would produce the most desirable outcome—defined to mean the *largest net economic value* for society?

By comparison, approaches (1) and (2) are *non*-consequentialist; that is, the right action cannot be discerned solely by analyzing outcomes. Step (2) asks the question, "What action am I duty- or rule-bound to make, either by allegiance to religious law or by a commitment to rational thought?" Step (3) brings to light issues of character that relate to personal growth. It asks, "What way of being is virtuous and how and why should I become such a virtuous person?"

When pressed to come up with a *reason* for making an ethical choice, people give a variation on these three answers: the choice produces the best consequences, the choice adheres to basic rules or duties, and/or the choice derives from a moral intuition or reasoning about being a good person. In the following section we apply these principles to the analysis of automobile safety.

2.3 USING ALTERNATIVE ETHICAL FRAMEWORKS

We have identified three ethical frameworks that shed light on how GM managers might make decisions about life and death.

Ethical Egoism

The implicit moral framework apparently used by GM managers was that of corporate *ethical egoism*: the notion that the right course of action is that which is expected to produce the best outcomes for the corporation. One problem for ethical egoism is that it severely limits the scope of analysis to the self, in this case the producer of a good. Since one's actions can produce negative consequences for others, many consequentialists would say that actions should be judged not simply by their effects on oneself, but by their aggregate impacts on society.

Economic Welfare Theory

By considering a wider universe that includes consumers as well as producers, economic welfare theory would likely find that the GM manager's decisions were not efficient. The most "efficient" outcome is that which produces the largest net economic welfare for the entire class of *both* producers and consumers, not simply to one particular company or its shareholders. If consumers are misled about the safety of the car (not informed about the faulty fuel tank), the outcome is inefficient for society.[19] This outcome does not maximize the dollar value created because consumers were not allowed to make informed rational judgments as to what to buy. Hence, even though GM managers used the economic way of thinking (analyzing marginal costs and marginal benefits), their scope of analysis was too narrowly focused to produce an outcome that economists would generally ascribe to as being desirable.

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[19] This situation is known as asymmetric information. One party to a transaction (in this case GM) has relevant information not available to the other side.

When certain basic conditions are present, however—the existence of competition, no asymmetric information, and no external costs like pollution—a market left to its own devices is said to get close to the outcome of maximizing the net dollar value created for the entire class of consumers and producers (see Chapters 5 and 6 for elaboration). If these circumstances exist, people can follow their own best interests (ethical egoism) and the results will be equivalent to maximizing economic welfare.

This theory is called the "invisible hand" theorem—the proposition that when each economic actor pursues his or her own private gains, society's economic welfare is maximized, even though no one intends it. The intellectual foundation for this view goes back to Adam Smith, the 18th century Scottish philosopher who is considered the "father" of modern economics. As shown in Chapter 7, however, Smith's views are actually contrary to ethical egoism, a philosophy he explicitly rejected. In short, ethical egoism is at times compatible with economic efficiency, but the particular circumstances matter to this determination.

Utilitarianism

Other ethicists would dispute the notion that human "welfare" can or should be measured by the net economic value produced in markets. The most famous version of consequentialism is **classical Utilitarianism**, which postulated that it would be possible and desirable to assess the potential outcomes by way of a different metric: that of the *net pleasure (or happiness) produced in society*. Each act generates a certain amount of pleasure and a certain amount of pain that varies in intensity and duration. If we add up all the pleasure and subtract all the pain we end up with the net utility produced. The action that produces the greatest net pleasure or utility is called moral.

Hence, classical Utilitarians would agree with economists that welfare should be measured by the calculation of costs and benefits, but these should not be denominated in dollars and cents but in psychological pleasures and pains. In the Malibu case, Classical Utilitarians would say the decision not to fix the gas tank did not pass the moral smell test because the slight additional profit from GM's decision ($6.19 per car) would give shareholders a very small increase in pleasure. But the few cases of death and burns to customers would create enormous physical and emotional pain for the victims and their families that likely far outweigh any pleasure generated for shareholders.

Duties and Rules

A different argument against ethical egoism would come from **duty- and rule-** based ethicists. These viewpoints vary, but derive from the notion that one's decisions ought to reflect one's duty (either to a rational process or to rules given by God). The economic calculation *not* to fix the gas tank fails the moral test because it shows a disregard for the basic dignity and worth of every human being. By failing to fix the tank, GM managers were essentially using others as a means to their own ends and disregarding basic moral norms.

One can find a surprising justification for the duty-based view in the writings of Milton Friedman, a Nobel Prize winning economist who championed the notion that businesses should focus on making profits. Friedman wrote, "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."[20] But Friedman did not think that corporate

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[20] Milton Friedman, *Capitalism and Freedom* (Chicago: The University of Chicago Press, 1962): p. 133.

executives could therefore ignore moral rules and duties. On the contrary, the business manager is *duty-bound* to carry out the wishes of shareholders who own the company. Friedman's approach is explicitly based on non-consequentialist duties.

