Some Contemporary Ethical Issues Concerning Adam Smith's "The Wealth of Nations"

Kenneth S. Bigel
Touro College

Abstract

As time goes on, interpretations of Adam Smith's The Wealth of Nations (TWN) evolve. Most contemporary readers are unaware of Smith's prior work and assume that TWN, whose purview is strictly economics, is his sole monument to the history of ideas; their views concerning Smith and capitalism, as may be common today, therefore, are often devoid of ethical content. Examined from a contemporary lense, which, admittedly, may be different than Smith's original intention, can we indeed say, as ethicists would argue, that TWN, examined alone, provides society with an ethical system, which makes life better? What are some key questions that may be asked from the contemporary view? While the results are inconclusive, it is abundantly clear that Smith's TWN, viewed independently, has profound implications for business-ethical praxis today.

Introduction

Adam Smith's The Wealth of Nations, or TWN hereforward, (1776) has profound moral implications, the interpretation of which meets with new perspectives - and difficulties - as the world evolves. Most contemporary readers are unaware that Smith was first a moral philosopher, having written the Theory of Moral Sentiments (TMS) years earlier (1759). Smith is often popularly thought of as an "economist," rather than as a "philosopher." This is understandable. There is little doubt that TWN constitutes the seminal work upon which our capitalist system is based to this day. Thus, given the writer's background, TWN certainly has profound bearing not only on economic, but also on moral behavior as well, albeit only subtly. Even if one were unaware of the very existence of TMS, the morality of TWN is nonetheless readily apparent to the trained eye.

It is a well-known fact among scholars that the famous term, "the invisible hand," usually ascribed to TWN, appears therein merely once, but more frequently in his earlier tome. Still, most contemporary readers ascribe this phrase to his "economics," i.e., to TWN,[1] and assimilate it therefrom into their own business weltanschauung, and not necessarily for the better. More specifically, society today often seems to reflect the rationalization that Smith actually promoted "self-interest," i.e., "selfishness," and that Smith justified selfishness morally and systemically via the magic of the "invisible hand" argument, with its ultimate and beneficent impact on the aggregate economy. As a result, a position is often held in popular circles, which asserts that business and ethics (both individual and corporate) are, from the point of view of the microeconomy, inherently and ideologically contradictory, yet in the end, complementary in the aggregate. Therefore, it is OK to be "bad." Or so it goes, more or less. This is the crux of the popular view of Smith and TWN.

Given the foregoing, this analysis will attempt to address several questions or issues, namely:

1. Is classical, Smithian economics - as viewed independently today - an amoral system?
2. Is self-interest "evil"?
3. Can self-interest, in the present macroeconomic context, be viewed as a "mutual good"?
4. Does self-interest lead to "market failure"?
5. Is market failure a "bad" thing?
6. Is there a connection between good ethical praxis and aggregate economic output?

The answers to the foregoing questions may significantly impact business praxis.

1. Is classical, Smithian economics - as viewed independently today - an amoral system? The popular notion of Smith.

We must first justify the speculative statement that the contemporary, popular view of classical economics is amoral or self-interested. This is easy. Indeed, popular culture has portrayed the businessman in film and in theater quite unfavorably; recent examples of this type of portrayal are too numerous to list, but some, which are memorable to this writer include, Wall Street (1987), Glengarry GlenRoss (1992), and The Insider (1999). The list, in fact, is quite lengthy.

Non-fiction books have similarly depicted the gloomy personages, which are characteristic of the business world, for example, The Predator's Ball (1988), Serpent on the Rock (1995), and Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen (2003). Often the motivating factors driving the reprehensible characters depicted in these narratives are, in fact, ambition and greed. Ambition, representing the drive to improve oneself and to succeed, in itself, need not be immoral, except when coupled with greed, i.e., the self-interested and unbridled pursuit of wealth, which at times, comes to the detriment of others.

It should not, however, come as a surprise that ambition and greed are the featured characteristics of the business phenomenon. These motivations are endemic to western, capitalist culture. The veritable father of capitalism, Adam Smith, in his monumental, classical work, The Wealth of Nations (1776), suggested that the self-interested motivations of business owners, while arguably morally lacking, will lead, in the end, to increased aggregate wealth due to the mysterious mechanism of the "invisible hand." Here, one "intends only his own gain," and, in so-doing, is "led by an invisible hand to promote ... the public interest." This well-known phrase represents a contemporary and pandemic genre of cynical thought frequently held by the business public. It matters not to the unknowing public that Smith did not emphasize the invisible hand in TWN, but rather in his earlier work entitled The Theory of Moral Sentiments (1759); what is important is that business practitioners popularly ascribe the notion to Smith and are unaware of the TMS' existence.

