IS ECONOMICS INDEPENDENT OF MORALITY?

PERSPECTIVES

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On questions of morality, ‘Contemporary Economics’ stands mute. Economists prefer sidestep moral issues. They like to say that they study trade-offs, and incentives and interactions, leaving value judgments to the political process and society. Today, Economics is commonly regarded as separate from and independent of ‘Ethics.’ It is not that the two are different subjects, like Mathematics and History, but that they are disciplines unrelated in any fundamental way; because they are seen to be so different from one another. Keeping economics and ethics separate, is viewed as a highly desirable state of affairs. On the one hand, their argument is that Economics is a science, and as such is concerned with facts. Ethics, on the other hand, is concerned with values, which are not amenable to the same rigorous treatment as facts. With this view of facts and values, economists quite naturally want to put as much distance as possible between ‘Ethics’ and Economics.

Economics did not begin as a science independent of Ethics. Adam Smith, who is generally regarded as to be the founder of “Free Market Economics,” was both a moral philosopher and an economist. Smith came to his philosophy of economic behaviour, described in *The*

Wealth of Nations through his view of moral behaviour espoused in his first book, *The Theory of Moral Sentiments*. He made no attempt to draw a sharp line between ‘Ethics’ and Economics, or to keep the two separate. Indeed, *The Wealth of Nations* is Smith’s attempt to explain and defend a system of natural liberty (Smith, 1976a and 1976b).

Smith suggested that rational self-interest informed by moral judgments based on fairness and justice, would lead to promote the best interests of society, guided by the invisible hand of the market place. He approached Economics with a deep sense of right and wrong and talked about the need to maintain the ‘Laws of Justice’ in all things. Efficiency was important so was sustainability. With freedom came responsibility. Freedom did not mean that we could ravage the planet for short term gain. It did not mean that mortgage salesmen could sell loans which would force borrower into destitution. ‘Freedom’ in the enlightenment sense, always carried a responsibility to others and to society. Smith also believed that wealth should not just benefit the individuals who created it, but wider society too. So he thought that the rich should be taxed more than the poor. He also said that profit should not be too high. If it were, he said, ruin would soon follow.

In Smith’s Sort of Economics, profit was defined as “returns sufficient to maintain a business long term.” If they got too high, he believed that the invisible hand would ensure a stiff dose of competition brought them back into line. This was everyone’s interest because excessive profits, act against social harmony. They increase income inequality.

Today, we have abandoned Smith's Sort of Economics. In the decision making process, there is no place for '**ethical decision making**' in the current context of Economics. Milton Friedman postulated that "**the social responsibility of business is to increase its profits.**" "Maximizing shareholder value" is how it would be described today. Milton Friedman argued that competition between big businesses suffices to safeguard the public interest, but in practice, it is almost always insufficient, especially where there is collusion among the players to safeguard their market dominance, and their political influence (Friedman, 1962 and 1980).

We can observe that in the technology and many other sectors, companies generate huge profits. Moreover, many of the financial institutions that have made the modern market economies so unstable in the recent years, make their profits from speculating. They just do not make excessive profits, they hardly add any economic value either. The same is true of the trading houses, commodities brokers, property developers. Some of the big investment banks regularly make more than \$ 100 million a day, simply betting on the market. They gamble but fiddle the outcome in their favour. Is it acceptable that many of the largest companies in the world make their profits from gambling, rather than supporting economic growth or financing business development?

It should be evident however, that this is not a reliable route to a good society. Five major problems emerge around this strategy of profit maximizing behaviour: instability, insecurity, inequality, monopoly

power and unsustainability. The problem of economic instability was all too obvious in the wake of the global financial crisis. Economic institutions pursuing profit without social responsibility resulted the most sharply pronounced financial crash, since the Great Depression in 1929.

Economics has made its own attempt to solve some of the problems involved in the moral judgment, in what we know as *Welfare Economics*. I believe this attempt has been a failure. ‘Welfare Economics’ attempts to ask the question “*What do we mean when we say that one state of a social system is better than another in strictly economic terms?*” The Pareto-criterion compares two social states, A and B, and makes a claim about whether the policy change that brings us from A to B is desirable or not. The most celebrated answer given is *the Paretian optimum*, which states that if in B all individuals have the same welfare as in A, and at least one of them has a higher level, then moving from **A** to **B** is a Pareto –improvement, and the Pareto criterion recommends the move from A to B on grounds of efficiency.

Many, if not most, economists accept the Paretian optimum as almost self-evident. Nevertheless, it rests on an extremely shaky foundation of ethical propositions. As many have argued, the Pareto-criterion remains undecided about the fairness or legitimacy of **A** as the starting point. *The Pareto-criterion also doesn’t attach any importance to distributive issues in either A or B.* If those who are living in misery stay equally miserable, but due to some policy or social change the ultra-rich become even richer, then can we all agree that this social

change is a social improvement? I am using this example of the Pareto criterion merely to support the claim that economists need to think more about the values embedded in their theories.

There is good reason to think that economic theory is itself in crisis and that arriving at a better understanding of Economics, is a necessary goal of long-term prosperity. Human societies neither move like planets, nor like molecules or DNA, of which the movements can be mapped with mathematical precision. The people in societies move under the laws of motion determined by themselves. The ambition of modern economic theory to resemble the Natural Sciences, has excluded the aspects of economic life that have no reliable parallel in nature, and therefore, cannot be understood with the aid of methodologies designed for the Natural Sciences. The exclusion of the moral quality of economic phenomena in the name of scientific objectivity has produced a 'reductionist' and 'determinist' discipline.

