Markets and Morality

J. R. Clark and Dwight R. Lee

Adam Smith was a moral philosopher, and economics clearly began as a discipline concerned with both normative and positive considerations. Over time, however, as economics became more "scientific," positive analysis of the consequences of economic activity increasingly crowded out normative analysis of the morality of that activity. It is now common for economists to boast that economics is "value free."[1]

The problem is not with positive economics. Without the ability of economic analysis to make reasonable predictions about the consequences of policies and to provide coherent explanations of observed economic phenomena, there would be no value to economics regardless of the value system applied. But without recognizing that moral values are embodied in economic analysis, economists severely limit their ability to understand economic phenomena and to communicate effectively what they do understand. Furthermore, when economists dismiss the moral dimensions of their discipline, they leave the field to others who have an endless supply of pronouncements on the morality of economics in general, and the market order in particular, that are as logically appalling as they are publicly appealing. Only by coupling positive

---

Cato Journal, Vol. 31, No. 1 (Winter 2011).

J. R. Clark is Professor of Economics at the University of Tennessee at Chattanooga, where he holds the Probasco Chair of Free Enterprise. Dwight R. Lee is the William J. O'Neil Professor of Global Markets and Freedom at Southern Methodist University.

[1]The claim that economics is, or can be, a positive science free of values has increasingly come under attack from a variety of perspectives (see Heyne 2008: chap. 2).

economics with a willingness to engage in moral discourse can economists use their understanding to effectively defend market arrangements, and the general benefits they provide, against moral sophistries used by politicians and their special-interest clients to justify policies to protect politically favored groups against the discipline of market competition.

Unfortunately, making a moral case for markets faces a serious problem. Arguments supporting the morality of markets confront a widespread view of morality that predisposes most people to see markets as fundamentally immoral. This is not a problem that can be overcome by advances in positive economics.[2] It is our view that the most effective way to make a moral case for markets requires accepting the dominant view of moral behavior as a legitimate one, while recognizing that the superiority of markets is the result of their ability to generate desirable outcomes without relying on what is widely seen as moral behavior. This leads us to argue that markets are essential for decent and humane social order because they can be substituted for the morality of caring that is necessary for decent and humane relationships.

Our discussion of morality focuses primarily on what is commonly referred to as duty-based morality (behaving the right way out of a sense of duty) as opposed to outcome-based morality (behaving in a way that achieves the best outcomes). This does not mean we ignore economic outcomes. Obviously when assessing the desirability of behavior, the desirability of the outcomes resulting from that behavior cannot be ignored. But, as we shall argue, much of the criticism of markets results from widespread disapproval of the morality of the behavior that drives the market process, quite independently of the outcomes that are generated. Given the prevailing view of duty-based morality, even those who accept the superiority of markets at generating material comforts commonly see that superiority as so morally tainted that they are sympathetic to political action to restrict normal market practices at the cost of considerable market efficiency.[3] As Joseph Schumpeter ([1942]

[2]On this point, we part company with some economists for whom we have great respect. For example, Milton Friedman (1953: 5) states that "differences about economic policy among disinterested citizens derive predominantly from different predictions about the economic consequences of taking action—differences that in principle can be eliminated by the progress of positive economics—rather than from fundamental differences in basic values."

[3]This willingness is accentuated by the low personal cost of expressive voting

1950: 137) observed, "The stock exchange is a poor substitute for the Holy Grail."

In the next section, we consider characteristics most people see as satisfying the conditions of duty-based morality—which we call *magnanimous morality*—and compare it with the morality that underpins the market process—which we call *mundane morality*—and note the emotional basis for the public appeal of the former over the latter. In our third section, we consider examples of moral hostility toward markets obscuring the benefits of the market, and relate that hostility to the persistent desire for an economic system based on magnanimous morality. Our fourth section points to the impossibility of an extended market order based on magnanimous morality. In our fifth section, we contrast the abilities of magnanimous morality and mundane morality of the market to foster the moral ideals of social harmony and human liberty, while recognizing the importance of both moralities when confined to their proper spheres. Our final section contains some concluding comments on making a moral case for markets.

Two Kinds of Duty-Based Morality

For our purposes it is useful to distinguish between two types of duty-based morality, which we designate as magnanimous morality and mundane morality. When most people think of moral behavior, it is magnanimous morality they have in mind, and we consider it first, and in greater detail.

Magnanimous Morality

Magnanimous morality can best be defined in terms of helping others in ways that satisfy three characteristics—helping intentionally, doing so at a personal sacrifice, and providing the help to identifiable beneficiaries.[4] Helping others is considered magnanimously moral only if the help is intentional. Consider the well-known story *A Christmas Carol* by Charles Dickens. Ebenezer Scrooge ends up helping the Cratchet family, and their crippled son

resulting from the extremely low probability that any one vote will decide an election outcome (see Brennan and Lomasky 1993: chap. 3).

[4]We do not claim these characteristics are exhaustive, but we believe they are of primary importance in distinguishing between the two types of morality being considered.

Tiny Tim, intentionally after he is transformed into a caring human being by his Christmas Eve encounter with the ghost of his former partner and the three ghosts of Christmas. This story, written in 1843, still invokes a strong emotional response to Scrooge's desire to help others as a result of his moral awakening.