Smith may thus have inadvertently presaged or instigated the famous mantra, articulated by Gordon Gekko, a central character in the movie Wall Street: "Greed is good." This notion, mundane and profound, is part of the fiber of our culture, for better and worse. It is not a big leap to travel from self-interest to greed. The difference between greed and self-interest may only be a matter of degree.

Greed is ugly. There is nothing ignoble, in contrast, about a calm and moderate desire to advance one's own welfare, married to a sympathetic regard for the well-being of others. (Anonymous, 2005, p. S17)

One may ask the question whether, in light of the recent deluge of corporate scandals, our capitalist system is inherently infused with immorality. "Morality requires self-denial while capitalism runs on self-interest" (Bragues, 2005, p. 179). Business relies on "vicious impulses," including deceit, avarice, and more. This is the contemporary state of affairs. It does not matter that Smith intended self-interest to coexist with cooperation, harmony, and collaboration; this meant that entrepreneurs were expected to act virtuously - self-interestedly, but not "greedily."

2. Is self-interest evil? The Microeconomic Conundrum of Self-interest.

What then is the popular philosophic basis for the notion of self-interest as a morally justifiable economic means?[2] In fact, the conflict between self-denial and self-interest appears to have preceded Smith. In his analysis of Mandeville (1714), Bragues indicates that a business ethicist must distinguish between the public and private domains. For Mandeville, "the type of self-interest, which dominates private, economic activity is…" a vice (Bishop, 1995, p. 167). In short, greed is selfish; morality is selfless. Business and ethics are mutually exclusive. There is no difference between greed and self-interest. It is that simple. This view appears to have survived to this day.

By contrast, one may alternatively argue that neither greed nor self-interest is a moral factor in the microeconomic scheme of things. Carr (1968) famously indicated that business is nothing more than a game in which the economic actor must submit to a set of implicit or legal "rules." As in poker, "bluffing" is permissible - and moral - in business, as long as one plays by the rules. In football, for example, it is OK to hit someone in order to gain an advantage; it is not OK to do this while waiting in line for a bus. The rules are different. Ethics are merely a matter of rule-observance. Hence, there is no such thing as ethics in business; one does what s/he may "get away with." Observe the rules, and don't get caught when you "break 'em."

An example of a legal or moral rule, which is pertinent to the way in which business is conducted today in the United States, is illustrative. Often in business, the principle of caveat emptor pertains. (It is also true that this principle today is growing increasingly unpopular.) A seller is not obliged to disclose all s/he knows about a property; instead, it is the responsibility of the buyer to probe and find out what needs to be discovered in order to negotiate a fair price. The seller can bluff or ask any high price that s/he thinks s/he may successfully obtain, without showing his/her cards, and let the buyer beware![3] That's the game! In short, business is an amoral affair. Mandeville would, quite probably, agree. Smith probably would not.

Friedman (1970) views private and public activities as morally disparate. Although he did not refer to business as a "game" per se, he clearly viewed it as an activity with rules, as does Carr. Government, in Friedman's case, by and large establishes the rules. By contrast, one may say that Smith would deem government as unnecessary, were people to consistently act virtuously. Neither Smith nor Friedman necessarily views self-interest as selfishness or greed. Their views are not necessarily amoral; in fact, some argue that Smith and Friedman are both deeply concerned with the avoidance of adverse effects on others (James, 2000, p. 659).

Still, according to Friedman, if a businessperson wants to further laudable social objectives, let her do it by delivering a profit (as long as s/he plays by the rules of the game – whatever they are)! That is what distinguishes capitalist from socialist systems.[4] Apparently, patrolling greed is the government's responsibility; greed and self-interest are what make the capitalist system work.

In a socialist system, by contrast, the citizenry has no economic choices; all decisions as to prices, quantity, and participation are centrally mandated. There is no demarcation between self-interest and system-wide interests. The system and the economy are one and the same; both exist to serve the public interest. Economic self-interest is verboten.