A further cause of disquiet is the Mathematization of human behaviour and desire for predictive models. Heavy emphasis on Mathematics has caused Neo-classical Economics to rely upon increasingly questionable presuppositions about individual autonomy and full information in decision making. The over-reliance upon mathematical formulae is at the root of why economists have become detached from ethical aspects in their professional studies. The use of Mathematics in Economics is undoubtedly very impressive, but there would appear to be a paradox here. Mathematics being synonymous with rigour and

precision, how is it that, it plays such a role in a discipline where vagueness reigns. As the economic and social world is so difficult to grasp schematically, to reduce to simple laws, the temptation is to take refuge in fictitious worlds, in models which have little to do with what can actually be observed but which lend themselves to endless mathematical refinement. The most important of life's criteria and its purpose are ignored. Behind the shield of Mathematical Formalism, Economics has given remarkably little attention to its hidden moral assumptions.

Further, we have created a society in which Materialism overwhelms moral commitment, in which the rapid growth that we have achieved is not sustainable environmentally or socially, if we do not act together to address our common needs. Market Fundamentalism has eroded any sense of community and has led to rampant exploitation of innocent and unprotected individuals.

I believe that much of Economics, as it is now taught, is morally bankrupt. The renowned economist John Maynard Keynes said, "Practical men who believe themselves exempt from any intellectual influences are usually the slaves of some defunct economist". The Neo-classical Approach has become increasingly irrelevant in understanding of the modern capitalist system.

There are three pervasive economic myths that have been around for a long time. The first is that markets are fair. Markets do *not* provide the right outcomes for the benefit of most of the people. Sometimes, this

myth is linked to the idea of 'invisible hand' of Adam Smith. But the situation on which he predicted, it was that there were a large number of buyers and sellers, none of whom could influence the price and that those actors were behaving in a moral way. Now neither of these assumptions applies. We see huge concentration of power in many markets. Look at the purchasing side. Do people have equal purchasing rights? The second of the three myths is that prices tell the truth. But, prices do not tell the social or the environmental truths. Third myth is that more income equals more happiness. For many people in the world it does not. It probably holds true if you are poor.

Much of Economics is morally insolvent, because so many people cling to these old myths. Clearly it suits the most powerful people to keep perpetuating these myths. The time has come for Economics to change direction and to find a path which does not deviate from true human values. The obvious unrealistic nature of Neo-classical Economics has begun to attract many calls for change. Many Presidential addresses of the American Economic Association, in recent times have paid attention on this issue. One of the strongest agitations regarding this issue has come from university students.

In France, in June 2000, a group of Economics students from some of the most prestigious universities including Sorbonne published a petition on the web protesting the lack of realism in Economics teaching, uncontrolled use and treatment of Mathematics as 'an end in itself,' the repressive domination of Neoclassical Theory and

Approaches in university Economics curriculum. They further argued that the drive to make Economics more like Physics, was flawed and, that it should be pulled back in line with its more social aspects. They called Economics they were being taught an '*autistic science*', lost in imaginary worlds.

In June 2001, a group of Ph.D. students at Cambridge University published their petition "Opening up Economics". By "Opening up Economics" they meant becoming mindful of the limitations of the mainstream approach – that is Neo-classical Approach to Economics. To understand the real world economic issues, they argued that the validity of the Neo-classical Approach is disputable.

More recently, in November 2011, about 70 undergraduates walked out from Professor Mankiw's EC 10 Economics lecture at Harvard, claiming that his teachings have driven the inequalities in today's society. They were deeply concerned about the overly conservative bias in this Introductory Economics course.

Economics has not experienced such a pressure to change since the 1930s. Then the complaint was its inability to explain the "Great Depression" and to effect a recovery. It responded by inventing macroeconomics. Today, indictment is both more general and more serious: Economics, as taught in universities neither explains contemporary reality nor provides a framework for the critical debate of the issues in democratic societies.

Does Economics merely study society or does it play a decisive role in *creating* it? If we actually construct reality with our thoughts and actions, then we all have a quite different moral responsibility for what we say and do. The increased knowledge of ethics should improve the policy prescriptions of economists. Economic policies, like any other actions, can be judged by ethical standards. If economists recommend a policy on economic grounds, but ignore the ethical side of those policies, they can endorse policies that promote harmful moral principles, principles that the economist himself might disagree with, if he reflects on them.

For example, economists often recommend policies on the grounds of economic efficiency. As long as the efficient use of resources takes place within a social system, that respects rights, this is a desirable aspect of economic activity. But what about advocating the poor rural women to go to Middle East for jobs. This policy may be efficient in terms of reducing the rate of unemployment and increasing the inward foreign remittances. Even if these policies are efficient, are they desirable?

Another advantage of exploring the relationships between Economics and Ethics is that it would give Economics a broader and more humane focus. It would help economists focus on the rich contexts within which economic choice is made. It would emphasize that Economics is more than the study of maximizing, it is also the study of social order, which requires acceptance of moral principles. In sum, incorporating Ethics into Economics will make us more cognizant of the effects of

our policy, will improve our theory, and will give Economics a broader and more humane focus.

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