The importance of intentions to magnanimous morality is related to the requirement of personal sacrifice. The greater the sacrifice a person makes to help others, the clearer it is that the help is being provided intentionally and the greater the morality attributed to it. In terms of magnanimous morality, the amount of the sacrifice is typically more important than the benefit created. This is illustrated in the biblical story of the widow who, by dropping two pennies into the collection box, prompted Jesus to tell his disciples "I tell you the truth, this poor widow has given more than all the others who are making contributions. For they gave a tiny part of their surplus, but she, poor as she is, has given everything she had to live on" (Mark 12:41–44, New Living Translation).

In contrast, profiting by helping others is almost always seen as an indication that the primary intention is to profit, not to do good. Rarely is highly profitable behavior seen as moral no matter how great the benefits it generates for others. There is a strong tendency to overlook the benefits from profitable activities, or even to see them as harmful to others. Despite the efforts of economists at least since Adam Smith, and the clear evidence provided by dramatic increases in both global population and per capita income over the past two centuries, the zero-sum belief that those who get rich must be doing so at the expense of others remains common.

The third characteristic of magnanimous morality—providing benefits to identifiable people or particular causes deemed to be worthy—is more likely to be considered moral than providing widely dispersed benefits impersonally and indiscriminately. Organizations soliciting contributions to fight hunger in poor countries, for example, commonly appeal to our sense of morality by offering the opportunity to contribute to a specific child in return for his or her picture and history. Another example is found in the very different reactions to philanthropists and investors. Philanthropy is seen as a moral act that can moderate the public's negative view of someone who has become wealthy, even though he became wealthy by providing far greater benefits spread over more people than his philanthropy does. Saving and investing money, in contrast, is seldom seen as a moral act even though the investor-entrepreneur surely does more to help others for every dollar saved than the philanthropist does for every dollar given away. As opposed to philanthropists, who decide what they want beneficiaries to have, entrepreneurs let the beneficiaries (consumers) decide what they want. Also, private investors provide their benefits without the beneficiaries having to lobby for them. But even though the investor-entrepreneur creates more social value than the philanthropist, the former receives no moral acclaim because his help is provided indiscriminately rather than going to clearly identifiable recipients. Finally, the investor-entrepreneur is not seen as intending to benefit others or making a personal sacrifice to provide the benefits.

Evolutionary imprinting provides a plausible explanation for the above conditions being widely seen as requirements for morality (Rubin 2003). Human evolution has taken place almost entirely while humans lived in small bands (probably consisting of 25 to 125 or so individuals) of hunter-gatherers. Survival was critically influenced by how people reacted to the behavior of each other, and those reactions with the greatest survival value evolved into emotional responses that helped enforce what became to be considered desirable, or moral, behavior. The type of behavior necessary for the mutual support and cooperation needed for survival in small hunter-gatherer bands was obviously limited, given that each band was almost entirely self-sufficient. The assistance that people provided each other was given intentionally by and to identifiable people who knew each other well. Although there were expectations of reciprocity, helping others was also motivated by a sense of personal caring and mutual sharing, without any need for formally imposed obligations on those receiving the help. True, making personal sacrifices to help others was easily seen, and established a reputation for generosity throughout the relevant community that may have been almost as effective as a formal claim on reciprocity. But such a reputation would have been tarnished if it were thought the help was being given for personal profit, as measured in the accumulation of material wealth much in excess of that prevailing in the band. Some limited specialization and exchange did take place within the band, so while hunters and gatherers did not live in strictly a zero-sum society, it was close to one. The belief that anyone accumulating more wealth than generally possessed was doing so at the expense of others would have been a reasonable one.

Mundane Morality

The magnanimous morality discussed so far in this section contrasts sharply with the mundane morality we now consider. Mundane morality can be described broadly as obeying the generally accepted rules or norms of conduct such as telling the truth, honoring your promises and contractual obligations, respecting the property rights of others, and refraining from intentionally harming others. As stated by Smith ([1759] 1982: 82),

> Mere justice is, upon most occasions, but a negative virtue, and only hinders us from hurting our neighbor. The man who barely abstains from violating either the person, or the estate, or the reputation of his neighbours, has surely little positive merit. He fulfills, however, all the rules of what is peculiarly called justice, and does everything which his equals can with propriety force him to do, or which they can punish him for not doing. We may often fulfill all the rules of justice by sitting still and doing nothing.

No one should conclude that Smith slights the importance of what we are calling magnanimous morality. He is merely distinguishing between negative merit and positive merit, reserving the latter for those who are sympathetic to others and show generosity to those in need—those who demonstrate magnanimous morality. And he believed this morality was an important part of our psychological makeup. Smith ([1759] 1982: 9) opens *The Theory of Moral Sentiments* with the sentence "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it." Anyone who believes that Adam Smith was a champion of greed has not bothered to read him carefully.

Of course, Smith recognized that each of us also has a healthy regard for his own interest. Again, quoting Smith ([1759] 1982: 82), "Every man is, no doubt, by nature, first and principally recommended to his own care; and as he is fitter to take care of himself than of any other person, it is fit and right that it should be so." Yet, he also recognized that none of us in modern society (including his at the time) can maintain his life style without the help of far more people than we can care about, or who can care about us, or as Smith ([1776] 1981: 26) expresses it, "In civilized society [each] stands at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons." The fundamental insight of Smith comes from his understanding that the limited numbers who care for us in no way limits a network of mutual assistance and support from expanding to include everyone in a position to provide each of us all the help sufficiently valuable to justify its provision. The most famous statement of this insight by Smith ([1776] 1981: 456) is that since every individual endeavors to direct his industry where

> its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. . . ; and by directing that industry in such a manner as its product may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.

