

Economics and Ethics: The Issues Revisited

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Abstract: *Ethics is about being “fair” to other people, while economics deals with the creation of wealth from individual selfishness. Fairness and selfishness are conflicting individual characteristics, and this is the source of heated debate between economists and ethicists on various issues. If one is to assess whether an action or policy is “fair” or not, then value judgments need to be made, but economists opposes such normative analysis based on their belief that economics is a positive science. But can ethics be ignored in economic analysis? Many will argue in the negative way because ethical issues are indeed intimately connected with many economic issues; for example, when economists perform cost-benefit analysis, they have to fix the standard which will be used to determine what should be considered as a benefit and what as a cost. On the other hand, in economics individuals are seen as not only having values but also preference relations between those values. Based on this, it can be argued that economics is already an ethical science, possessing its own perspectives and has the potential to contribute to ethical thinking. Finally, even though virtue ethics, as the study of moral character, has historically been an important part of moral philosophy, contemporary economists have paid little attention to it. Virtue ethics has been critical of the market economy and of economics in general. This critique is however not flawless. All these issues are critically examined in this paper.*

1. Introduction

Ethics and economics have traditionally experienced a troubled relationship. It is generally believed that ethics is about being “fair” to other people, while economics is about the creation of general wealth from individual selfishness:

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Ethicists think that economists hold a poor opinion regarding human nature (characterizing it as selfish), and at the same time, they have little regard for moral behavior. Economists, so argue the ethicists, are obsessed with incentives and markets as the panacea for all economic problems. On the other hand, economists allege that ethicists are constantly preoccupied with discovering mystical intrinsic values, and in the process sacrifice systematic thinking through their relevance for the real world. Traditionally, economists have generally tended to avoid making value judgments rooted in ethics and have stuck to positive and objective analyses of policy issues in order to be 'scientific'. The adoption of a positive methodology may indeed have diminished the usefulness of such studies, and according to some analysts, the results of such analysis may even have been erroneous. Thus, there is a clear scope for a deeper integration of economics with ethics.

2. Positive versus normative economics

Most economists agree that economics is a positive science which is concerned with "facts" and that it should be distinct from a normative inquiry into "values" and what ought to be. After all, there is a clear distinction between facts and values, between what is and what ought to be. Most economists therefore strongly believe that economics should be regarded as a "positive science" that aids policy makers in choosing the means which can be used to achieve their ends. What has been said so far is standard undergraduate microeconomics text book stuff. But many economists do not agree with this "standard" view for several reasons.

Firstly, economic "science" is a human activity, and like all human activity, it too would be governed by values. Of course, the values that govern the activity of economists need not necessarily be the same as those that govern policy-makers. This will make the policy decision even more value-loaded or normative. Secondly, economics is largely built around a normative theory of rationality. Can we distinguish the values implicit in such theories from the values that govern policies? If these values are different, then a conflict is likely to arise. Thus, for example, we cannot say that for the individual, rationality means maximizing behavior, but simultaneously insist that social policy should resist maximizing growth, for example, in the name of freedom, rights, or equality.

Most economists would argue that the relevance of economics to policy can be traced to the (positive) information that economic analysis provides regarding the consequences of policy. Yet these very same economists do not hesitate to offer their advice on how to fix the economy! Moreover, the whole field of welfare economics is normative economics. Economists typically use the yardstick of

welfare to assess outcomes, because they believe that economics has the appropriate tools to address welfare issues. Economists have written about other dimensions of moral appraisal, but welfare has received the maximum attention. There is little wonder, therefore, that normative economics has often been referred to as “welfare economics”.

3. Dominance of normative economics during the Middle Ages and the subsequent rise of utilitarian ethics

The ancient philosophers and theologians of the middle ages focused not so much on analyzing how the economy works but rather concentrated on providing advice on morally acceptable behavior in the economic arena. Between the twelfth and the sixteenth centuries the dominant economic issues were ‘just price’ and ‘usury’, and these were always considered from the standpoint of ethics and separated from the working of the economy as a whole.

