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Disciplinary Brief

ECONOMICS AND THE VIRTUES

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We suspect that most economists, both academic and professional, if asked to comment on the role of the virtues in economics, would look somewhat surprised to be asked, as the virtues do not figure in the standard frameworks of economics as currently practiced. The exception might be those whose training has included the history of economic thought, and might be aware that there was an older discourse which did address the role of the market in fostering good behaviour in economic activity, and a later discourse which understood the market as being inimical to virtuous behaviour.

The purpose of this brief is to provide signposts to these older literatures, and to indicate that the collective amnesia in the profession is a mistake: there are significant issues that need to be revisited if we are to understand the functioning of market capitalism now. First, we will sketch the debate that emerged in the late 18C, and took a different turn in the 19C. A particular emphasis will be on the role of Adam Smith as one of the early economists in the modern era who entered the debate. We will also briefly consider why the rhetoric about the virtues in markets disappeared from the mainstream economics narrative. Second, we will consider contributions to a recent literature which have attempted to reinstate the virtues as part of the discipline. Third, we will consider another recent literature, which explores the question: ‘Why good incentives are no substitutes for good citizens’ (Samuel Bowles (2016)). This literature owes a good deal to very recent developments in game theory, economics of information, and behavioural economics.

***Doux commerce*’ versus ‘self destruction’**

Those who wish to trace the history of ideas about virtues in markets the 18C and 19C are greatly in the debt of A O Hirschman, who provided an illuminating narrative in a classic article published in 1982. There were, according to Hirschman, two narratives in play.

Montesquieu on Commerce as Civilising

The first is the *doux commerce* narrative which views commerce as a civilising agent of considerable power and range. The story begins with key sentences from Montesquieu *The Spirit of the Laws*, written in 1749:

> '.. it is almost a general rule that wherever manners are gentle (*moeurs douces)* there is commerce, and wherever there is commerce, manners are gentle'
>
> 'Commerce … polishes and softens barbaric ways as we can see every day'.

Hirschman notes that this view was accepted unquestioningly by subsequent thinkers. The causation was mainly from commerce to good character and behaviour, but there was a reinforcing causation in the other direction. The key idea is that commerce brings people together for mutual benefit and that makes them more honest, reliable, self-disciplined, orderly, friendly, and helpful, and desiring to avoid conflict. That in turn enables markets to function better.

Marx and self-destruction

The second is the *self-destruction* narrative. The narrative can also be traced back to 19C thinkers, including Karl Marx who railed against the impact of commerce on social relations, with market exchanges crowding out traditional values such as love, family, concern for others, and patriotism. In market exchanges, the virtues were entirely absent in the behaviour of the participants:

> '… The bourgeoisie, wherever it has got the upper hand, has put an end to all feudal, patriarchal, idyllic relations. It has pitilessly torn asunder the motley feudal ties that bound man to his 'natural superiors', and has left no other nexus between people than naked self-interest, than callous 'cash payment'. It has drowned out the most heavenly ecstasies of religious fervour, of chivalrous enthusiasm, of philistine sentimentalism, in the icy water of egotistical calculation' (Marx and Engels, 1848, p. 13-14)

Adam Smith on Virtue and Vice

Ambivalence about the links between markets and virtue (or lack of it), is also evident in the writings of Adam Smith. The exegetical literature on the matter is too extensive to summarise here, but there is a paradox that some read Smith as supporting the *doux commerce* thesis while others argue that Smith suggested that markets tended to undermine virtues, the origins of which lay outside markets. The paradox has been illuminated by a study by Graafland and Wells (2021) who have used a 'semantic network data-mining approach' to study the text of *The Wealth of Nations.* The methods 'allow us to analyze what Smith *meant* by examining empirically (quantitatively) what he *said*' [p 32]. The units of analysis are the numbered paragraphs in the text, which are extensively utilised in Smith scholarship. A detailed scan of the text identified the terms that Smith used to refer to the market economy, the virtues/vices, and societal flourishing (defined much more broadly than the economist's preoccupation with productivity, wealth, and factors of production). The method then picked up the linkages between these terms in each paragraph. The results showed that in 60% of instances, free markets are associated with virtues, but in 40% the association is with vices.

The next step was to consider the association of virtues with societal flourishing: the association is overwhelmingly positive. The authors point out that this contrasts with Mandeville's parable of the hive, which Smith is often said to have endorsed: that private vices like vanity, selfishness and even dishonesty can be conducive to economic flourishing. Their next enquiry was to ask which virtues were thought by Smith to be conducive to societal flourishing. As expected, *temperance* and *prudence* emerge strongly in his writings. Perhaps less expected is a relatively strong showing for *benevolence*; for Smith the virtues of care and kindness to others are important, which contradicts the oft-asserted view that he thought the pursuit of self-interest was integral to a successful economy.

