The Undemanding Ethics of Capitalism

William A. Niskanen

The United States and many other countries are now experiencing the first major financial crisis in over 75 years, a condition that too many people have been quick to blame on an outbreak of greed that they claim is characteristic of capitalism. Blaming a financial crisis on greed, however, is like blaming airplane crashes on gravity.

Greed and gravity are always with us, and capitalist markets usually channel self-interest into mutually beneficial behavior. On occasion, the public and private institutions that have the responsibility to monitor economic behavior fail to perform their roles before there are large losses to other parties. The Securities and Exchange Commission, for example, was slow to react to early information about the misleading accounting by the Enron Corporation and the massive Ponzi scheme by Bernard Madoff, and the private credit rating agencies are often among the last to recognize that they have substantially underestimated the risks of some securities. The current financial crisis, however, is primarily a consequence of public policies to promote home ownership that have long been supported by politicians of both parties combined with recent changes in the private market for mortgages, policies and market institutions that have led to massively unwise behavior but with little evidence of a knowing unethical exploitation of other people.

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William A. Niskanen is Senior Economist and Chairman Emeritus of the Cato Institute. This article is a revision of a lecture presented at the Chautauqua Institution on July 21, 2009, as one of a series of lectures that week on "The Ethics of Capitalism."

Forms of Human Interaction

An understanding of the market requires that we put it in context of other forms of human interaction. All forms of human interaction involve one or more of three types of relations: caring, exchange, and threat. In a caring relation, one person does what another person wants (or needs) because he (she) cares for the other person. In an exchange relation, *each* person does what the other person wants. In a threat relation, one person threatens to do what the other person does *not* want unless the other person does what the threatening person wants.

Caring

A caring relation is inherently limited to one's family, friends, and others with whom one wants to maintain a close relation. In *The Theory of Moral Sentiments*, Adam Smith rejected the idea that man was capable of forming moral judgments beyond a limited sphere of activity centered on his own self-interest, stating:

> The administration of the great system of the universe … the care of the universal happiness of all rational and sensible beings, is the business of God and not of man. To man is allotted a much humbler department, but one much more suitable to the weakness of his powers, and to the narrowness of his comprehension—the care of his own happiness, of that of his family, his friends, his country [Smith (1759) 1976: 386].

Similarly, the late Paul Heyne, who may have been the most thoughtful contemporary writer about the relation between theology and economics, concluded that the New Testament ethics of face-to-face relationships have almost nothing to contribute to understanding how large-scale social systems are or should be organized. And he extensively documented the inconsistency and foolishness of contemporary theologians and others that have judged commercial society by the morality of face-to-face relationships (Heyne 2008). All the same, even children learn quickly that there is also some role for both exchange and threat in interactions in which caring is the distinctive relation. Neither families nor friendships are likely to survive *without* some consensual exchange or *with* more than a minimum amount of threat.

Exchange

The market, of course, is the interaction in which consensual exchange is the distinctive relation. This makes it possible to have economic transactions with almost countless people that one does not know and for whom one has no special caring. This makes it possible to have a much finer division of labor than is possible within a family, among friends, or within a firm, and the combination of increased trade and comparative advantage leads to a higher level of output and income for most everyone.

Economic relations also accommodate some amount of caring even if not especially dependent on it. I learned this lesson from my father, who owned two quite different small businesses, in one of which I worked summers through college. On occasion, my father would tolerate some temporary lack of responsibility by a usually reliable employee, supplier, or customer. I never understood whether this represented genuine caring or was merely a good business practice, but that did not matter because only my father's wealth was at risk to these decisions.

I am more skeptical of the case for social responsibility by larger firms with a broad ownership. In these cases, executives demonstrate their caring by spending part of the wealth of the other owners; I doubt whether most such manifestations of corporate social responsibility are consistent with the expectations and interests of the other owners. A reputation for social responsibility may best benefit the owners if it leads to some fiscal or regulatory preference by the government but, of course, at the expense of the owners of other firms that do not benefit from this preference. The strange Chevron billboards that encourage people to reduce their energy use, for example, may benefit the Chevron shareholders if they lead to additional free allowances under the pending cap and trade legislation.

I am *profoundly* skeptical of the views expressed in the recent encyclical by Pope Benedict XVI (2009) that calls for a new global economic order based on social responsibility, concern for the dignity of the worker, a respect for ethics, and stronger and more representative international organizations. The encyclical asserts:

> Charity … is the principle not only of micro-relationships (with friends, with family members, or within small groups) but also of macro-relationships (social, economic, and poli-

> tical ones). … Only in *charity, illumined by the light of reason and faith,* is it possible to pursue development goals that possess a more humane and humanizing value.