This passage has been criticized for well over two centuries on both positive and normative grounds. We believe the criticism that has most influenced public opinion has been firmly rooted in normative, or moral, considerations. True, much of the criticism has pointed to market failures that are ignored in Smith's statement of the "invisible hand." But, this alone would hardly create the widespread skepticism toward markets that has always existed. Of course, positive economics can point to imperfections in real-world markets. But when compared to positive analysis of the real-world alternatives, whether full-blown central planning or political attempts by democratic governments to correct market failures (real or otherwise), criticisms of market imperfections are difficult to take seriously as a general condemnation of markets. It is much easier to understand the persistent criticism of markets, and of the invisible hand justification for them, once the strong emotional attachment to magnanimous morality is considered. Most people see market behavior as largely lacking in moral behavior as they instinctively understand it and that view is reinforced by the invisible hand justification for markets since it ignores any role for magnanimous morality.

Indeed, the importance of the invisible hand characterization of the market is that the truly impressive performance of the market at motivating mutual help and assistance does not involve intention, personal sacrifice, or identifiable beneficiaries. According to the invisible hand case for markets, more help is provided because people do not intend to provide it; the help is motivated and generally accompanied by personal gain; and the benefits go to society, in other words to no one in particular. So not only does the market not require the behavior that most see as moral, it is seen as motivating a level of indifference to that morality that is widely seen as immoral—in particular, rewarding greed and the willingness to profit from the problems of others. This view of markets is intensified by the tendency for people to be suspicious of the motives of others, particularly those of strangers.

Hostility to the Market Obscures the Desirability of Its Achievements

The instinctive hostility toward the lack of morality (and immorality) widely seen as motivating the market process commonly undermines appreciation for markets no matter how desirable their outcomes. In the minds of many, the ends of the market process are contaminated by the means of that process. This anti-market mentality is illustrated by considering some examples of outcomes applauded as noble achievements when accomplished in the absence of market incentives, but which cease to be appreciated when accomplished, and accomplished better, through markets.

Barn raisings appeal to our sense of morality since they involve people coming together in a spirit of sharing with the clear intention of helping someone in the community who has lost his barn or some other physical structure. Most agree that it would be nice if barn raisings could be extended beyond small homogenous communities to involve large numbers of diverse people dispersed around the globe caring for and sharing with those who needed help replacing a loss. But lack of information about remote losses, and little expectation of reciprocity from strangers, confines the mutual generosity exemplified by barn raisings to small, close-knit groups. Yet, an extended community of "barn raisers" is possible, and has been realized by shifting our reliance from magnanimous morality to the mundane morality of financial incentives. We are obviously talking about insurance, which is provided by profit-seeking firms pooling the risk of large numbers of people, acquiring information on where losses occur, and ensuring that each person's contribution assisting others is reciprocated when, and if, they need assistance. The outcomes of insurance are actually better than traditional barn raisings. The risks are shared far more widely, and those suffering losses receive money with which to hire specialists in the type of work needed, which means better work and fewer injuries. But this achievement is seldom appreciated as an improvement over traditional barn raising because the provision of insurance is at best seen as an impersonal process completely lacking in concern and sacrifice for others. Appreciation of the widespread network of mutual help made possible by insurance is largely trumped by thoughts of profiting from the misfortune of others.

Consider conservation, which is an example of sharing with future consumers, often those yet unborn. Almost without exception, conserving our resources for the benefit of future generations is considered the moral thing to do. The morality of conservation, however, does not reduce the difficulties faced by any serious effort to conserve wisely. For example, how much of a resource is it desirable to conserve? Obviously conserving more of a resource makes sense only as long as its marginal value is less today than it will be in the future. And even if we knew how much to conserve, what motivation do people have to act on that information? Conservation requires current sacrifice, and the temptation is strong for people to depend on others to do the conserving. Even if one is initially willing to accept her share of the sacrifice by using less of a resource, she is unlikely to continue doing so when seeing others persisting in their shortsighted ways. What few recognize, or appreciate, is that the most effective force for conserving resources is speculators communicating through and responding to market prices in search of profits. Speculators are constantly responding to changing information on the likely value of particular resources in the future and, when they believe a resource's value will increase, they seek to profit by entering into contracts which increase its current price, motivating all consumers to consume less today and making more available in the future.[5] There would be little conservation without the incentives of the higher market prices generated by speculation, yet speculators are widely despised as profiteering hoarders even by those who consider themselves strongly in favor of conservation. The view of speculators as immoral is understandable given the lack of magnanimous morality involved in speculation. And it is another example of the widespread hostility toward the morality of markets obscuring the desirability of its achievement.

Some goods and services have strong emotional connections to a tradition of caring and sharing in highly personal settings that extend through almost all of human history. Medical care is an example that comes to mind. As a result, it seems reasonable to expect magnanimous morality to be a more important factor in evaluating the provision of medical care than in many other productive activities. This is surely a partial, but important, explanation for the large government role in medical care. Until very recently, medical care was provided almost entirely by a family physician who often knew those he treated, not only as patients but as fellow members of the community. The personal connection between doctors and patients increased the sense of caring between them, and this commonly extended to patient fees being adjusted to their particular circumstances. The personalized nature of medicine weakened as medical technology increased the number and importance of medical specialties, with a patient often seeing several different physicians in the treatment of an illness or injury. As medical insurance (most of which is acquired through employers) became an increasingly significant way of paying for medical care, the personal relationship between patients and physicians was further eroded. This erosion has surely affected the public response to rising medical-care costs that have been increasing faster than inflation rates partly because of impressive but expensive improvements in medical technology, and partly because of the moral hazard created by low-deductible health

[5]Similarly, speculators who believe that a resource's value will decline (that conservation is excessive) can help correct the situation and profit (if they are correct) by entering into contracts that reduce the resource's current price and increase current consumption.

insurance.[6] With most of these increased costs reflected in the higher premiums charged by impersonal insurance companies (which employees pay both directly and with lower salaries and wages), there is little sense of personal connection and caring to moderate the hostility toward what is seen as profiteering. Not surprisingly, politicians have used this as an opportunity to showcase their "compassion" by increasing government subsidies for health care to reduce the perceived medical-care costs. Of course, these subsidies serve to increase costs, but the higher costs are blamed on the greed of insurance companies and doctors.