Why 18th Century Ideas were Abandoned

These findings of Graafland and Wells (and there is much more detail than can be reported here) enabled the authors to address the '*doux commerce*' and '*self-destruction*' theses in Smith. Their conclusion is he referred more frequently to the former, but was also very alert to the latter. Notably Smith was concerned that the two virtues of temperance and benevolence were vulnerable in free markets.

So how was it that these ideas of the 18C economists were forgotten or abandoned by the economics profession in the 19C and beyond? Hirschman has made some suggestions. First, the experience of the industrial revolution did much to destroy the optimism of the *doux commerce* thesis: it did not *look* as if the rampant capitalism which emerged had much to do with virtuous actors. Second, economists ignored the emerging sociological literature which suggested that division of labour required a degree of social coordination, and that market contracting generated social relations between the contracting parties. The presumed fissiparous tendencies of the market did not entirely undermine the social solidarity that market contracting required. Third, the development of economic theory, especially in the first part of the 20C, emphasised the market model of 'perfect competition', which assumes anonymity of buyers and sellers, and the absence of any communication between them. The model was favoured for its supposed property of optimal allocation of resources, rather than its descriptive realism. In the past fifty years of economic theory, the need to model markets more appropriately has given rise to game theory, information economics, and behavioural economics: knowing with whom you are transacting in the market is often central to the concerns of the analyses, not least knowing if you can trust them.

Revisiting the Virtues in Economics

The Bourgeois Virtues

In her book, *The Bourgeois Virtues: Ethics for an Age of Commerce*, Deirdre McCloskey (2006) presents a robust defence of the market capitalist economy as it developed in Western economies, notably since the 18C. Her claim, contra the critics of capitalism who claimed that markets were destructive of virtue, was that markets as they have developed are in fact both permissive of and conducive to virtuous behaviour, and dependent on virtues for their successful functioning. She presents a strong version of the *doux commerce* thesis. Her arguments are based on her observation of the historical and contemporary functioning of markets, particularly in North America but also in Europe, notably historically in Amsterdam, and a sharp critique of those who appeal to *a priori* arguments often based in economic theory as it developed in the 20C. She has little time for the utilitarian thinking that has become one of the foundations of modern theory, which she characterises as 'Prudence Only'. Her method is to explore one at a time what she identifies as the seven Classical and Christian virtues, explaining how they are present in market economies, and (to a lesser extent) how they are sustained in such economies. Here we will outline her treatment of three of these 'virtues' to illustrate her thinking (but this will not capture the full riches of her writing).

Love She begins her review of the virtues with Love, noting that this virtue is generally dismissed in standard theory with its emphasis on 'rational economic man' who seeks only their own self-interest. Her assertion is that the 'love' for other economic actors that emerges from game theory models is inadequate to the task of explaining the level of trust that underpins markets: experimental games with real participants show that they behave in disinterested ways, motivated by some notion of what might be a 'fair outcome'. McCloskey calls this 'solidarity'. Moreover, regard for others is central to living a flourishing life in areas that have little to do with commerce or other economic activities. Her critique applies particularly to economists like Becker (1981, 1993), who have sought to apply rational economics to modelling marriage, divorce, and the family [reference required]. She also questions the thesis of sociologists/ economists like Bellah (1996) and Putnam (2010) that the fragmentation arising from reliance on markets alone has led to a loss of social solidarity, describing it as social science 'myth' with little supporting evidence.

Courage She sees the virtue of courage evidenced in entrepreneurial behaviour, either in the face of competition from others in a market, or more directly in the pursuit of new business ventures. She notes that business people delight in pursuing 'new ventures' for their own sake, not just for the financial rewards that they bring. The point is that market capitalism provides a context in which this kind of courage can be exercised, and indeed that it is essential to the functioning of a successful market economy in terms of competition and innovation. She also warns that this kind of courage can become all-absorbing, resulting in pride, covetousness, envy, and greed. It needs to be balanced by other virtues such as temperance and justice. But too much temperance can crowd out courage, leading to timidity, sloth, and an unwillingness to experiment, leading to a stagnant economy which lacks innovation and energy. It is an important part of her message that the virtues come as a set, and all need to act in concert, without giving undue weight to any single virtue in the behaviour of individuals and groups.