In capitalism, one may freely choose to participate in a particular economic market, or not. The choice is purely individual. If one wishes to sell a good or to take a job, s/he may do so under the conditions, which are most favorable to him/her – if the conditions are obtainable in a free market. S/he must only abide by the rules, which are made by government. Government serves to fill, inter alia, the ethical and social void left by the economy. Hence, the social responsibility of business is to deliver a profit to owners of business, while government solely serves the public. Socialism's failure to recognize the selfishness inherent in human nature, Friedman may argue today, explains its demise. Capitalism, albeit amoral, is an efficient, rules-based system.

It appears therefore that Smith's microeconomics, viewed independently constitutes an amoral system. It is unreasonable to expect, given human nature, that a person would consistently act virtuously in business. Indeed the law, or despotic enforcers, is universal. Given the foregoing, it is reasonable to question whether Smith, from whom all the above-cited writers derive their thoughts, one way or another, was correct - morally. It seems that the environment condones self-interest, within the parameters of legal constraints, and views it in terms inconsistent with the deontological fiber of the activity. Put more simply, self-interest, even when viewed as morally wrong, is a tolerated evil at best.

3. Can self-interest, in the present macroeconomic context, be viewed as "mutual good"?

A little historical insight here may be warranted. Some argue that Smith's macroeconomics constitute a deeply moral system; after all he had written a notable, earlier work entitled Theory of Moral Sentiments (1759). At the time The Wealth of Nations was written, the dominant economic system was not Socialism, as one may infer from reading Friedman, but Mercantilism. Marx' Das Capital (1867) was not written for nearly a century after The Wealth of Nations. (We recall that Friedman, in part, justified selfishness and capitalism by contrasting the capitalist and socialist systems. We must also recall that he wrote at the height of the cold war.)

The purpose of Mercantilism was to maximize the power of the nation-state by making the state self-sufficient (Bassiry and Jones, 1993). As a result, consumers suffered because the state protected producers so that (net) imports would be minimized and "wealth," as it was thought of then, would thereby be accumulated. In effect, consumers subsidized producers. An authoritarian government centrally determined economic policy. (This may not differ, in substance, from past Japanese and present-day Chinese international trade policies.)

Smith's system, on the other hand, was market-driven and consumer-oriented. Production would be driven by means of expressed consumer demand. In this manner, maximum consumer welfare would be realized; as such, capitalism may be viewed as producing a "mutual good." Unlike Mandeville, Smith justified self-interest consequentially, with reference to the increased aggregate good, which he expected it to produce via the invisible hand argument (Bishop, 1995). Self-interest itself was morally neutral (as long as no rules or laws were broken) and justified by its outcome. Smith steered the world away from Mercantilism and the authoritarianism it entailed.

> Smith's paradigm shifted the institutional emphasis from monopoly to competitive markets… (by means of) a spatially expanding division of labor, and from producer appropriation of the societal surplus to consumer sovereignty. (Bassiry and Jones, 1993, p. 622)

The unrestrained economic growth that Smith implicitly advocated by means of the pursuit of economic self-interest potentially creates other problems. Malthus (1798) essentially proposed that human population would outgrow the world's resources, which would be needed to sustain it. He did not foresee the benefits that technology would eventually have on food production. Nonetheless, today the non-industrialized, impoverished portion of the world, which constitutes a substantial portion of the world's population, is experiencing high birth rates and low death rates. The Malthusian nightmare is, once again, being discussed in serious circles.

Hardin (1968) echoed the Malthusian dilemma by borrowing from Bentham (1789). He pointed out the impossibility of achieving the greatest good for the greatest number. Maximum population and the greatest good cannot both be achieved simultaneously. While population is sparse, we can allow our herds to graze on the commons, without detracting from other herds' food sources. However, if a herdsman adds one more cow when the pasture has reached its limit, all herdsmen will proportionately share in the resulting decreased availability of food and will, as a consequence, suffer. The negative economic effect of overgrazing will be distributed to all herdsmen.

In other words, as we become more prosperous, more and more parties cannot increasingly share land and other resources; incremental consumption by one party will affect another's ability to survive. All will suffer as a result of one person's increasing wealth. The world shall reach a point at which a Pareto (1906) solution, which would provide positive utility at the margin, would be impossible. Ergo, the optimum population is less than the maximum.