Additional examples come to mind of outcomes that almost everyone would applaud if they were generated by behavior satisfying the conditions of magnanimous morality, but which go unappreciated or worse when generated by the mundane morality of the marketplace. The most effective way to help relieve Haiti's poverty would be for wealthy countries such as the United States to open their markets to the products that Haitians have a comparative advantage producing, in particular sugar. Making it possible for Haitians to help themselves by producing and exporting sugar, and other products, would do more to increase the long-run prosperity of the Haitian people than occasional and temporary relief efforts. Yet there is no apparent political pressure in any of the wealthy countries currently restricting sugar imports from Haiti to lift those restrictions. Providing help indirectly to unidentified foreigners through impersonal commercial exchange does not generate the moral satisfaction as does providing help directly to identifiable victims of natural disasters.

Finally, kidney transplants are a life-saving surgical procedure, and applauded as such when the kidneys are provided in a morally acceptable way—without compensation and therefore without any intent to profit from the plight of others. Unfortunately, fewer kidneys are donated than are needed, and plausible arguments supported by empirical evidence support the view that a market in kidneys would extend thousands of lives each year by increasing the number of kidneys available (Becker and Elias 2007). But such markets are outlawed in the United States and almost all other

[6]Low deductibles on health insurance are motivated by tax policy that does not tax the cost of health insurance premiums paid directly by employers as income to the employees. Therefore, the lower the deductible the greater the proportion of health care costs paid with pretax income.

countries, with little public support for legalizing them. The noble desire to save lives is universally and adamantly proclaimed, but it is apparently not strong enough to overcome the moral aversion to doing so for commercial reasons.

The emotional appeal of behavior conforming to the ideas of magnanimous morality provides a plausible explanation for the illusive search for a "third way," or "capitalism with a human face." These terms can refer to a number of policy proposals, but they are often nothing more than political slogans suggesting the possibility of an economy that provides the prosperity of free markets with the personal compassion and caring of magnanimous morality. No matter how much this possibility appeals to our instinctive morality, it is not possible, which explains why President Vaclav Klaus of the Czech Republic has stated his preference for "capitalism without adjectives." But French President Nicolas Sarkozy appealed to the dominant morality in his keynote speech to the 2010 World Economic Forum in Davos by urging, "We must re-engineer capitalism to restore its moral dimension, its conscience" (Lincicome 2010). Such political appeals are particularly effective at creating public support for expanding government control over the economy during economic crises by proclaiming the magnanimous morality of government in contrast to the mundane morality of the market place. The result is a widespread belief that more government is needed to solve economic problems that were primarily caused by an already excessive government (Meltzer 2010).

It Takes More than Caring

Caring for others is universally seen as a moral imperative. There are two reasons, however, why it can never be the basis for widespread cooperation and prosperity. First, the number of people we can meaningfully care for is tiny compared to the number we have to cooperate with in a productive economic order. We all depend on the specialized efforts of countless others for the goods and services required to maintain our standard of living. Assisted living is not just for the elderly. We all need the benefits of assisted living, with literally hundreds of millions of assistants. Of course, this assistance has to be mutual with it expected that we will reciprocate with specialized productive efforts of our own to provide others with the assistance they need. There is no way that more than the tiniest amount of this mutual assistance can be motivated by people sincerely caring about each other.

Second, even if we could care about many millions of consumers scattered all over the globe, we would need to have information on what they most want. Even if we somehow knew that, producing what they want efficiently requires information on how to best combine our resources and specialized skills with those of countless others. And how do we communicate to those benefiting from our productive efforts what we want them to produce for us?

Given the magnitude of the task of providing the motivation and information needed for countless people to coordinate their actions to serve their mutual interests, it is obvious that no economic system does, or can do, a perfect job. But anyone who thinks about the prosperity enjoyed in market economies should recognize that somehow people are doing an impressive job communicating vast amounts of information back and forth to each other and responding to this information *as if* they cared for each other. The explanation for this is that the market is a truly amazing information-processing network that has been operating since long before the arrival of what we now call the Information Age (Lee 2001). The market allows the constantly changing information that is possessed in fragmented amounts by literally billions of widely dispersed individuals on their unique preferences, abilities, expectations, and circumstances to be aggregated and communicated to those best able to respond to it, and done so in a way that motivates mutually beneficial responses. This is accomplished through market prices which emerge from a process of what are largely impersonal exchanges of private property without the need for those benefiting from each other to care for each other (Hayek 1945).

Despite the widespread benefits created by market outcomes, we have seen that those outcomes are commonly unappreciated because they are determined by trades that are commonly impersonal—that is, they take place between people who don't know or care for each other—and motivated solely by self-interest. And even when the outcomes of the market are appreciated, there remains a longing among many for an economy that provides the benefits of the market in ways more consistent with widespread views of morality—for example,"capitalism with a human face." It should be obvious, however, that impersonal exchange and self-interest are necessary for realizing those benefits.