Prudence As might be anticipated, McCloskey gives considerable attention to the virtue of prudence, given its prominence in Adam Smith. The usual definition of prudence is ‘good judgment’ or ‘practical wisdom’. It might be thought that this is not a virtue, but just a display of common sense in market behaviour. But it does have a moral dimension, in the sense of an obligation to self-development, and to use wisely the gifts, training and experience that one brings to a market economy. That will hopefully bring a financial reward, but acting prudently is its own reward in building up the virtuous character. This contrasts with the utilitarian focus of modern economics on actions that enhance a person’s wealth, or satisfaction with the goods that can be acquired with the financial gains from entering the market.

McCloskey draws together her assessment of the role of the virtues in market by suggesting that in actual markets (as opposed to the theoretical constructions of neoclassical economists) a full range of virtues are displayed – the so-called Christian virtues of love, hope and faith, and the pagan values of courage, temperance, prudence, and justice. Not all will be present to the same degree, but as she takes some pains to illustrate, they work together, and all are necessary to the good functioning of the market system. They are also all present as motivations for market behaviour. She makes a distinction between prudence (P), and what she terms solidarity values (S) such as society, sympathy, stewardship, sharing and other sacred values which motivate behaviour, and argues that both are needed to explain what happens in actual markets. Her criticism of neoclassical economics is that it ignores S, and simply presumes that those values can be identified as ‘tastes’ which do not need further interrogation. She identifies cases where behaviour cannot be understood without unpacking S: the most ubiquitous example is relationships within the family, which cannot, *pace* Gary Becker, be explained without appeal to other virtues such as love, hope and justice.

It is hard to do justice to the scope and depth of McCloskey’s book in a few short summary paragraphs. Our assessment is that her critique of ‘Prudence only’ as the basis for much thinking about market economies and societies is largely correct. She is right to draw attention to the presence of other virtues that motivate people in their economic activities, and which also serve to temper the tendency to excess of a focus solely on production and consumption. But she does not, in our view, demonstrate conclusively that the S virtues will emerge in the functioning of markets: that they are present is undeniable, but they could be nurtured elsewhere in a community or culture, and imported into market behaviours. Nor does she demonstrate that the market, motivated by prudence only (price, satisfaction, pleasure, utility) will not tend to destroy the S values as the self-destruction thesis asserts.

Reclaiming Virtue Ethics for Economics

Bruni and Sugden (2013) note that economic analysis has been critiqued for its reliance on instrumental rationality (‘rational economic man’) and on extrinsic motivations (such as pursuit of profit or utility). That analysis fails to understand that market transactions are human practices with their own values and intrinsic motivations. To address this richer understanding, the authors appeal to Macintyre’s definition of a ‘practice’, defined as ‘a coherent and complex form of socially established cooperative activity’. They argue that markets are such a ‘practice’ which has its own intrinsic values and standards of excellence that enables the purposes of the activity to be pursued.

Uncovering the Telos of the Market

The first step is to uncover the telos of the market. The authors note that the fundamental purpose of markets is to facilitate mutually beneficial voluntary transactions. The building blocks of elementary economic analysis include the famous ‘Edgeworth Box’ diagram which illustrates the mutual gains from exchange between two persons, and the Ricardian gains from trade between nations arising from comparative advantage. Market participants understand that transactions bring mutual benefits to the transactors, and that this motivates their market behaviour. Implicit in actual market behaviour are values such as universality, enterprise, alertness, respect for other’s preferences, trust, trustworthiness, acceptance of competition, self-help, and the stoical acceptance of outcomes.

It is worth looking at some of these in more detail to understand the role they play in markets. *Universality* is the disposition to make mutually beneficial trades with others on terms of equality, without discrimination. *Trust* and trustworthiness come into play in the common situations where monitoring and enforcement of contracts or deals is difficult or prohibitively expensive. If you cannot trust the other party, then trade will not take place. Acceptance of *competition i*nvolves the realisation and acceptance that other parties are not obliged to enter trades with you if there are better offers from other traders in the market. *Self help* is the understanding that you can only realise gains from trade if you have something (a good or a service, or labour) to offer in exchange. *Acceptance of outcomes* is just that: some deals will work out well, and others less well. There is no basis for an attitude that presumes that a trader is entitled to a particular return just because they entered the market. Nor should a trader be envious if some others prosper more than they do. Uncertainty (and luck?) are pervasive in trading.

Reflecting on our experience of markets, it is evident that a market economy would not function without these values; it is rather strange that they seldom feature in the teaching of elementary economics. The questions then are how these values can be turned into virtues exhibited by market actors, where ‘virtues’ are settled dispositions to act in accord with those values; and whether, as explored above, markets are supportive or undermining of those virtues.

