

# More or less capitalism?

The IoD's Richard Baron, Head of Taxation and Graeme Leach, Chief Economist & Director of Policy, look at the morality of the market.

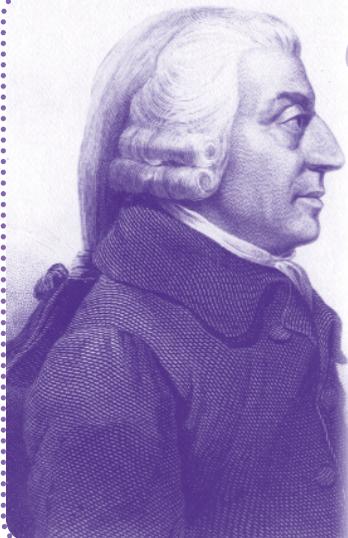
## A MORAL CRISIS?

Advocates of free-market capitalism can all too easily feel that they are put on the back foot by ethical concerns. It relies on individual greed, the idolisation of money, and an exclusively materialistic vision. Everything is reduced to money. Customers see the price, not the exploitation that is needed to achieve it. Those who have the capital, have the power. And so on.

In the wake of the financial crisis we have seen widespread speculation as to whether the failings in the banking system represent a crisis of capitalism full stop.

Much of the criticism of capitalism stems from discomfort at the idea that the self-interest of one individual can further the welfare of others. Self-interest is seen as co-terminous with selfishness. But that is a misconception. From the beginning of the debate over the role of markets, the unbridled pursuit of self-interest was never the view of Adam Smith – and is not the position of the IoD.

Below, we can examine what Smith actually said in *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776):



*“Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage indeed, and not that of society, which he has in view ... He is led by an invisible hand to promote an end which was no part of his intention”* (Wealth of Nations, Book 4, chapter 2)

**Adam Smith** (1723–1790) Scottish economist

## SNAPSHOT

- Capitalism is seen to be most ethical when it combines effective competition with individual self-restraint. When these forces are eroded, capitalism appears uglier and less attractive.

- Free-market capitalism emerges from our ethical examination looking much better than its detractors would have us think. Advocates of free market capitalism should be on the front, not the back foot.

- Deontology, consequentialism and virtue ethics provide a rich body of support for capitalism.

Smith's qualified recognition that social benefits may accrue from the self-interested investment of capital, is a far cry from the typical claim that unconstrained pursuit of self-interest in all areas of economic activity always promotes the general welfare.

Smith clearly recognised the failings of human nature and how, individually or corporately, people could engage in economic activities detrimental to society. In *The Theory of Moral Sentiments* (1759) Smith recognised that in addition to the impact of competition, economic excesses may also be constrained by a desire to seek the approval of others. Responsible people would constrain themselves in the pursuit of self-interest.

We can see this thought at work in the “my word is my bond” ethic that surrounded the genesis of London as a financial centre. So the recent failings of the financial sector could be said to be the result, not of a failure of capitalism but instead, of the abandonment of an ethic that is central to the effective working of a capitalist system.

Clearly one can debate the source of this loss of virtue and the relative weights of secular and religious influences, but historically the excesses of capitalism were moderated by the influence of absolute standards of behaviour. Some attach great significance to religion. Irving Kristol has written:

*“To the degree that organized religion has decayed and the attachment to the Judeo-Christian tradition has become weaker, to that degree capitalism has become uglier and less justifiable.”*<sup>1</sup>

Whether or not one accepts that view, a key point is that capitalism cannot be said to be morally bankrupt. Only people can be morally bankrupt. Perfect people would operate a perfect economy. If there is moral fault, it is people who are at fault, not an economic system. Of course a free market is not perfect, but do we really expect it to be? We do not, but that does not mean we should abandon a capitalist economy.

Adam Smith cautioned that less capitalism and more state intervention was not the solution:

*“I have never known much good done by those who affected to trade for the public good.”*<sup>2</sup>

Any failings of capitalism should not be seen simply as the result of ownership – private versus public. Changes in ownership merely create new sets of incentives and motives for those in the public sector. State control of the banking system would potentially remove recent excesses, but historic experience shows that it would also progressively undermine economic performance in the long term. A better solution is more, not less capitalism – greater financial market competition and shareholder activity.