There have been spectacular advances in communications technology in recent decades, but the ability to communicate effectively with the digital marvels of the Information Age pales in comparison to communication with market prices. For example, if the value Canadians realize from bananas increases relative to that realized by Americans, the best way for Canadians to communicate their desire for Americans to share more bananas with them is through the higher market prices resulting from their increased demand. As opposed to a mass e-mailing from Canadians asking Americans to consume fewer bananas, the higher price goes only to those in the best position to respond to the request—Americans who eat bananas. And as opposed to the information we get from many of the e-mails we receive (such as someone in Nigeria who wants to transfer millions of dollars into our banking account), when receiving information from prices we take it seriously and respond to it *as if* we care as much about the concerns of others (the desire of Canadians for bananas in our example) as we do our own. Also, the Canadians have no idea how much any particular American should reduce her banana consumption, or how much all Americans should reduce their consumption in total. But each American banana consumer will response to higher banana prices, using the information that only she has on the value she receives from bananas, by reducing her consumption only as long as the value she sacrifices is less than the additional value a Canadian consumer realizes. And the total amount by which Americans will reduce their banana consumption will almost exactly equal the total amount of additional bananas that Canadians want to consume at the higher price.

Market prices are obviously impersonal (even more impersonal than a mass e-mail), and they are also the result of an exchange process that is motivated almost entirely by self-interest. But for market prices to embody accurate information on the value of what is being bought and the cost of making it available, the buying and selling has to be informed by the information dispersed over those participating in the exchange. And what each individual knows better than anyone else is how his interests are affected by acquiring or making available a good or service. So the information embodied in market prices has to be based on the self-interest of those making economic decisions in order to provide the information that is vital to the global network of mutual assistance upon which we all depend. Without that network only a small fraction of the world's population could survive, and those who did would live short lives in wretched poverty.

Yet, lack of appreciation for the market remains widespread as reflected in a constant stream of recommendations to substitute caring and compassion for exchanges and market prices. Serious attempts to implement such recommendations, however, often require price controls that lead to unintended and unfortunate consequences such as shortages, higher costs, lower quality, black markets, and the substitution of criminal for legal activity. But such adverse outcomes are routinely trumped by misplaced morality. Consider, for example, the view expressed by Steven Rockefeller (a son of Nelson Rockefeller) about his experience working in the rental office in Rockefeller Center:

> I found myself going around knocking on doors and saying things like, "Hello, I'm Steven Rockefeller and I'm here to raise your rent." It was ridiculous. . . . I was interested in politics and religion, in questions about the moral basis of democracy and the nature of the "good society." There's a basic conflict between this level of thinking and going around trying to raise somebody's rent, especially when it didn't seem to me that the family needed much more money. I didn't need more money, didn't need more than I already had. I already sensed an injustice in us having all we had, in the midst of a world with such great need on the part of so many [Collier and Horowitz 1976: 612–13)].

No matter how deeply Steven Rockefeller cared about the well-being of renters, rents based on his caring and sense of justice are unlikely to be anywhere nearly as effective as market rents at productively and harmoniously reconciling different views on the costs and benefits of alternative uses of New York City office space.

The market is often faulted on moral grounds for rewarding a few people lavishly without caring about their merit relative to that of the many who work harder and commonly lead more respectable lives, but earn far less. It is easy to see this as an unfair feature of the impersonal nature of markets. Why should someone who happens to be born with a beautiful voice, great athletic ability, or good looks and acting talent be able to earn more in a few weeks (while receiving the adulation of a multitude of fans) than most earn in an obscure lifetime of hard work? It is tempting to defend markets against this criticism by arguing that markets do reward people on the basis of merit. But this defense is unconvincing to most people, who see merit in terms of a morality not contained in the mundane morality of the marketplace. And it should be unconvincing. In markets, people are rewarded for serving others and the greater the value of the services they provide, as evaluated by those receiving them, the larger the reward. Because of the impersonal nature of most market exchanges, consumers are not nearly as interested in the merit, moral or otherwise, of those producing the goods being bought as they are in quality and price of those goods.[7] In markets, people do not have to be hard-working, particularly intelligent, well educated, loving spouses, or very nice to become wealthy. All they have to do is possess things or abilities that people value (which they may have acquired by pure luck) and respond to the information communicated through market prices to benefit others. What critics of markets tend to overlook is that impersonal market exchanges increase the benefits that consumers realize from the special abilities that some people have. Consumers are far more likely to benefit from a child born with the potential to become a great singer, athlete, actor, writer, or entrepreneur if that child is born in a country relying on markets, where he or she can become fabulously rich by benefiting others, than if that child is born in North Korea, Cuba, Zimbabwe, or another country in which markets are suppressed.

But it is not just those with special talents from whom consumers receive more benefit in a market economy than they would in an economy that attempted to reward people on some moral measure of merit. Most of the day-to-day benefits we receive in market economies come from the multitude of ordinary people pursuing their private interests doing rather ordinary things in response to market prices with little concern for the vast majority of those whom their efforts are benefiting. Any attempt to adjust the return people receive to reflect their merit instead of what consumers are willing to pay them for the goods and services they provide would destroy

[7]This interest is understandable for reasons other than self–interest. As Hayek (1960: 96) points out, it would "be impossible for us to reward all merit justly, . . . it is only the value of the result that we can judge with any degree of confidence, not the different degrees of effort and care that it has cost different people to achieve it."

the information contained in market prices—information that is needed if we are to know how to develop our potential abilities, and how to make the best use of those abilities to improve our own situations by serving the interests of unknown others.

