

FROM ADAM SMITH TO



SUSTAINABLE DEVELOPMENT



THE RETURN OF ETHICS TO ECONOMICS

DANIELS ETHICS INITIATIVE

Daphne T. Greenwood, Professor of Economics
February 6, 2017

This material was developed by Daphne Greenwood, Ph.D, and is intended for classroom discussion rather than to illustrate effective or ineffective handling of administrative, ethical, or legal decisions by management. No permission or compensation is needed for classroom use as long as it is acknowledged to be the creative work of the author and the UCCS Daniels Fund Ethics Initiative. For publication or electronic posting, please contact the UCCS Daniels Fund Ethics Initiative at 1-719-255-5168. (2018)

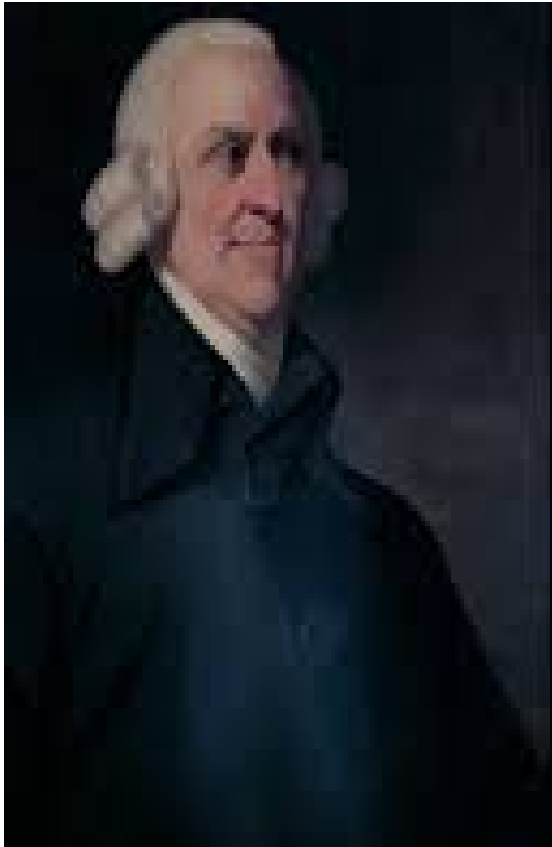
Ethics and economics

- Is it about professional economists?
 - *Inside Job* → code of professional conduct proposed by American Economic Association
- More about participants in the economy who shape framework where markets operate
 - consumers
 - owners and investors
 - workers and managers
 - + judges/legislators/voters

Broadening focus of economics to include issues of sustainability supports the same ethical concerns the Daniels Fund has

- Mainstream economics evolved over last fifty years to compartmentalize ethics, values, justice
- Considers them the concern of religion/other disciplines when actually deeply intertwined with economics

Prophet of self-interest, the invisible hand and free markets?

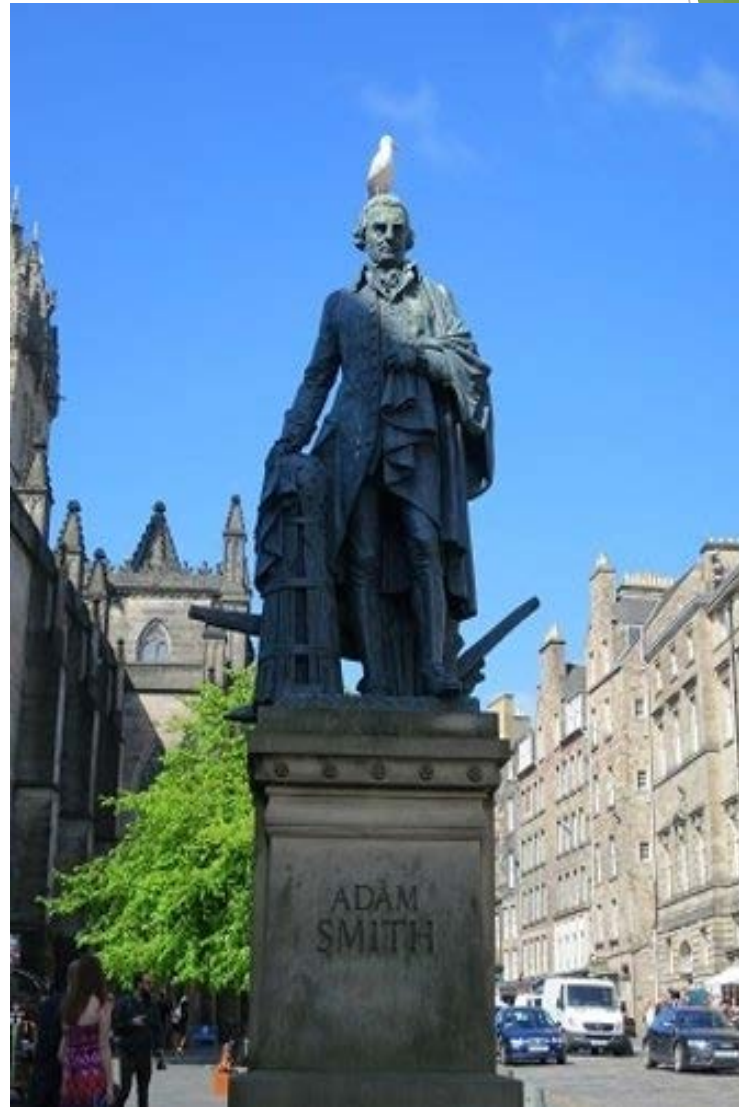


It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.