Advocates of the free market can point out that it has led to a far higher standard of living, for far more people, than any of the alternatives. Over the long term, economies with smaller states and a greater role for private markets have enjoyed faster growth



**Irving Kristol** (1920–2009)  
American columnist and journalist

<sup>1</sup> The Disaffection from Capitalism, in Michael Novak (ed.), *Capitalism and Socialism: a Theological Inquiry*, 1979, page 28

<sup>2</sup> *An Inquiry into the Nature and Causes of the Wealth of Nations*, book 4, chapter 2

and a higher standard of living. But we need not rely solely on an argument from results, important though those results are. We can examine the ethical status of the free market from several different perspectives, including perspectives that are either only indirectly utilitarian or not utilitarian at all. The free market emerges from the examination looking much better than its detractors would have us think.

## APPROACHES TO ETHICS

It is traditional to identify three broad approaches to ethics.

**Deontology** focuses on duties, usually expressed as rules with which one must comply. **Consequentialism** focuses on the consequences of actions. Its most common form is utilitarianism, which advocates action that will maximise happiness (across the population, not just for oneself or for one's family and friends). The focus of **virtue ethics** is on the virtues that one should have, in order to be well-equipped to respond appropriately in particular situations.

This tripartite scheme ignores many of the complexities of ethical thought, but it gives a workable sketch map of the territory. It is certainly sufficient for the purpose of showing that there are more ethical arguments in favour of the free market than the fact that it works.

We can show this by showing how users of each of these approaches could find reasons to approve of the free market. It does not follow that all users of any of these approaches would support the free market. Each of the approaches could be used to support objections to the free market. But it does follow that those who support the free market need not be on the back foot. They can do a lot more than merely respond to the objections that are sometimes raised.

## DEONTOLOGY

One cannot judge an economic system against a set of duties unless those duties are first identified. Lists of duties may be supplied by religious traditions, by other traditions or by general principles, such as Immanuel Kant's categorical imperative. This principle has several formulations, but the basic idea is that moral duties are universal. You can only regard a rule as a moral maxim if you can wish it to be everyone's maxim.<sup>3</sup>

There are some obvious candidates for a list of moral duties – so obvious that it is not surprising to see them listed in both religious and secular codes. We should not do physical violence to others, or steal, or break promises, or bear false witness. These are some of the basic rules by which the members of any society need to abide, if it is to function well.

Now consider a free-market economy. If you wish to buy or



**Immanuel Kant** (1724–1804)  
German philosopher

<sup>3</sup>For the various formulations of the categorical imperative see Kant, *Groundwork of the Metaphysics of Morals*, pages 421, 429 and 438 in the Prussian Academy numbering

sell goods or services, or borrow or lend money, people can have dealings with you or not, as they please. And they will only be willing to have dealings with you if you will keep your side of any bargain. That amounts to keeping your promises. And if you have entered into a bargain that involves your borrowing money, or buying goods on credit, keeping your side of the bargain means repaying the money or paying for the goods: not to do so would amount to theft.

The free-market economy is not free of cheating or corruption, but there is a powerful weapon against malpractice in the hands of every participant in the market: they can simply refuse to do business with culprits. That is why reputation is important. Those with a bad reputation find that they are left with no customers, or no sources of finance.

Thus the free market gives everyone a powerful motive to act in accordance with some of the duties that are typically identified by deontological moralities. The deontologist might not be delighted, because the motive would not be that of morality. Kant in particular argued that the truly moral action had to be appropriately motivated.<sup>4</sup> But even though the free market might not promote moral motivation, it does promote outcomes of which deontologists can approve. And when economic agents do not have in their hands the weapon of refusing to do business with miscreants, we can expect cheating and corruption to rise. Command economies are certainly not free of bad practice.

The point was well-recognised in the eighteenth century. It has been convincingly argued that David Hume, contemporary and friend of Adam Smith, saw our conduct as regulated, not by external lawgivers but by a natural concern for how others see us.<sup>5</sup> Hume identified internal sources of this concern, in our natural empathy with others and sociability. But the need for a good reputation that naturally arises in the free market works with, not against, the grain of these sources and of their effects.



**David Hume** (1711–1776)  
Scottish philosopher, economist, historian

## CONSEQUENTIALISM

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By far the most common form of consequentialism is utilitarianism – to the point where the terms are often used as if they were synonymous. They are not, but if a utilitarian case can be made for the free market, that will satisfy most consequentialists.

The guiding principle of utilitarianism is that we should act in order to promote the greatest happiness of the greatest number of people. There is scope for refinement, for example to take account of the relative worth of different distributions of the same amount of happiness. There are also alternative forms of utilitarianism: we can adopt the most beneficial binding set of ethical rules, or decide what to do from scratch on each occasion, or adopt some intermediate position. But the basic idea is simply that we should maximise happiness.