The Moral Ideals of Social Harmony and Human Liberty

Morality has consequences, and we have been considering the tendency to dismiss and disparage desirable economic consequences when they are achieved unintentionally through the mundane morality of the market process. We now examine two consequences of that mundane morality that, because they are moral ideals themselves, cannot be so easily dismissed even if people recognize that they depend on mundane rather than magnanimous morality. Those ideals are social harmony and human liberty.

Social Harmony

A noble, though illusive, ideal that is universally praised is harmonious and peaceable relations among people. The difficulty is that people have different goals and aspirations that are always in conflict to some degree. So it is commonly suggested that we subordinate our personal objectives to common objectives upon which we should all agree. But achieving such unity of purpose is possible only in small homogenous groups or temporarily in response to serious crises.[8] So as a supplement to common goals, we also hear that it is important to celebrate our diversity as a way of promoting social harmony. Unfortunately, when our differences are politicized there is a real risk that the celebration will involve some high-octane fireworks, as illustrated by recent events in the Middle East and other global hot spots. The setting most conducive to social harmony is one in which we can each pursue our particular objectives in ways that help others pursue theirs, no matter how different those objectives may be. This is exactly what the impersonal exchanges of markets facilitate, which explains why markets do far more to promote harmony among diverse people

[8]This provides an explanation for why politicians talk about the nation as a family and depict small and often nonexistent problems as crises when they are trying to mobilize public support for expanding government.

than attempts to reach agreement on common objectives (Lee 1994). For example, a Baptist looking for lumber to add a wing to his church is not likely to be concentrating on the lifestyle of those selling lumber, so if an atheist playboy in the lumber business offers the best deal he will probably get the Baptist's business. The result is that the Baptist facilitates a lifestyle that he abhors and the atheist facilitates a religious practice that he considers absurd, and they do so in a completely harmonious way. Trying to achieve the same harmonious cooperation by encouraging the two to have more personal contact to celebrate their diversity is more likely to create conflict than promote harmony.

Increasing our concern for others is commonly recommended as a way of achieving social harmony. Unfortunately, it often has the opposite effect. Indeed, a compelling argument can be made that one of the most effective ways of reducing social conflict is by increasing our reliance on markets because they encourage us to subordinate concern for others to concern for our financial success. The sad reality is that long-standing grievances and animosities between members of different religions, nationalities, and ethnic groups has often meant that the concern people have for the well-being of others is accompanied by the desire to inflict as much harm as possible on them. For example, Muller (2002:15–16) points out that

> The great historical fact that served as the moral backdrop for thinking about capitalism was . . . war between men with rival views of ultimate salvation, men who were so sure of their view of salvation that they were prepared to shed the blood of their fellow man in order to save his soul. It was in this setting that intellectuals set themselves the task of developing a political and social theory that would allow those of radically different visions of the good and holy life to live together. . . . [T]hey tried to redirect men's fears from their eternal salvation to their earthy well-being, believing that the prospect of improving their worldly well-being would provide broader grounds for consensus, or at least for peace.

Although one can quibble with Muller's suggestion that intellectuals did more than theorize about how political and economic institutions that were emerging at the time (without any help from human design) could moderate social strife, it is surely true that intellectuals began recognizing that such moderation could result from market exchange and the pursuit of financial success. Samuel Johnson famously said, “There are few ways a man can be more innocently employed than getting money” (Hirschman 1977: 58). Voltaire commented on the London Exchange (a major center for international capitalism during his time) by observing:

> Although the Episcopalian and the Presbyterian are the two main sects in Britain, all the others are welcome and live quite well together, while most of their preachers detest each other. . . . You will see assembled representatives of every nation for the benefit of mankind. Here the Jew, the Mohametan and the Christian deal with one another as if they were of the same religion, and reserve the name ‘infidel’ for those who go bankrupt [Muller 2002: 29].

Moving forward a century, John Stuart Mill (1848: 120) stated, “It was in vain to inculcate feelings of brotherhood among mankind by moral influences alone, unless a sense of community of interest could also be established; and that sense we owe to commerce.” And in the 20th century John Maynard Keynes ([1936] 1997: 374) wrote:

> Dangerous human proclivities can be canalized into comparatively harmless channels by the existence of opportunity for money-making and private wealth, which, if they cannot be satisfied in this way, may find their outlet in cruelty, the reckless pursuit of personal power and authority, and other forms of self-aggrandizement. It is better that a man should tyrannize over his bank balance than over his fellow-citizens.

No one would argue that commercial pursuits can motivate us all to join hands and sing “We Are the World.” But the mundane morality of commerce and trade does not have to do a great job promoting social harmony to outperform the magnanimous morality we inherited from our hunter-gatherer ancestors.

The desire for a harmonious and productive society based on magnanimous morality has led people to hope for what has been referred to as the “new man.” The new man, and woman, would possess an impressive willingness to sacrifice for the common good and have a benevolent concern for others—many others—without regard to their race, nationality, or religious beliefs. This vision of morally elevated men and women and the utopian social orders they would make possible has been so attractive that many have found it impossible to wait for the new man to arrive before trying to create the social orders that depended on him. Of course, the new man never reported for duty, and even if he had, the social orders based on him would be neither productive nor harmonious.