This emphasis on moral and ethical issues can be traced back to the great Greek philosopher Aristotle in his *Nicomachean* (350 B. C.) who condemned accumulation of wealth through commerce, and in particular castigated commerce in money, that is, loans with interest . Later on in the 13th century, the Scholastic writer St. Thomas Aquinas expressed his opposition to the charging of interest on loans in principle, but justified a moderate rate of interest. The moral condemnation of interest for consumption loans continued till the 16th century, although charging interest on commercial loans was viewed as justified at the doctrinal level somewhat earlier.

The Scholastic notion of ‘just price’ also is a normative concept which dates back to Aristotle. ‘Just price’ was defined by Thomas Aquinas as the price prevailing in the markets in the absence of fraud or monopolistic practices. It may be noted that at that time the competitive market was the exception, and so reference to market price had a normative value, but no descriptive value.

The study of economics by classical philosophers and theologians of the Middle Ages was heavily biased towards moral issues because their objective was to ensure through their writings that people displayed morally acceptable behavior in their economic relation with others. However, when political economy was born, the focus shifted to two issues: the moral issue and the scientific issue. Insofar as the moral issue was concerned, the question was which rules of conduct human beings should follow in the field of economic activities. On the contrary, the scientific issue was how a society based on the division of labor should function in order to maximize the wealth of a nation. Obviously, the two questions

are connected, and the answer to the moral issue depends on the answer to the scientific issue.

If we consider how the relationship between ethics and economics has evolved historically, we find that it depended on how the moral issue was thought of at that particular period of history under consideration. During Medieval times a 'deontological' approach to ethics was adopted, while a utilitarian ethics later came to the fore in the eighteenth century.

The deontological approach to ethics maintained that moral judgments were based on absolute criteria, independent of circumstances. Thus it was argued that actions are 'good' or 'bad' in themselves. In other words, the moral quality of any action is a characteristic intrinsic to it; killing is bad, helping the sick is good. Deontological theories in ethics were traditionally associated with religious commandments and were typical of societies oriented towards respect for tradition. Scholastic economics is a good example of that approach.

By contrast, in utilitarian ethics, moral judgments were mainly anchored to the factual effects or consequences of the act under consideration at a particular time. This 'consequentialist ethics' began to gain ground in the 18th century, particularly through the works of Bentham (1776). The consequentialist approach maintained, by contrast to the deontological approach, that any action should be judged within the specific context in which it takes place that is by looking at its consequences. Thus, harming a person may be 'good' if, for instance, one is forced to do so in order to prevent the person from killing somebody else. Consequentialist theories of ethics came to the fore with the new rationalistic orientation of the Enlightenment age.

Consequentialist ethics was summed up by Bentham in the phrase 'the greatest happiness principle', or 'the principle of utility'. Bentham wrote, 'it is the greatest happiness of the greatest number that is the measure of right and wrong'. (Bentham, 1776, p. 393). Bentham proposed the 'felicific calculus' as an essential component of his consequentialist ethics. It comprised of quantitative evaluation and algebraic summation of pleasures and pains emanating from an action or set of actions (where pleasures have a positive sign and pains a negative sign). When the felicific magnitude is positive it implies good which increases the 'amount of happiness' within human societies. Bad is whatever gives as its result a negative felicific magnitude, and such action reduces the amount of social happiness. The 'felicific calculus' was used to evaluate the social impact of both individual action and public policy choices, though Bentham focused on the latter.

For a long time, those writing in the field of economic matters did not clearly separate the moral issues from the scientific issues. Consequently, we witness the birth of political economy as a moral science, and as a science of society. But gradually the two fields of research began to be separated. This change in perspective was prompted by discoveries taking place in the natural sciences. It was gradually recognized that scientific issues, which concern our understanding of the physical world, need to be analyzed differently and independently of moral issues. Machiavelli (1469-1527) had taken a similar turn in his writings when he distinguished between political science and moral philosophy. In the former there is analysis of the behavior princes must adopt in pursuit of power. In the latter there is moral judgment on such behavior.

4. The connection between ethics and economics: can ethics be ignored?

Values and virtues are studied in ethics. A value is a good to be achieved or a standard of right to be followed, while a virtue is a character characteristic that makes it possible for someone to attain the good or act rightly. Ethical issues are intimately connected with economic issues. To take an example, when a cost-benefit analysis is undertaken, economics gets directly linked to a major issue in ethics: what standard should we use to determine what should be considered as a benefit and what as a cost? There are various standards like happiness, equality, freedom, and so on.