Pope Benedict expresses special concern that the competition among government economic policies to attract foreign businesses may weaken trade unions and social safety networks. My primary concern about this encyclical, however, is that it is too demanding of the human spirit, asserting that "solidarity … a sense of responsibility on the part of everyone with regard to everyone" is necessary to improve the human condition. I pray that this encyclical generates sufficient intellectual debate within the Catholic Church to challenge Pope Benedict in terms of their shared values.

A comment by the economist C. Lowell Harris illustrates this issue:

> Reality cannot compete with dreams, at least not "fairly." How easy to romanticize, perhaps about free enterprise, perhaps about possibilities of improving the world by some governmental policy which will restrict the freedom of others: Mr. Dooley made a good point when he said, "A man that'd expect to train lobsters to fly in a year is called a lunatic; but a man that thinks men can be turned into angels by an election is called a reformer and remains at large" [Harris 1972: 4].

A recent event illustrates this comparison: This summer, Bernard Madoff began a 150 year sentence for organizing a $60 *billion* private Ponzi scheme, but presidents Roosevelt and Johnson are honored for leaving us with a debt of $100 *trillion* for the government Ponzi schemes called Social Security and Medicare.

A market economy, in contrast, is very dependent on some minimal level of threat, primarily to enforce property rights and contracts. In this sense, as Adam Smith observed in *The Wealth of Nations,* every firm is dependent "on the powerful arm of the civil magistrate" (Smith [1776] 1937: 670). Several roles for the government other than enforcing property rights and contracts may increase economic well-being but are less critical to the success of capitalism.

For these reasons, I have described the ethics of capitalism as *undemanding*, because they operate primarily on the abundant supply of self-interest. A capitalist economy accommodates some amount of the limited supply of caring but is not dependent on this relation that is usually more valuable in more intimate forms of human interaction, and it minimizes the necessary dependence on the awesome instruments of threat.

Nobel Laureate economist James Buchanan makes much the same point in a comment about Adam Smith's *Wealth of Nations*:

> "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest." This statement is, perhaps, the most renowned in this classic book on political economy. From Smith onwards, the appropriate function of political economy, and political economists, has been that of demonstrating how the market system, as a perfectible social organization, can, and to an extent does, channel the private interests of individuals toward the satisfaction of desires other than their own. Insofar as this cruder instinct of man toward acquisitiveness, toward self-preservation, can be harnessed through the interactions of the market mechanism, the necessity for reliance on the nobler virtues, those of benevolence and self-sacrifice, is minimized. This fact, as Sir Dennis Robertson has eloquently reminded us, gives the economist a reason for existing, and his "warning bark" must be heeded by those decision makers who fail to recognize the need for economizing on "love" [Buchanan 1965: 1].

Buchanan would surely agree with the more obvious conclusion that it is also important to minimize the dependence on threat as a means of organizing social interaction.

At a Cato book forum in June 2008, my colleague Will Wilkinson came to an even broader conclusion: "Capitalism makes us better people." He argues,

> The expansion of the cooperative order and the prosperity and freedom that it tends to bring, simply makes life seem less cheap and expendable. But it also creates situational contexts in which cooperation and peace are reinforced over and over again. The much derided "bourgeois virtues" in the end turn out to be the key ingredient in a good apple [Wilkinson 2009: 10].

Threat

The government, of course, is the one institution that is almost completely dependent on the institutions of threat, in the form of taxes or regulations, to accomplish its objectives. Some government enterprises, such as the Postal Service, are financed primarily by the exchange of services for revenue, but even such enterprises are usually dependent on some exercise of threat to raise the revenues for subsidies or to restrict competition. Many government programs may be motivated by some targeted caring by the dominant coalition, but the implementation of these programs requires revenues that are raised by threat or regulations that are enforced by threat. The several health care bills now before Congress, for example, reflect the combination of a targeted caring for those without health insurance and of several types of both taxes and regulations. Moreover, only some competition among governments assures that there are any net benefits to those who are not part of the dominant coalition in a specific government. In summary, government has an essential but limited role.

The core principle for determining the limits on the powers of government is best described in John Stuart Mill's classic statement *On Liberty*:

> The only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. … Over himself, over his own body and mind, the individual is sovereign [Mill (1859) 1869: 9].

Conclusion

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, and it minimizes the dependence on threat. The public and private institutions of a capitalist economy are not immune to error, even major error as the current financial crisis is evidence, but most of these errors are evidence of bad judgment and inadequate monitoring, rather than an outburst of greed or malevolent intent. We would all value a better understanding of the conditions that led to the current financial crisis. Most valuable but all too rare would be sufficient intelligence to understand the conditions that are likely to lead to the next major crisis and the courage to act on this intelligence.

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