- Adam Smith

Will the real Adam Smith please stand?

- ▶ Professor of philosophy at University of Glasgow
- ▶ First explored what held society together and how it functioned in *The Theory of Moral Sentiments*



Smith: Humans are distinguished by capacity for sympathy (what we now call *empathy*)

- ▶ *“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.”* (MS- Sec.I, Ch.1, p.1)
- ▶ People social - seek the good opinion of others
 - ▶ Through empathy, respect and understanding
 - ▶ Also by emulation including material possessions

Smith's next work examined emerging market economy of England in 1700's

- ▶ Government: kings and queens
- ▶ Growth in domestic & international trade
- ▶ Early stages of industrialization
 - ▶ Newcomen's steam engine invented 1712
 - ▶ 233 pumped water from mines before James Watt's in 1800's
- ▶ *The Wealth of Nations* (1776) first comprehensive book about economics



Smith - a radical of his day - laid the foundation of modern economics

- ▶ Rejected conventional wisdom
- ▶ **Gold** NOT the source of wealth
 - ▶ Don't waste money sending explorers in its pursuit
 - ▶ Don't subsidize exports to bring in more gold



True wealth:
capability to
produce

- ▶ Better use of resources through specialization of labor
- ▶ More total output through competition by different sellers
 - ▶ Keeps prices down
 - ▶ Encourages cost reduction
- ▶ Government: stop granting special privileges to favored businesses!

More surprises from *Wealth of Nations* return us to our theme....

- ▶ Smith advocated free public education:
 - ▶ NOT to increase worker skills
(factory work was rote)
 - ▶ To keep minds of citizenry alert & active
- ▶ **SOCIAL PURPOSE** RATHER THAN ECONOMIC
- ▶ Smith expressed concern for the almost universally unequal bargaining power of workers vs. “masters”

Smith's "good society" relied on both empathy and self-interest

- ▶ Self-interest: incentives to work hard, invent, create ... but also unethical behavior that harms the public
- ▶ *"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."*
- ▶ Purpose of market competition is to limit that.. but market forces operate within a social and legal structure **THAT IS ESTABLISHED BY HUMANS**

Smith was both optimist and realist:
self-interest would often triumph over
empathy in the business world

- ▶ What was ideal for the economy & consumers NOT ideal for business
- ▶ Business maximizes/stabilizes profits with LESS COMPETITION
 - monopoly power
 - less information (or transparency)
 - shift costs to someone else

Modern economic analysis has left behind the real Adam Smith

- ▶ Neo-classical (marginalist) revolution of 1880's
 - ▶ an answer to weaknesses in classical economic analysis
 - ▶ Marx used classical analysis to show eventual breakdown of the capitalist system

Goal: How to make economics a respected science like physics

- ▶ Pursuit of absolute laws that were objective/value free
- ▶ One result: discarded any ethical basis for decision-making or evaluation of the outcome
- ▶ Reasoning of today's economists: makes the graphs and math impossible 😊

If you teach a parrot to say demand and supply will you have an economist?



- ▶ Modern day demand curves based on assumption that people care only about their own well-being
- ▶ Modern supply curves derived from models assuming businesses interested only in profit-maximization

These are more than just simplifying assumptions for microeconomics(and finance)

- ▶ Economic rationality becomes defined as only self-interest
 - for individuals
 - for businesses/corporate leaders
 - for public officials
 - for nations

The result of teaching that individuals should (and do) pursue only self-interest ...

The longer students study economics the more likely they are to cheat and/or express lack of interest in social values (Frank et al, JEP, 1993)

Top Fortune 500 businesses in the post WWII decades would brag about how well they treated all their workerstoday?

Corporate level: maximizing shareholder wealth the only goal

- ▶ If they engage in corporate social responsibility that cuts profits (affecting stock prices & shareholder wealth)
 - ▶ CEO's can be replaced by stockholder vote for lack of attention to duties
 - ▶ Corporations can be sued by investors
- ▶ Around half of states now charter "social benefit" corporations that can legally pursue profit along with other goals

Necessary because some good deeds are “win-win”but not all are

- ▶ Benefits of looking beyond immediate profits often far in future
 - ▶ Present value discounting means even high future benefits have low value today
- ▶ Also many benefits are intangible
 - ▶ Well-being of others: freedom and equality as well as material goods
 - ▶ Preservation of non-economic values in nature and society