No matter how motivated people might be to serve the interests of others, the information they need to do so through positive-sum cooperation is lacking without the prices and profits made possible by the mundane morality of impersonal market exchanges. Clearly positive-sum activities with everyone improving their situation over time is more conducive to social harmony than zero-sum activities with those who gain doing so at the expense of others. And when attempts to create a society based on magnanimous morality fail, the inevitable result is more government control over the distribution of goods and services, always in the name of promoting fairness and social harmony. As opposed to reliance on impersonal market exchanges, when political considerations dominate economic decisions, the emphasis shifts from creating new wealth to distributing existing wealth, and positive-sum cooperation is increasingly replaced by zero-sum conflict. A recent article in *The Economist* (2010: 16) on attempts in European countries to maintain and promote social cohesion with greater government control over the economy concluded "that many of the policies espoused in the name of social cohesion do not promote compassion over cruelty. Rather, they encourage decline, entrench divisions, and thus threaten the harmony they pretend to nurture."

Human Liberty

Finally, consider human liberty, which is clearly a moral ideal. Indeed, moral behavior requires liberty in the negative sense of freedom from arbitrary coercion. Behavior that is properly considered moral when performed voluntarily is hardly moral if coerced. But the absence of coercion without responsibility is not liberty, but license, and will not long be tolerated. Relying on magnanimous morality to discipline behavior in responsible ways hardly provides a strong foundation for the responsibility upon which liberty depends. Given our limited moral capacity, magnanimous morality is quickly overwhelmed by temptations to free-ride on the responsibility of others, and not much responsibility remains. This leaves political suppression, which destroys all but the most clandestine exercise of freedom, as the only hope for constraining irresponsibility—a hope that is inevitably dashed by the irresponsible behavior of those with the political power.

Far more effective than magnanimous morality at protecting liberty by motivating responsible behavior is the information and discipline of the market. When people face prices that result from private property and voluntary exchanges, it is in their interest to behave responsibly by taking the interests of others into consideration. It is this responsibility that allows freedom to flourish to a far greater degree than would otherwise be tolerated. When private property and market exchange are impossible, or outlawed, freedom is the first casualty. Consider pollution. Because the atmosphere cannot be sliced up into multitudes of separate sections with individuals owning their own slice, people are unable to buy the right to pollute the air owned by someone else or sell the right to let someone pollute the air they own. The result is that polluters face no prices that reflect the cost their pollution imposes on others. Therefore, the motivation is to continue polluting, even though the marginal value realized from doing so is less than the marginal cost to others. The freedom to pollute would not be exercised responsibly, and so the freedom to pollute is not tolerated, even though the restrictions on that freedom and the way they are imposed are controversial. If private ownership of slices of the atmosphere were possible, prices would provide the information and motivation for people to cooperate in making the best use of the atmosphere for both breathing and polluting without having to restrict anyone's freedom to pollute.[9] And there would be no more reason for there to be social conflict over the freedom to pollute than there is over the freedom to buy shirts, eat out, take vacations, or buy a pair of eye glasses.[10]

[9]We ignore here the possibility of controlling pollution with transferable pollution rights. Such pollution rights do not establish anything close to perfect markets, but they would motivate pollution reduction with less government restrictions on our liberty.

[10]This may sound strange to many, but primarily because there is no natural way of parceling out slices of the atmosphere as private property. Yet it is useful to consider doing it as a way of understanding the advantages we realize (in terms of freedom and social harmony—not to mention the prosperity from making the

It needs to be emphasized that our argument is not that magnanimous morality is antithetical to social harmony and human liberty. Being sensitive to the concerns of others, being friendly and helpful to those we encounter in our daily activities, and being willing to make personal sacrifices to help those in need are critical to the emergence of, and general adherence to, social norms that facilitate productive and harmonious relations between people. These social norms, and widespread obedience to them, make it possible to dispense with a proliferation of formally imposed requirements, prohibitions, and mandates that would otherwise be widely demanded, even at the expense of restricting our liberties. It is important to recognize, however, that the benefits from magnanimous morality are realized primarily from applying this morality to our interactions with the relatively small number of people with whom we are in direct contact. It is the attempt to impose restrictions and prohibitions in the commercial sphere on behavior guided by the mundane morality of the marketplace rather than by magnanimous morality that is destructive to social harmony and freedom, as well as to the productivity upon which we all depend. As Hayek (1988:18) so insightfully pointed out,

> If we were to apply the unmodified, uncurbed, rules of the micro-cosmos (i.e., of the small band or troop, or of, say, our families) to the macro-cosmos (our wider civilization), as our instincts and sentimental yearnings often make us wish to do, *we would destroy it*. Yet, if we were always to apply the rules of the extended order to our more intimate groupings, *we would crush them.* So we must learn to live in two sorts of worlds at once.

Clearly Hayek's "rules of the micro-cosmos" are based on what we are referring to as magnanimous morality and his "rules of the extended order" are based on what we are referring to as mundane morality.

---

best use of our resources) from voluntary exchange and market prices in those many cases where private property is possible. Of course, as we have been emphasizing throughout this paper, no matter how great the benefit realized from markets, there will remain in the minds of many the belief that these results are contaminated by the lack of magnanimous morality motivating the impersonal market process.

Conclusion

No one denies the value of magnanimous morality. But neither can it be denied that, like almost all valuable things, this morality is scarce—there is less genuine personal caring and concern for others and it is extended to a smaller number of people than would be desirable if the costs of expanding and properly directing it were zero. But such caring is obviously costly.[11] Of course, people are capable of caring for a limited number of others, and willing to do so despite some personal cost. Part of the reason for this willingness is that, up to some point, the marginal private return from behaving in ways consistent with magnanimous morality exceeds the marginal private cost. But not even economists believe that people respond to others in caring and compassionate ways solely because of the expectation that the costs will be repaid with reciprocity. Adam Smith ([1759] 1982: 9) recognized this in the first sentence of his first book, which we quoted in the second section.