Behavioural Economics and the Economics of Information

Behavioural economics and the economics of information have begun to address these issues. For example, there is an extensive literature in game theory about the emergence of trust: in principle, people can be cajoled into being trustworthy in situations where they are hoping to have a continuing presence in a market over time, and where information about deception or failure to fulfil promises is widely available to others in the market. [See Nowak and Highfield (2011) for a highly readable non-technical exposition.] Note, of course, that acting ‘well’ in such circumstances has nothing to do with virtue: it arises out of pure self-interest. There is also a literature that suggests that virtue is eroded where market incentives are introduced. The most quoted example is the Haifa creche. The creche had a problem with parents arriving late to pick up their offspring, so instituted fines for late collection. To their dismay the problem got worse. Parents interpreted the fine as a price for an additional service, for which they were willing to pay the fine. The introduction of the fine changed the mindset: previously arriving late was regarded as a failure to act appropriately towards the staff, but that was undermined. Sadly, when the fine was suspended, parents continued to arrive late in even greater numbers, because the virtue of being punctual and conscientious towards the creche staff had disappeared. The literature has moved towards accepting that market participants cannot always be relied on to behave virtuously, so the emphasis is on the development of mechanisms to reduce the impacts.

It is unclear (at least to us!) whether Bruni and Sugden are going beyond a conclusion that without virtues relating to mutual benefits from cooperation in trades the market will not function effectively according to its telos, to an expectation that these virtues will arise from the experience of market activity as participants recognise that virtuous behaviour is necessary to sustain the markets over time. The problem is that introduction of extrinsic motivations such as monetary gains or profits can easily displace good behaviour: even if bad actors will eventually be identified, they may have been able to make sufficient short-term gains not to care about being exposed, as they can retire with their ill-gotten loot!

Good incentives are no substitute for good citizens.

In his 2016 book, *The Moral Economy: Why good incentives are no substitute for good citizens,* Samuel Bowles gives a comprehensive discussion of why the *doux commerce* thesis might not work in economies that emphasise incentives in the functioning of markets. He reviews evidence from ‘laboratory’ experiments which involve participants in playing games involving making economic decisions. The evidence is clear that offering a monetary incentive to participants based on their ‘success’ in the games, no matter how small the incentive, tends to crowd out altruism (he terms this ‘categorical crowding out’), and that the bigger the incentive offered, the larger the degree of crowding out (‘marginal crowding out’).

Why Monetary Incentives Crowd out Virtues

He offers a range of suggestions for these findings. The first suggestion is that incentives provide information about the situational set up in the game, and so in some situations crowd out moral sentiments because it is appropriate not to be morally concerned: it is appropriate to be self-interested in the supermarket, but not within a family setting. The second suggestion is that incentives alter the process of learning to act morally, and so alters the weight given to altruism in the person’s preferences. The third is that the offering of incentives is taken to provide information about the designer of the incentive, in particular the intended effect on the agent, and about the nature and purpose of the task to be performed: that information may be construed as playing down or even eliminating moral sentiments. The fourth suggestion is that incentives can lead to moral disengagement: if markets are believed to be places where agents act without moral consideration, then even a morally alert agent may act as if moral concerns are not relevant. Fifth, incentives may compromise agency: if the incentives give a self-interested reason for something that the agent would have done altruistically, then the agent may become cynical about their motives and allow it to undermine their sense of altruism. Finally, in his listing of suggestions, Bowles notes that incentives fire up the deliberative part of the brain, whereas the emotional part of the brain is more effective in prompting altruistic behaviour. Strong incentives may effectively silence those promptings.

Liberal Societies more often Display Civic Virtues in Markets

This analysis leaves a question about how it is that market-based cultures in the West do have cultural norms that support good citizens, and at the same time rely on markets for economic and social interactions. If the presence of market incentives undermines altruism (the 'self-destruction' thesis) then how does it come about that what is observed is closer to *doux commerce*? He explores this in a seminal paper (2011) which asks the question 'Is liberal society a parasite on tradition?'. The paper reports studies that show unequivocally that market incentives crowd out moral motives. But it also presents convincing evidence from international comparisons of different societies that it is precisely the market based liberal societies that most exhibit civic virtues conducive to the functioning of markets. How can these contrasting pieces of evidence be reconciled?