The results of economic analysis also directly give rise to ethical issues. For example, when capitalism and socialism are compared, some argue that capitalism is good while others argue that socialism is good in theory, but it is not practical. It is implicit in the argument in favor of capitalism that practical consequences determine goodness. On the other hand, implicit in the argument of those who believe socialism to be an impractical ideal is the view that goodness is different from practical consequences. This discussion on goodness gives rise to a second important connection between economics and ethics. Should goodness or badness be determined by real world practical consequences or by using some criteria such as divine revelations, rational consistency, or dictates of an inner conscience?

From the foregoing discussion we get two questions of ethics that bear directly on economics. Firstly, what is the standard of good? Secondly, how do we establish that something is good? A third relevant question of ethics is: Who should be the beneficiaries of the good? Should we focus on self-interest? But the question that begs itself here is whether self-interest is moral, amoral, or immoral? If a person takes responsibility for his life and works to achieve happiness, will this be moral

behavior? On the other hand, if a person accepts responsibilities for others and is willing to sacrifice for them, should we label this as morality? This is the debate in ethics between egoism and altruism.

In debates on the morality of capitalism, Adam Smith's thoughts on self-interest assume great importance. Smith wrote in *The Wealth of Nations*, "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from regard to their own interest." (1776, P. 16). In this famous statement, Smith has taken the middle path between traditional ethical theories which have emphasized altruism and his economic theory which expresses optimism about the egoistic behavior of individuals in a free market.

Self-interest has traditionally been viewed as immoral because it works against the interests of society as a whole. And since capitalism is based on self-interest, it has to be a system which gives rise to conflict. And because the overall social good is the standard of value, it follows that self-interest and capitalism must be restrained.

Adam Smith, a professor of moral philosophy, held on to the traditional ethical belief that the good of society as a whole is the moral standard of value. However, he demonstrated through his perceptive analysis that the pursuit of self-interest by individuals would lead to the social good in a capitalistic economy characterized by division of labor, the profit motive, and property rights.

The debate between egoism and altruism is also reflected in environmental values and policies. Egoists see the environment as a pool of resources which is there to be used by humans for their benefit. By contrast, altruism dictates that humans should sacrifice their interests to the needs of other species or to the environment as a whole. In this view, we humans should preserve the environment rather than use it thoughtlessly.

5. Inter-relationship between ethics and economics

If we consider the fact that two of the most influential classical economists, Adam Smith and John Stuart Mill, added strong doses of ethics in their economic analysis, then we start to realize the importance of ethics in economics. After all, Smith was a professor of moral philosophy and Mill an ethical and political philosopher. True, in more recent times, the worldly philosophers have moved away from ethics. But we can ill-afford to ignore the fact that the subject of economics is ethical- the study of human character and its virtues. Any attempt to sidestep ethics will lead to wrong economic analysis.

If economics fails to address the ethics of getting more, which is undeniably part of any pursuit of happiness, then study of such economics can hardly be justified. Since the 1920s, economists have channeled all ethical questions to the branch of economics called “welfare economics”. The students of neoclassical economics have been taught for generations that they should diligently avoid making ethical judgments in their analysis because otherwise it would not remain positive economics. The only ethical judgment that an economist could legitimately make was the least controversial one, namely, what is labeled “Pareto optimal”: if every person is made better off by some change, then the change should take place. Admittedly, in more recent times, welfare economics has attempted to handle more complex ethical issues, as evidenced in the works of the philosopher-economist Amartya Sen. But the bulk of welfare economics still remains 19th century utilitarianism.

Modern economics began its journey as ethical reflections about commercial societies. But now it has substituted perhaps too much of rationality for the fuller reflections by the founders of economics. In fact, ethics and economics have had a strained relationship from the outset. Ethics is perceived to be about being fair to other people, while economics justifies selfish behavior of individuals which is believed to lead to the social good. Ethicists view economists as being obsessed with markets and incentives as the solution to all problems and in the process overlook the richness and morality of human nature. By contrast, economists think that ethicists are obsessed with unraveling mystical intrinsic values which have little relevance in the real world. But moral philosophers have rightly criticized economics for refraining from making explicit ethical arguments, preferring to stick to a more neutral, scientific approach.