The consequence of Hardin's Malthusian analysis directly relates to Smith's most essential tenet. In Smith's paradigm, there is a critical and arguably destructive theme, which - incorrectly - posits that individual, self-interested decisions will be optimal for all of society. Hence, in terms of a utilitarian framework, Smith's economics would be "immoral." That is, the ends are, in fact, undesirable and hence cannot justify self-interested means. The situation appears irresolvable.

> The problem is that economists… have little they can legitimately say about the ends of human endeavor, while ethicists… have equally little they can say about the means of reaching those ends. (Hosmer & Chen, 2001, p. 619)

It appears that the historical context supports the contemporary view of self-interest. Social scientists and business persons, have little shared intellectual interests with ethical philosophers. They do not speak the same language! In fact, given Malthus' claims, and the contemporary state of economic affairs, wealth does not seem to be fairly distributed. Perhaps instead, it is up to the rich nations of the world to eradicate poverty (Sachs, 2005). Present economic circumstances yield a Malthusian outcome whereby people die simply because they are too poor. The unfortunate result may be a world in which the poor grow in population, and the rich, with their far lower birth rates, die away.

It is the responsibility of the developed world, i.e., certain governments and especially, the United States' government, to end this state of affairs. Sachs, in stark contrast to Malthus, further claims that this relief can be accomplished at a very small price. All we (i.e., the rich nations) need to do is set aside - individually - a small sum of money periodically to defray the cost of saving the impoverished people of the world. He invokes religious and moral principles in order to galvanize governmental action.

Perhaps the government can cajole its well-off citizenry to be altruistic by means of moral suasion. This activity seldom, if ever, works. Alternatively, there are also critical moral and economic issues relative to any forced distribution of resources, even if minimal. First, such redistribution interferes with one's rights (Hosmer & Chen, 2001, and Hayek, 1976). Second, it must be noted that there are some who have questioned whether indeed economic efficiency leads necessarily to wealth equality (Hosmer & Chen, 2001, and Putterman, Roemer, and Silvestre, 1998). Additionally, the enforcement of economic equality, even if not effected in absolute terms, negatively impacts input-output ratios, or economic efficiency. Individuals may have greater equality, but the average person will be worse off, and the aggregate economy will be smaller (Hosmer & Chen, 2001, and Blinder, 1987).

In sum, the aggregated morality of self-interest, if assessed on utilitarian principles, may be simply circumstantial, that is, it is a function of the state of our technology and the extent to which economic development is dispersed. The issue, by a sort of default, degrades into the erstwhile microeconomic question discussed above.

Today, in contrast and unfortunately, self-interest is all-too-often systematically and implicitly viewed instead as a tool to justify executive immorality in order to secure competitive advantage; thus, morality may, de facto, reside in the free market and not in individual organizations or the managers thereof (Bishop, 1995).[5] Let the invisible hand police business praxis!

4. Does self-interest lead to market failure?

In fact, Smith, Malthus aside, indeed was concerned about the numerous, possibly negative, outcomes of his paradigm, foremost of which would be the concentration of economic resources among a few oligopolistic or monopolistic corporations (Bassiry and Jones, 1993; Wilson, 1989), a well-known form of "market failure." In the absence of (perfect) competition, management would become ineffective (Ginzberg, 1979). His system depended upon there being many small operators, none of whom would have any market impact, and all of whom would be pricetakers. In fact, it has been argued (Bishop, 1995) that merchants and manufacturers desire restrictions of free competition in order to garner economic power. Smith refers explicitly to the baneful effects of monopoly as a disruption of free markets and as inimical to the maximization of the public good.

It has alternatively been argued that the invisible hand mechanism itself serves to restrain the systematic encouragement of self-interest by governing market transactions so that no one achieves a long-term economic advantage (Werhane, 2000). Smith, in contrast to Mandeville, was not a radical individualist; Smith believed that people need one another. Accordingly, the Mandevillian notion of turning self-interest ("private vices") into aggregate good ("publick virtues") properly belongs not to Smith, but to Mandeville. For Smith, it is wrong to hurt others, to harm one's property rights, or not to honor contracts. In fact, it was Smith himself, long before Friedman, who indicated that every man may pursue his self-interest as long as he does not violate "the laws of justice" (1776, IV, ix as in Werhane, 2000, p. 194). Absent "justice," or given the possibility of avoiding justice, are people committed to doing the right thing in all instances? Res ipsa loquitor.