Bowles answer is that there is co-evolution between the development of market economies, and the rise of social institutions such as private property and the rule of law, which mutually support and strengthen each other. In this he finds support in the Enlightenment narratives put forward by secular humanists, that moral sentiments can thrive in social culture. His contention is that liberal institutions counteract and more than compensate for any 'parasitic' effect of markets on virtues. He dismisses the alternative argument that the development of markets grew out of the social cultures of traditional societies.

Religion and the Morality of Markets

Notably he does not address the much-contested sociological argument that there has been a historic link between Protestantism and the rise of market economies in the West, as famously proposed by the sociologist Max Weber in the *The Protestant Ethic and the Spirit of Capitalism* (English translation 1938), and meticulously explored by R H Tawney in *Religion and the Rise of Capitalism* (1926, 1938). [1] The proposition is that the Reformation values of work as a 'calling', avoidance of personal extravagance and waste, upholding the ideals of integrity, truthfulness and honesty in market dealings, and an obligation to care for the other parties to a transaction, all enabled markets to function effectively and prevented opportunistic behaviour.

Fred Hirsch in his *Social Limits to Growth* (1977) also addressed the issue of the erosion of moral restraints in markets, and how that might be reversed. He is clear that a moral basis is needed if markets are not to be undermined by opportunistic behaviour on the part of participants. It can only operate successfully if there is general acceptance of standards of honesty, truth, trust, and absence of intimidation. While standards can be reinforced by a body of law, e.g. contract law, consumer protection, that is not sufficient in the absence of social consent. The entry of legal procedures into every contract would undermine the advantages of decentralised economic decision making, which is perceived to be the special genius of markets. Hirsch's thesis is that market capitalism originally succeeded because it had inherited a strong religious and moral framework, which served to prevent the pursuit of self-interest. However, with the erosion of religious sanctions, the market begins to operate less effectively for the reasons outlined in the 'self-destruction' thesis, and market behaviour begins to invade non-market areas. An interesting consequence is that without an ethic that sees the payment of taxes as a social responsibility, tax evasion and tax avoidance become the norm, and attract an even more complex structure of tax law to try to close the loopholes. Hirsch points to the decline of traditional Christian morality as the source of these problems, but has little to suggest how the situation might be rectified. At best he comments that a new social ethic is needed urgently, and optimistically asserts: 'The functional need for change in social ethic can be expected, over time, to promote it'.

In a provocative article (2011), Bowles outlines some evidence that markets crowd out virtues, but then attributes their overall success in western societies to the effect of also crowding out 'traditions'. What he means by traditions relates to the anthropological category of 'lineal-segmented societies'. These are societies based on related clusters of families who in the distant past exercised loyalty to the 'in' group and hostility to the 'out' group. Bowles notes that advocates of traditional values/societies often idealize them, and do not notice their more destructive tendencies, typical of lineal-segmented societies, such as a lack of respect for outsiders, the rule of law, or inclusive social decision making. Thus, secularized societies may be impacted negatively by markets crowding out virtues, but the retreat of 'traditions' more than offsets this. His argument is in contradiction to the Weber thesis, because he does not distinguish between traditions which are akin to mafia clans (lineal-segmented societies), and traditions such as Protestantism which encourage commerce by treating 'in' and 'out' people equally as bearers of the image of God, and so are consistent with inclusion, trust and other market-friendly virtues.

The Serious Costs of Ignoring the Virtues in Economics

This brief review of the relevant literature suggests that the ignorance of most economists about the virtues is a serious shortcoming. There is sufficient evidence to show that the 'self-destruction' effect in market economies is likely to be widespread in economic behaviour, and that the more optimistic *doux commerce* effect is present, but is probably not robust unless sustained by a moral framework imported from outside the market.

One solution is to seek to design market institutions and mechanisms to counter bad behaviour, so giving incentives to act well. A common response by the political authorities is to resort to law and regulation, seeking to counter damaging behaviours (such as corruption), or to constrain agents to behave in ways that are beneficial to all market participants. The danger is that regulation (and even more, legal constraints) will become a costly intervention which will undermine the market freedoms that underpin market capitalism. Moreover, as the experience of regulation amply demonstrates, the framing of rules can just give the regulated an incentive to seek ways around the rules, with costs both for the regulator and the regulated. The alternative is to seek ways of encouraging people to be ‘good citizens’ who care about the others with whom they are transacting in markets. The literature strongly suggests that historically it was external moral codes coming from religious cultures, such as the Reformation, that formed the emergence of ‘good citizens’. The optimism of some writers that secular moral codes can take the place of religious codes seems to us to be a triumph of optimism over a realistic assessment of the economic world in which humankind now lives.

Endnotes

[1] See Whinster (2005/6) for an account of the related contributions of Weber and Tawney.

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