In defense of economics it may be said that a great deal of economics is concerned with ethical issues. If we understand it properly, economics is found to be applied moral philosophy. For it focuses on understanding, managing and fulfilling the heterogeneous and often conflicting values, interests, and capacities of large numbers of individuals who are operating within the constraints of limited resources in a particular community. This attention to the key aspects of heterogeneity, conflict, and scarcity within a community should be a central concern of moral philosophy, but it generally isn't.

Economists have come up with an interesting conceptual innovation from which moral philosophy can take lessons. In economics, individuals are seen as not only having values, but also preference relations between those values. Thus, individuals are allowed to not only evaluate whether things are valuable or not,

but also to determine their relative value, that is, how valuable they are relative to other valuable things. Thus economics allows individuals to make rational choices when they cannot have everything they desire because of scarcity. In moral philosophy, however, only sources of intrinsic value are identified, for example, of Nature. Thus, it can be argued that economics is already an ethical science, possessing its own perspectives, and has the potential to contribute to ethical thinking. At the same time, however, economists should not get carried away by some sense of scientific neutrality and ignore the perspectives that moral philosophy can bring, something they have tended to do ever since the Marginalist revolution. Perhaps the greatest ethical problem economists are faced with is not that they lack ethical interests, but their belief that “economic scientists” should not talk about ethics.

6. Ethics and welfare economics

The determination of what things are intrinsically good for human beings has been a central question addressed by moral philosophy. This is not at all surprising because individual welfare or well-being is assigned an important place by all plausible moral views. This is definitely true of utilitarianism wherein it is held that what is right maximizes total or average welfare. Even non-utilitarian views have to give importance to welfare if they are concerned with the interests of individuals, or if they recognize the virtue of benevolence.

What constitutes well-being? Understandably, there have been different answers to this question. Among economists, the view that initially prevailed was that of hedonism, wherein good is considered to be a mental state such as pleasure or happiness (which can be measured). Subsequently, the view shifted to one where welfare can be measured by the satisfaction of preferences. It should be noted that equating welfare with the satisfaction of preferences is not equating welfare with any feeling of satisfaction. If we measure welfare by the satisfaction of preferences, then a person is better off if what he or she prefers comes to pass, regardless of whether that occurrence makes the agent *feel* satisfied. However, it should be realized that once we equate welfare with preference satisfaction, then making interpersonal welfare comparisons becomes questionable, and this is why few economists defend a utilitarian view of policy of maximizing total or average welfare. Instead, they have attempted to make welfare evaluation of economic outcomes and policies without making interpersonal comparisons.

Let us consider two economic outcomes S and R. Now suppose some people prefer S to R and that nobody prefers R to S. In this case, S is “Pareto superior”

to R or S is a “Pareto improvement” over R. So, we can conclude that people’s preferences are better satisfied in S than in R, and we don’t need to make any interpersonal welfare comparisons to reach this conclusion. If there is no situation that is “Pareto superior” to S, then economists say that S is “Pareto optimal” or “Pareto efficient”. Here efficiency refers to efficiency with respect to satisfying preferences rather than minimizing inputs to produce a unit of output.

An economist would argue that if a state of affairs is not “Pareto efficient”, then some people’s preferences can be satisfied better without reducing the welfare or worsening the preferences of any other person. Such an improvement in welfare is costless. So, if a Pareto efficient state has been reached, then society avoids the failure of being unable to costless improvement of social welfare.

Apart from this, a Pareto efficient state has no other obvious virtue. Yet mainstream economists have found these concepts useful in two ways. First, they have proved two theorems which focus on properties of perfectly competitive equilibrium. The first theorem states that perfectly competitive market equilibrium are Pareto optimal, while the second says that the allocation of resources in perfectly competitive market equilibrium is Pareto optimal. Both theorems emphasize the importance of competitive markets and explain why mainstream economists view perfectly competitive markets as ideals. However, in view of the fact that perfectly competitive markets are hardly, if ever, found in practice, the significance of these theorems is debatable. The second way in which economists have used the idea of Pareto efficiency is to perform cost-benefit analysis, which is a widely used and accepted tool for policy analysis.