In the end, prosperity itself would eventually negatively impact the work ethic upon which Smith's paradigm depended. Prosperity has the perverse effect of reducing the desire to pursue self-interest as one's wants are increasingly realized. In this case, a wealthy society would provide goods that individuals would otherwise independently pursue on their own. Smith himself conceded that market failures would require the government provision of public goods. Let us have a closer look at market failure itself.

5. Is market failure a "bad" thing?

Typical economic analysis and college textbooks posit "perfect markets." In this approach, it is assumed that economic markets are characterized by information symmetry, and by the absences of public goods, monopoly and/or monopsony, and externalities. Markets therefore provide the optimal society-wide quantity of goods and services at market-clearing prices.

In fact, market imperfections are common; numerous meddlesome factors frequently dominate business transactions, and thereby affect price and quantity outcomes. The effect of this is that the equilibrium conditions predicted by standard analytic methods, which rely on perfect market assumptions, are frequently incorrect. For example, typically, microeconomic decisions are rendered in the absence of considerations that impact aggregate economic outcomes. A simple example, frequently used pedagogically, is pollution.

A manufacturer - theoretically - need not pay for (all) pollution costs that impact the health and real estate values of the surrounding residents and their community respectively.[6] As a result, the producer supply curve is lower than it should be if, in the alternative, the total societal cost – including increased health care costs etc. – were recognized, as it would be in the aggregate analysis.

That is, the "private costs" reflected by the manufacturer do not correspond with the total "public cost" to society-at-large, or in the aggregate. The result of this sub-optimal condition is excess supply at a lower production cost (and hence consumer price) than ideally should be the case. Classical economics, which assumes perfect markets, was not intended for the modern, complex, and inter-dependent world in which we live.

Market failures clearly have ethical implications. Borrowing further from the analysis concerning pollution, a utilitarian will weigh the consequences of polluting against the benefits. A deontologist would argue that pollution is never justified. Yet, environmental hazards are, today, nonetheless epidemic. One must ask who is responsible for this universal phenomenon. Some argue that the corporation itself is responsible for ethical behavior rather than the individual or government alone (Reilly and Kyj, 1990). Are market failures the inevitable outcome of the corporate expression of the innate and universal human desire for more (profits)? If so, are the individual and aggregate effects of market failure the same?

On a moral level, it is reasonable to posit that profit maximization should be consistent with maximum social welfare. No one should benefit at another's expense. Society consists, however, of individuals with varying economic and personal resources, talents, and ambitions. Thus, while it is compelling to argue that maximum profits should be delivered for the benefit of all members of society - as it would appear that Friedman postulated - this proposition ignores the matter of the equality, or equity, of the distribution of economic benefits.

Some have asserted that, to date, there is no evidence that complete economic equality is unattainable (e.g., Putterman, Roemer, & Silvestre, 1998). Others claim that the very measurement of well-being, given today's tools, is impossible (Hosmer & Chen, 2001). Varying levels of income would have to be considered; hence, some relative measure of satisfaction would have to be concocted. The preferences of the poor and their most basic needs would have to be over-weighted. Moreover, interpersonal differences would have to be accommodated relative to one's income and relative to some ranking of one's individual preferences versus others' preferences. Only a benevolent dictator would be able to effect this, as proven by Arrow's Impossibility Theorem (1951).

In any case, it is not clear whether economic equality is a moral imperative. Blinder (1987) and Sachs (2005) would advocate, at minimum, assisting the poor who are needier than the rest of the population. Be that as it may, increased efficiency and greater output, distributional arguments aside, raise the living standards of all members of society[7]. The question must then be raised as to whether businesses are commonly operated for the laudable purpose of delivering maximum profits.

There is increasing evidence that business operators are not "maximizers," but "satisficers." While it is agreed that more is better than less (Blinder, 1987), there is considerable evidence that business operators are often satisfied with a sub-optimal amount of profits, and will, upon achieving this level of satisfaction, trade additional profits for leisure – or other preferences.

Satisficing is the choice strategy according to which one ceases to search for alternatives when one finds an alternative whose expected utility or level of preference satisfaction exceeds some previously determined threshold of what is to count as "satisfactory." (Byron, 1998, p.71)

Standard economic analysis has yet to come to grips with the value of leisure, or any alternative, "sub-optimal" preference, its effect on decision makers, and the related aggregate outcomes. By way of further examples, fear of loss and inherent cognitive shortcomings, among other factors, notoriously impact decision-making. The impact of innumerable behavioral inputs on the efficiency of economic decision-making has yet to be fully catalogued and understood.