Friedman added an explicit moral caveat, which in the GM case should have been printed in capital letters and placed on the supervisor's desk. Managers, Friedman asserts, ought to maximize profits "while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."[21] In other words, there is a larger moral universe within which managers must operate. The cost-benefit analysis is fine—as long as managers first comply with basic moral rules that are non-consequentialist.

A basic moral rule in religion might be "Do unto others as you would have them do unto you." Would you want someone to sell your daughter a car knowing it has a dangerous fuel tank—when it would cost less than $9 to fix? Proponents of **natural rights theory** would argue further that every human being has a negative claim against others—namely, not to be hurt or killed. If I have such a right, it implies that GM has a duty not to abridge that right.

So, a key complaint against GM managers is that they failed to consider basic ethical duties toward other human beings. The outcome of profit overshadowed the process of according minimal respect. The decision not to fix the tank lacked adherence to common duty to treat other persons as moral equals. That is perhaps why the jury acted with apparent outrage in assigning such a huge award to injured parties. What the managers had done was simply not "human."

Character (or Virtue)

A third type of analysis in the Malibu case derives from **virtue** ethics. It is fine and well to talk about duties and rules, but why should anyone be ethical in the first place? Virtue ethicists argue that it is important to start by cultivating managers of character who have developed self-control before discussing the duties and rules they are expected to follow. Moreover, moral intuition or reasoning about virtue may be the ultimate basis for rules and duties.

As we will learn later, some theories of moral psychology would argue that humans make complex decisions—such as ones involving moral content—not by rational thought but by emotional instincts or intuitions. In a different context Justice Oliver Wendall Holmes wrote, "It is the merit of the common law that it decides the case first and determines the principle afterwards."[22] This "moral sympathy" approach to virtue ethics can be traced to Adam Smith (see Chapter 7). By contrast, Aristotle's account of virtue ethics is grounded in reason.

To virtue ethicists the GM managers' decision would not pass the smell test not because of calculations of pleasure and pain as in classical Utilitarianism and not because of societal rules and duties, or even for calculations of economic value—but simply because of notions of what a good person should do if confronted with a similar choice. Would a good person be able to tell their

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[21] Milton Friedman, "The Social Responsibility of Business Is To Increase Its Profits," *New York Times Sunday Magazine*, September 13, 1970, at p. 32.
[22] "Codes and the Arrangement of the Law," cited in John H. Wood, *A History of Ideas, Interests and the Macroeconomic Policies in the United States.* Manuscript, Ch 6, p. 14.

mothers and their children that they had failed to fix a faulty gas tank, even though it cost less than $9 per car? Would a good person have been able to sleep at night?

The Big Picture

Public debates about policies, just like jury deliberations about GM's liability, are rarely orderly. That is, arguments come at us from all directions. While such discussions can appear cacophonous, we can learn to categorize the viewpoints into three overlapping frameworks. That is, we can usually place an argument in terms of its type of moral argument advanced: whether it is about consequences, duties and rules, or the character of the persons involved.

Attention to a wider scope of ethical analysis could have saved GM's managers from what turned into a terrible disaster for some consumers and ultimately for the company itself. Using the "big picture" to frame a discussion may take some time, but offers insights not available when we stick within one ethical framework.

2.4 ETHICS AND FOOD CHOICES

Once ingrained, the habit of seeing "the big picture" of ethical frameworks is of enormous value in understanding competing points of view and in crafting public policies. In this section, we see how the big picture can help us understand choices when it comes to the basic instinct for food.

When we were young my siblings and I always teased my mother, "Why don't you eat seafood?" She would grimace and tell us that just the smell of fish made her sick. She gave a *reason* that related to predicted *outcomes*. *If* she ate seafood, the *consequence* would be an upset stomach; since an upset stomach is a bad outcome, the best choice is to not eat seafood. This may not seem like a "moral" choice except it has ethical precepts: namely, that doing what produces the best outcomes for oneself individually is an acceptable way of analyzing right from wrong.

However, if we asked a devout Muslim or Jew why they don't eat pork the reaction might be quite different. The answer might be, "One ought to make decisions in accordance with religious law. Sacred texts forbid eating the flesh of a pig; therefore it is wrong to eat bacon, ham, and other such products." The decision is based on a duty to a God-given rule, rather than to a particular consequence or outcome.[23] In the next chapter we'll discuss a different type of duty-ethics: one arising from a respect for rationality (Kantian duty).

Finally, asking a vegetarian why he does not eat meat might evoke a third type of response. A vegetarian might say, "I want to live the life of a virtuous person. I ask myself, 'What would Mahatma Gandhi do?' and try to follow that path, regardless of the imposition on me personally." This approach explores the intentions and feelings of someone who is striving to lead a fulfilled life of transformation and personal growth. It relates to qualities and habits of *character*.