There is no denying the fact that welfare economics dominates normative economics, even though it does not exhaust the subject. Subsequently, economists along with philosophers have actually contributed to recent research in ethics and normative social and political philosophy.

7. Virtue ethics and economics

Economists have not only used but also contributed to the development of different branches of moral theory. These include utilitarianism, social contract theory, libertarianism, and capability theories of justice. However, in spite of the fact that virtue ethics, that is, the study of moral character, has been an important part of moral philosophy for thousands of years, contemporary economists have paid little attention to it. One plausible reason for this could be that much of the philosophical work in virtue ethics has been critical of the market economy and of economics in general. The criticism is that the market depends on instrumental rationality (that is, rationality as

a means) and extrinsic (that is, not intrinsic) motivation. The result is that market interactions fail to respect the internal value of human practices and the intrinsic motivations of human actors by attaching central importance to market exchange. This critique is however not flawless, as argued by Bruni and Sugden (2013).

What is virtue ethics? Moral character- that is, what sort of person one is and should be- is the main concern of virtue ethics. Virtues are acquired character traits or dispositions that are judged to be good. Aristotle's *Nicomachean* (350 B.C.) is traditionally seen as the founding text of virtue ethics. The Aristotelian notion of virtue is that, within any practice or domain of life, goodness is understood in relation to the "*telos*" (literally, "end" or "purpose") of that domain. Aristotle was critical of the market and profitable exchange undertaken therein. He wrote, "The life of money-making is one undertaken under compulsion, and wealth is evidently not the good we are seeking; for it is merely useful and for the sake of something else." (Book I, Aristotle 350 B.C.). Two criticisms of economics originate from this idea of Aristotle. The first is that when individuals participate in markets, they are not acting autonomously; rather they are acting under compulsion. The implication of this idea is that a truly autonomous person would not need to seek wealth (perhaps, because he has as much as he needs without having to seek for it). The second critique is that the motivation for economic activity is extrinsic and hence of an inferior type- the things economic activity can achieve are merely useful and for the sake of something else.

Contemporary virtue ethicists have applied these ideas in their critiques of economics and the market. McIntyre (1984) provides an account of morality that is developed on the concept of a *practice*. A practice, according to McIntyre, is a coherent and complex form of socially established cooperative human activity which realizes goods internal to that form of activity. A practice has intrinsic ends and internal standards of excellence that make sense in relation to those ends. According to McIntyre, a person who fails to treat an activity as a practice with an internal end is failing to display virtue. If we think in this way, then markets immediately become morally condemnable. When goods are produced with the objective of exchange in the market, then this motivation conflicts with the idea that goods, or the activities that results in their production, are ends in themselves. So McIntyre argues that when a practice is exposed to market forces, then its excellence and virtues tend to get corrupted.

Anderson (1993) and Sandel (2009) accept that markets are an essential part of social organization. But they argue that the instrumental logic of markets is liable to corrupt virtues that are proper to other domains of social life, and hence the state should impose limits on the scope of markets.

Thus, in the literature of virtue ethics, the market is viewed to be in conflict with virtue because intrinsic values are not respected in markets. Intrinsic value is attributed to practices in which goods are produced (for example, the practice of art), as well as non-market practices which transfer goods between individuals, like giving gifts. But virtue ethicists are unwilling to treat the market as a practice in its own right, having its own forms of intrinsic value.

It can be argued that economists themselves are partly to blame for the difficulty that virtue ethicists have had in viewing the market as a practice. Beginning with Adam Smith (1776), generations of economists have conceived of the market as a domain in which the pursuit of private interests by individuals leads to socially desirable consequences. Two famous expressions of this idea are due to Adam Smith (1776, pp. 26-27,456) – the assertion that “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest”, and the description of the merchant who “intends only his own gain [but is] led by an invisible hand to promote an end which was no part of his intentions”. In Smith’s theory of markets, the primary motivation for action is self-love, although such self-interested actions combine to create benefits for all. It would, however, be erroneous to conclude from this that Smith lacked interest in virtue ethics. The virtues of sympathy and benevolence are important in Smith’s earlier work, *The Theory of Moral Sentiments* (1759), even though they play only minor roles in his economic analysis. According to Smith, self-interest pursued within the rules of a commercial society is not opposed to virtue. As Hirschman (1997) has argued, character traits such as prudence, temperance, and self-command, which are associated with the pursuit of long-term self-interest, are undeniably virtues.