Delving more deeply, it may be argued that, rather than viewing the (rational) economic player as being driven by self-interest only, an individual may simultaneously be driven by multiple motivations (Sen, 1987). Individuals may, interestingly, choose ethically oriented decisions rather than the maximization of self-interest.

The difficulty is that multiple and dissimilar personal preferences are impossible to quantify and then combine in a single utility calculus, and thus their aggregate impacts upon product and factor markets, and eventually upon productive outputs and social benefits, cannot be predicted. (Hosmer & Chen, 2001, p. 607)

Thus it is impossible to measure aggregate outcome effects if the individual utility measure is undefined. Individuals are often motivated by considerations other than material gains, including the reckoning of the interests of parties independent of the decision-maker.

At the firm level, and unfortunately, inefficiencies may be caused by management-owner, or agent-principal, conflicts of interest (Primeaux and Stieber, 1994, p. 287). Managers and others involved in the decision-making process occasionally abuse ethical mandates - or simply "make mistakes." One interpretation of Smith is that The Wealth of Nations does not apply uniformly to all members of society. A close reading…

…reveals that Smith thought the interests of merchants and manufacturers were fundamentally opposed to those of society in general, and that they had an inherent tendency to deceive and oppress…. (Bishop, 1995, p. 165)

In short, market failures are not always definable due to lack of clarity regarding economic objectives, which may go beyond immediate self-interest. Even when assumed to be monolithic and clear, market failures appear to be part of the very fabric of economic transactions.

It must be noted, however, that market failure is not necessarily solely bad. If one extends Smith's invisible hand argument and assumes that corporations exist to deliver profits to shareholders, a là Friedman, one may argue that innumerable, voluntary transactions among self-interested actors lead to the creation of, not just negative, but positive externalities as well (Narveson, 2003); such externalities may even have ripple effects. An example cited is the building of a beautiful private home, which provides aesthetic pleasure to passers-by, enhances the health of its residents, thereby enabling the residents to work more years, with cascading benefits ad infinitum. Although individuals do not consciously intend to "do good" (Psalms, 34:15), the effect is the same anyway. A similar argument may be made for merchants and entrepreneurs.

… why applaud when others prosper? … you are sure to be among the others. … the tendency of people to confine themselves to activities that benefit some while harming none is one that will in innumerable ways redound to one's own well-being as well. (Narveson, 2003, p. 208)

Thus, it may be argued further that anything that results in negative externalities should be prohibited; not only is harm perpetrated, but such harm may spread and multiply. This prohibition would require, it must be added, the assurance of protection from immediate harm, the advancement of aggregate wealth, and not in the promotion of vested interests. "The right way to organize society is to prohibit evil, not to inflict evils on some in order to compel them to do good to others" (Narveson, 2003, p. 211). It is primarily the individual who advances the good, albeit unintentionally, by engaging in economic activities. Hence, let us not interfere with the markets. Laissez faire! It is government who, wrongly, protects the interests of entities that produce negative externalities, even if it does so inadvertently.

In the final analysis, it is unclear whether this absolutist, positive, laissez faire notion is what Smith intended. It is difficult to imagine an absence of any negative externalities whatsoever in the presence of an undisturbed, omnipotent invisible hand. In any event, it appears that market failures are endemic and inevitable. Business, as the central, if not sole, producer of market failure, should therefore be held responsible, in some manner, for much, or all, of the discrepancy between private and public interests.

It seems that there is currently no uniform view as to the precise, ethical nature of the free enterprise system. Does laissez faire economics ensure that justice will prevail? Is the market itself - via the invisible hand - capable of policing "economic morality"? Does self-interest inevitably lead to market failure? Perhaps the confusion or disagreements discussed above explain the presence of market failure.

The following section will expand on the microeconomic view of market failure as it relates to the aggregate economy, and the more expansive effect good ethics have on output.

6. Is there a connection between good ethical praxis and aggregate economic output

In this section, we will try to make a case for a positive association of good ethics and higher aggregate output. Arrow (1973) promoted good ethics on the basis of "economic efficiency." To him, in a world, which is naturally suffused with information asymmetry - wherein knowledge is not evenly dispersed, economic efficiency is enhanced when people transact business with one another on the basis of "trust"; in the end, all society is better off. His base example is that of the physician who betrays his patient's trust - and the Hippocratic Oath. According to Arrow, betrayal on the part of a mere few physicians would have a ripple effect, resulting in reduced public confidence in the profession, higher costs, and lower net revenues. His reasoning is then extended to all economic activities.