Fundamental shift in thinking about economics also affects public sector

- Example: trade negotiations
- Joe Stiglitz, Nobel prize winner and former chief economist for World Bank, *Making Globalization Work*
 - ▶ Why not trade deals where every country benefits **at least a little?**
 - ▶ 1990's - made all rich countries better off and **Africa worse off**

Shift in thinking also affects trust in public sector

- ▶ “Public choice” school of economics assumes all elected officials and “bureaucrats” are in it solely to better themselves
- ▶ Cynicism contributes to decline in social capital
- ▶ Harder to get infrastructure and policies economy & society need

Sustainable Development

Built on a different set of
assumptions about human nature
and the world we live in



Adam Smith would be proud

Along with integrating new scientific knowledge... Ethical concerns are back

Concern for future generations

- ▶ Not always better to produce more cheaply now if it means shifting high costs to the future
 - ▶ Depleting fish stocks
 - ▶ Fresh water shortages
 - ▶ Climate change
- ▶ Naïve to assume “future” will always have technological fix

Why now?

- ▶ Since 1750
 - ▶ Population 9x larger
 - ▶ World output 200x more
 - ▶ Highly unequal between countries and people
 - ▶ Unsustainable methods
- ▶ While economists have always valued sustainability of physical manufactured capital
- ▶ Most treated nature as a “free good” and took social capital for granted

Concern for how costs of ensuring sustainability are borne today

Between countries

- ▶ Shifting of polluting industries to poor countries
- ▶ Southern hemisphere and island nations most exposed to climate change disasters
- ▶ Terrorism and wars related to desertification and water issues

Within countries

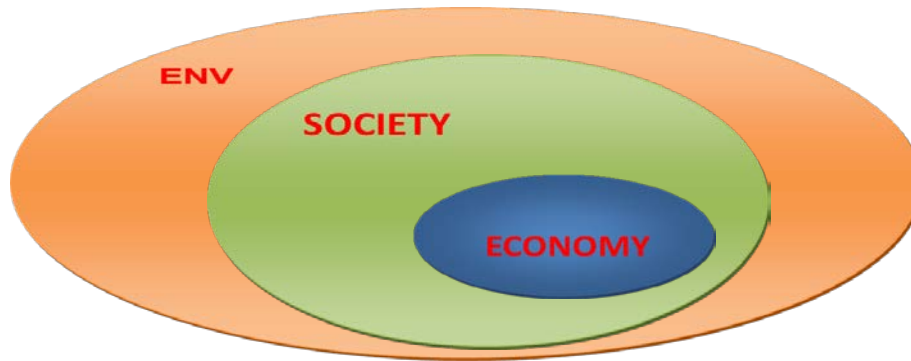
- ▶ Rising income inequality worldwide
- ▶ How to deal with groups affected by globalization and technological change?
- ▶ Ability to equably tax gasoline, carbon etc. without addressing wage and income inequality in US

DF Principles.....Sustainable Development

- ▶ Integrity & honesty
 - ▶ Trust
 - ▶ Fairness
 - ▶ Respect
 - ▶ Rule of law
 - ▶ Accountability
 - ▶ Transparency
 - ▶ Viability (long term value)
- ▶ These 5 part of “social capital” that Adam Smith and SDV address
 - ▶ Smith hoped a competitive market would assure these 2 - didn't depend on individual morality
 - ▶ Protect natural and social capital as well as physical capital that has assigned market value

Economics of Sustainability (2310)

- ▶ Starts with different way of looking at the economy, environment and society



- ▶ Natural world envelopes society & economy
- ▶ Institutions (social capital) shape economic decisions/outcomes: TRUST, INTEGRITY, LAW, RESPECT, FAIRNESS

Sustainability economics and new scientific knowledge

- ▶ “Bads” a side effect of “goods” production
- ▶ Negative spillover costs (externalities)
 - ▶ Pollution
 - ▶ Lack of affordable housing
- ▶ “Public goods” that have no market value
 - ▶ Ozone layer/atmosphere and other env services
 - ▶ Biodiversity and stocks of fish in ocean
 - ▶ Many elements of social capital also public goods

Sustainability economics: new research about human behavior

- ▶ Happiness and satisfaction are culturally dependent rather than innate to individuals
 - ▶ More stuff = more 😊? NOT ACCORDING TO SURVEYS
- ▶ Most people don't think like "economic man"
 - ▶ If they did: never have children (or treat very well!)
 - ▶ Status often more important than \$ or "stuff" (Smith writes at length about this in both his books)
- ▶ People can suffer from information overload - or be unable to process complex information
 - ▶ Most people are very poor evaluators of risk -
But consistently overestimate how good they are!

In the Economics of Sustainability (2310) this spring.....

Learning about economics differently-
from a foundation where **sustainability is a fundamental and multidimensional principle**

- Economic efficiency important
- So are justice and fairness

I want students to understand their role as actors that shape the economy rather than as passive participants: consumers, workers, investors, managers, voters, etc.

- Not all choices can be seen as “trade-offs”
- Some involve basic human ethics & values