[23] Evolutionary biologists might point out that improperly cooked meat can transmit bacteria, viruses, and parasites into human populations (e.g., trichinosis). Hence, in the distant past some societies developed "rules of thumb" against eating pork for good consequential reasons. Over time the rules of thumb became habituated and strengthened in culture through religious law. The essential point is that some people *today* may rely on religious law in making decisions, not on the analysis of consequences. Even though the danger from pork may be diminished today, social prohibitions may not adjust quickly.

The three basic approaches (consequences, duties/rules, and virtues) are not mutually exclusive. In addition to personal growth, a vegetarian might argue that not eating meat produces the healthiest outcome for himself and/or society. Another vegetarian might argue that eating fruits and nuts adheres to divine law.[24] So, vegetarianism can be supported by appealing to all three types of ethical arguments.

The fact that people say they make decisions in a certain way doesn't necessarily mean that this is *actually* the way they make decisions. Nor does it mean that people *ought* to make ethical decisions this way. This chapter has focused on normative arguments for how people ought to make moral decisions. However, any good normative theory will likely have a strong dose of realism about what people are actually capable of doing, or at least can imagine doing. Normative ethics, to a large degree, must reflect an understanding of positive ethics. (see Box 2.1).

BOX 2.1
NORMATIVE AND POSITIVE ETHICS

Studying how people actually reach ethical decisions is called **positive ethics**. Proposing a preferred method of ethical decision making is called **normative ethics**.

Normative ethics is the analysis of how we *ought* to reach judgments about right and wrong—and a good theory of normative ethics would likely contain an implicit notion of how people actually can make ethical judgments (positive ethics). If a normative theory argues we should decide right from wrong using a procedure that is physically or psychologically impossible, that theory could not be considered viable. Knowing something about human capabilities is likely to play a part in the evaluation of a moral theory.

As an example, if Frank told you that the right way to hang a painting on the wall is to hold the nail in your left hand, hold the hammer in your right hand, and support the picture using your *third* hand—you would think him nutty and pay no more attention. Said differently, a good normative moral theory likely has a strong dose of realism about what people are actually capable of doing. *Ought* implies *can*.

END BOX

In a subsequent chapter we will explore how moral psychologists and biologists answer the question, 'how do people actually make moral decisions'?

2.5 LOOKING AHEAD

The standard economic way of thinking about costs and benefits is highly productive to our assessment of many policy issues. Yet it is only part of the way of thinking about these issues. Economics operates within a larger moral framework: an economist who ignores larger moral road signs in making policy choices is thinking incompletely and thus failing to think critically about the issue.

[24] Genesis 29 proscribes as follows: "Then God said, I give you every seed-bearing plant on the face of the whole earth and every tree that has fruit with seed in it. They will be yours for food."

This book presents three alternative frameworks of moral analysis (consequences, duties, and virtues) without specifically endorsing any one. Most people probably utilize all three at various times and in different aspects of their lives. A popular adage says that "Consistency is the hobgoblin of a small mind." Indeed, a theme of this book is that all three ethical frameworks are useful for creating a successful world, and an example of how they work together is given at the end of the book.

Throughout this book we frequently quote from Nobel Prize winners in economics.[25] This alerts you, the reader, to the fact that ethical discourse is not only how the discipline of economics began in the 18th century with Adam Smith, but also how ethical reasoning has moved to the forefront of many issues that bright minds are working on today. Despite this, ethics in economics generally remains outside the mainstream, taught in a small (but growing) number of universities around the world. The thesis of this book is that economists will be better economists if they know something about ethical theory and its evolution within and outside the discipline.

Alfred Marshall, the great synthesizer whose textbook *Principles of Economics* set the stage for 20th century economics, wrote this in the preface to the first edition:

> But ethical forces are among those of which the economist has to take account. Attempts have indeed been made to construct an abstract science with regard to the actions of an "economic man," who is under no ethical influences and who pursues pecuniary gain warily and energetically, but mechanically and selfishly. But they have not been successful...."[26]

Marshall wrote those words in 1890, and the next hundred years produced an attempt to extricate all ethical reasoning from the "science" of economics. But as Marshall predicted, this effort would fail. It failed because of poor prediction in some important areas; and it failed because policy analysis cannot be done in isolation from an understanding of ethical frameworks. Hence, "[A] well-trained economist should be able to scrutinize the moral underpinnings of a policy statement."[27]

The next chapter addresses the consequentialist ethic in greater depth.

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[25] The Nobel Prize in Economics is actually the Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel. For simplicity it is referred to in this book as the Nobel Prize.

[26] Alfred Marshall, *Principles of Economics* [1890], 8th edition, 1920 (New York: Macmillan and Co.): p. vi.

[27] Anthony B. Atkinson, "The Strange Disappearance of Welfare Economics," *Kyklos* 54(2/3)(2001): p. 204.