Agreat deal of economic life depends for its viability on a certain limited degree of ethical commitment.... There is almost invariably some element of trust and confidence. Much business is done on the basis of verbal assurance. (Arrow, 1973, p. 1).

Donaldson (2001) propounds similar sentiments. Borrowing from Ricardo's (1817) theory of "Comparative Advantage," he argues that certain societies have competitive ethical advantages over others. He continues by citing Fukuyama (1995) who posited that some societies have innate cultural advantages, i.e., a kind of "social capital," which provides them with structural, competitive economic advantages. This logic parallels Porter's (1990) claim that some countries have certain intrinsic, structural advantages over others.

Donaldson enumerates several of these characteristics or "ethical economic advantages." These characteristics represent positive social values such as the protestant work ethic, respect for intellectual property, protecting the environment, equitable distribution of "primary" (as opposed to "luxury") goods so that no one lives in economic misery, etc., and a lack of negative values and behaviors such as bribery. At an interpersonal level, in "daily life, we prefer doing business with people who show an independent concern for values" (Donaldson, 1995, p.32). Trust and other endemic positive ethical practices increase economic efficiency. All told, these factors add to the "wealth of a nation."

If we accept the foregoing arguments, society clearly benefits from good ethical praxis. Therefore, it is imperative that business, its leaders, and professional managers confront the moral context in which economic matters reside (Bigel, 2005). The business firm, as a whole, must not only practice benevolence, but must win society's confidence and trust. Advertising must be truthful; products must be reliable; corporate governance must be honorable. Standard economic analysis, while dealing more and more with these issues, usually does not go far enough. Unfortunately, we have seen many recent, serious failures in business practice.

Summary and conclusions

Although Smith was a moral philosopher first, most TWN readers are unaware of or uninterested in his ethics. The popular view places Smith in an amoral context. Self-interest, arguably Smith's most oft-cited notion, is popularly seen, at worst, as a necessary evil in a dog-eat-dog, mercantilistic, zero-sum business world.

Self-interest clearly results, in many instances, in market failure. The philosophic issue of whether market failure is a "bad thing" is unresolved; however, it is certain that perfect markets are merely chimera. There is no doubt that economic decisions, whether self-interested or selfless, have moral implications relative to aggregate economic issues including employment, income distribution, and environmental impacts. We have found both positive and negative perspectives relative to the meaning of self-interest and its extension, via the invisible hand, to the aggregate.

Further, it is presently a matter of debate as to whether optimal economic efficiency, even when coupled with ethical praxis, ought to result in distributive economic equity. Given variations in personal endowments and ambitions, it is moot whether distributional economic equity is a moral mandate. It is certain, however, that a rising tide lifts all boats, even if disproportionately. In spite of numerous theories, which argue for a benevolent societal outcome to economic decisions, we cannot ignore the ubiquitous presence of market failure, in an imperfect world.

It is, hence, important that economists and business leaders understand the nature of imperfect markets and the context in which real-world market circumstances come about. Still, we all benefit economically if market players are moral. It seems apparent that the business entity in particular, as well as the individual, society, and government, all have important roles to play in the furtherance of ethical praxis. Are we up to the task?

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Notes-:

[1] Many "readers" of TWN ostensibly come to this book by means of secondary sources.

[2] We shall assume herewith that business persons think to some extent about moral issues and its impact on decision-making. Only pathologic criminals would not reflect at all on their behavior. This position is borne out by the literature on moral development.

[3] It is true, admittedly, that in certain circumstances, fraud may be imputed when pertinent information is not fully disclosed. Still, most economic actors, arguably, disclose only grudgingly.

[4] Take note that the context herein is the micro-economy; it is the political economy that drives the micro-economy; macroeconomics, as such, will be discussed below.

[5] Indeed there have been many critics of the government's interference with laissez faire capitalism by means of legislated morality, including the Sarbanes Oxley Act and the Corporate Sentencing Guidelines.

[6] It is recognized that there are laws governing pollution, penalties are levied for polluting, and that pollution rights may be purchased.

[7] We have already discussed certain Malthusian limits, which may also pertain.