Furthermore, there can be no doubt that the benevolent sense observed by Smith, and the caring for others that results, can be nurtured and expanded, at a cost. A significant amount of the gross domestic product of every country is devoted to civilizing people in the sense of developing their willingness to subordinate their private concerns to some degree to the interests of others. Such acculturation is an important function of families, schools, churches, and numerous social organizations. Given the durability of those institutions, it is hard to deny that the good they do exceeds their costs—if not at the margin then at least in total.

No matter how great one believes the marginal social value of caring for others is, the optimal amount of it is very limited, which suggests we should use our limited capacity to care where it does the most good and rely on market exchange as a substitute for caring—that is, we should view the market's mundane morality as a good substitute for magnanimous morality. Private ownership, voluntary exchange, and the mundane morality of the marketplace do a far better job, at a far lower cost, of promoting productive

[11]One of these costs involves filtering out the receipt of care from others we do not want. This is a cost that Henry David Thoreau (1904) surely had in mind when he wrote "If I knew for a certainty that a man was coming to my house with the conscious design of doing me good, I should run for my life."

cooperation and social harmony over multitudes of diverse and dispersed people than relying solely on magnanimous morality.

Moreover, by substituting markets for magnanimous morality, the extremely limited human capacity to care for others that is fundamental to magnanimous morality can be used where it is most precious—in the family and other small group settings in which individuals truly treasure one another. As William Niskanen (2009: 564) noted, "Of all the major forms of social interaction, capitalism is the least dependent on the inherently limited supply of caring, a relation that is better applied to more intimate social interactions."

Let us conclude by returning to our introductory remarks about making an effective case for market economies. The first thing to emphasize is that making such a case cannot ignore moral issues. But the only way to discuss morality when making the case in a way consistent with sound economics is by recognizing that markets cannot be defended on the basis of morality as commonly understood—namely, by relying on what we have called magnanimous morality. Any attempt to do so is dishonest and sure to be met with extreme skepticism, if not ridicule. We don't claim that making the case for markets on the basis of the mundane morality discussed here is sure to succeed. An honest case for the market inevitably confronts highly emotional and widespread understandings of morality that will always trigger reservations about the desirability of markets and the impersonal interactions upon which they depend. But better to achieve limited success with an honest case than to achieve even less success by making moral claims for markets that are, at best, misleading.

References

Becker, G. S., and Elías, J. J. (2007) "Introducing Incentives in the Market for Live and Cadaveric Organ Donations." *Journal of Economic Perspectives* 21 (3): 3–24.

Brennan, G., and Lomasky L. (1993) *Democracy and Decisions: The Pure Theory of Electoral Preference.* New York: Cambridge University Press.

Collier, P., and Horowitz, D. (1976) *The Rockefellers: An American Dynasty.* New York: Holt, Rinehart, and Winston.

Friedman, M. (1953) "The Methodology of Positive Economics." In *Essays in Positive Economics.* Chigaco: University of Chicago Press.

Hayek, F. A. (1945) "The Use of Knowledge in Society." *American Economic Review* 35 (4): 519 –30.

___________ (1960) *The Constitution of Liberty*. Chicago: University of Chicago Press.

___________ (1988) *The Fatal Conceit: The Errors of Socialism*. Chicago: University of Chicago Press.

Heyne, P. (2008) *Are Economists Basically Immoral?* Edited by G. Brennan and A.M.C. Waterman. Indianapolis: Liberty Fund.

Hirschman, A. O. (1977) *The Passions and the Interests: Political Arguments for Capitalism before Its Triumph.* Princeton, N.J.: Princeton University Press.

Keynes, J. M. ([1936] 1997) *The General Theory of Employment, Interest, and Money.* Amherst, N. Y.: Prometheus Books.

Lee, D. R. (1994) "Celebrating the Economic System That Makes Diversity Worth Celebrating." *Intercollegiate Review* 29 (2): 16–24.

___________ (2001) "The Internet, the Market, and Communication: Don't Ignore the Shoe while Admiring the Shine." *Cato Journal* 20 (3): 477–85.

Lincicome, S. (2010) "Clueless: Sarkozy Calls Free Trade 'Immoral.'" Scott Lincicome Blog (http://lincicome.blogspot.com/2010/01/clueless-sarkozy-calls-free-trade.html).

Meltzer, A. H. (2010) "Market Failure or Government Failure?" *Wall Street Journal* (19 March): A19.

Mill, J. S. (1848) *Principles of Political Economy, Vol. 2*. London: John W. Parker, West Strand.

Muller, J. Z. (2002) *The Mind and the Market: Capitalism in Modern European Thought*. New York: Alfred A. Knopf.

Niskanen, W. A. (2009) "The Undemanding Ethics of Capitalism." *Cato Journal* 29 (3): 559–65.

Rubin, P. H. (2003) "Folk Economics." *Southern Economic Journal* 70 (1): 157–71.

Schumpeter, J. A. ([1942] 1950) *Capitalism, Socialism and Democracy*. New York: Harper and Row.

Smith, A. ([1759] 1982) *The Theory of Moral Sentiments*. Indianapolis: Liberty Fund.

___________ ([1776] 1981) *An Inquiry into the Nature and Causes of the Wealth of Nations*. Indianapolis: Liberty Fund.

The Economist (2010) "The Cruelty of Compassion" (30 January): 16.

Thoreau, H. D. (1904) *Walden.* London: George Routledge and Sons.