Can the market be viewed as a practice with its own intrinsic values? From the standpoint of virtue ethics, the answer to this question begins by asking another question: what is the “*telos*” of the market? In other words, what is the characteristics end or purpose of the market?

Some economists of great repute have attempted to provide thoughtful answers to the above question. With regard to the question of coordinating economic activity, Milton Friedman (1962, p.13) wrote that, “The technique of the market place” is “voluntary cooperation of individuals”. In a similar vein, Buchanan and Tullock (1962, p, 103) wrote: “The *raison d’être* of market exchange is the expectation of mutual gains”. What emerges from the above two strands of thought is that markets do have a purpose, and that is mutual benefit from voluntary transactions.

An alternative answer to the question raised above is that the “*telos*” of the market is wealth creation. This line of reasoning comes from Adam Smith who in his book *The Wealth of Nations* (1776) had argued that wealth is created from the division of labor and the extension of the market. Division of labor, according to Smith, is the result of the human desire and inclination to exchange one thing for another.

Some economists have considered economic freedom as the “*telos*” of the market. Famous expositors of this idea include Mill (1848), Marshall (1920), Hayek (1948) and Friedman (1962). Economic freedom has been interpreted as the freedom a person has to use his own possessions and talents as s/he sees fit and to trade with whoever is willing to trade with her/him.

The common thread running through the above interpretations of markets is that they facilitate mutually beneficial voluntary transactions. Such transactions can be viewed as valuable for several reasons: they satisfy preferences of individuals, they create wealth, and they reflect economic freedom. Therefore, mutual benefit may be taken as the “*telos*” of the market.

8. Concluding remarks

Even though the study of economics began with a healthy dose of ethics and particularly moral philosophy in the Middle Ages, the gap between economics and ethics began to widen in subsequent years. In their eagerness to become ‘scientific’, economists tried to avoid normative analysis and value judgments and turned to a positive analysis of issues. In the process, ethics and morality were sacrificed at the altar of a presumed scientism. Surely this is not desirable because, among other things, any economic analysis devoid of ethical considerations may lead to wrong conclusions and faulty policies. There is therefore a strong justification for a deeper integration of economics with ethics.

Most economists believe that economics should be regarded as a “positive science” that can aid policy-makers in choosing the means which can be used to achieve their ends. Many other economists believe equally strongly that the practice of economics as a science is a human activity, and like all human activity it too would be governed by values. We also should not forget that economics is largely built around a normative theory of rationality. Hence, from the methodological viewpoint also, there is the need to integrate economics with ethics.

The relationship between ethics and economics has evolved over time depending on how the moral issue was thought of at that particular period of history. Thus

the “deontological” approach to ethics of the Medieval times, where it was argued that actions are ‘good’ or ‘bad’ in themselves, gave way to utilitarian ethics in the 18th century where it is argued that any action should be judged within the specific context in which it takes place; that is by looking at its consequences. The ‘felicific calculus’ of Bentham which is one important form of consequentialist ethics was based on a hedonistic philosophy. Modern economists use utilitarian economics but overlook the ethical underpinnings of this approach.

Ethicists are critical of economics because it portrays human beings as selfish and egoistical. Self-interest has traditionally been viewed as immoral because it works against the interests of society as a whole. It is further argued that since capitalism is based on self-interest, it has to be a system which gives rise to conflict and therefore should be restrained.

Virtue ethics- the study of moral character- is critical of the market economy and of economics in general because the market depends on instrumental rationality and extrinsic motivation. In this context it is critically important to examine the “*telos*” (that is, end or purpose) of the market to defend it against the criticism of virtue ethicists. In the literature of virtue ethics, the market is viewed to be in conflict with virtue because intrinsic values are not respected in markets. Some famous economists have shown in their writings that the market has a definite “*telos*” and hence not morally suspect. The “*telos*” of the market can be taken to be the satisfaction of preferences of individuals, the creation of wealth, and a reflection of economic freedom.

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