<sup>4</sup> *Groundwork of the Metaphysics of Morals*, page 390 in the Prussian Academy numbering

<sup>5</sup> James Harris, 'A compleat chain of reasoning: Hume's project in the *Treatise*, Books 1 and 2', *Proceedings of the Aristotelian Society*, volume 109, 2009, paper VII, pages 129–148

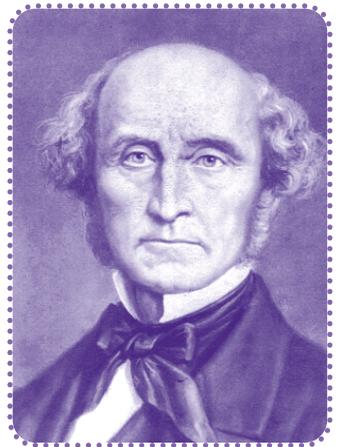
One might think that utilitarianism would recommend a command economy, and a centrally managed society more generally. But there are at least four strong arguments against such an approach:

- **The first is that a major contributor to our happiness is a sense of running our own lives, and taking our own decisions.**
- **The second is that it is impossible for a central management to know what individuals really want.**
- **The third is that central management stifles innovation, which is vital to the improvement of our lot. John Stuart Mill, the central figure in the utilitarian tradition, favoured liberty of lifestyle for this reason, as well as for other reasons.<sup>6</sup>**
- **The fourth is that even if some central management did have all of the information that was needed to do its job well, the problem of what people should produce and who should consume what output in order to maximise happiness would be just too complex to solve.**

It is, on the other hand, easy to make a utilitarian case for the free market. Not only is there clear historical evidence that it works much better than the alternatives. Advocates of the free market can also deal comfortably with all of the points that have just been raised against a command economy:

- **The first three points are dealt with together. Individuals decide what to buy, and how to trade off income against leisure time, so they have a measure of control over their lives, they act on their own desires without having to supply information about those desires to anyone else, and there is scope for innovators to offer new products in response to the demands of what may be quite small percentages of the population.**
- **The fourth point is dealt with by distributing the computation of what to make and how the output should be consumed. Consumers signal their preferences, and those preferences are automatically aggregated to the point at which they can effectively direct productive resources. The result may not be perfect. Sub-optimality is entirely possible. But the result is still likely to be a lot better than anything that could be achieved by central planning.**

There is, however, one goal that a utilitarian might well have, to which the free market makes no obvious contribution. This is the goal of ensuring that sufficient resources are directed toward giving a decent standard of living to the poor. While it is true that the free market does not directly address this issue, and a command economy could address it directly, the free market does



**John Stuart Mill** (1806–1873)  
British philosopher and civil servant

<sup>6</sup> *On Liberty*, chapter 3

tend to generate a surplus far more effectively than a command economy. This in turn allows for taxation in order to fund a welfare state. The free market plus a reasonable level of taxation (but not a level of taxation that is high enough to damage incentives and significantly reduce output) is far more likely to help the poor than a command economy.

## VIRTUE ETHICS

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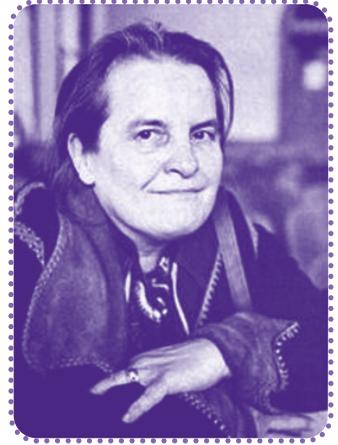
Virtue ethics places the focus on the virtues that we should have. The tradition is an old one, stretching back to the ancient Greeks, and it has enjoyed a resurgence in the past 50 years following the publication of Elizabeth Anscombe's paper *Modern Moral Philosophy*.<sup>7</sup> Philosophers who produce lists of virtues, as distinct from those who just discuss the project of virtue ethics in general terms, produce different lists. For example, some would include humility while others would exclude it. But there is still widespread agreement. Most lists would include virtues such as honesty, courage and a willingness to use one's talents productively.

So does the free market encourage the development and practice of the obvious virtues? Honesty is encouraged, as already noted. Some virtues, such as physical courage, rarely find application in the developed modern world anyway. And the use of one's talents is pretty obviously encouraged by a system which rewards those who find jobs at which they are good, and then do those jobs well.

There are other virtues that are not directly encouraged by the free market. These are the virtues of charity, of caring and of consideration for those with whom one does not have to work, and to whom one does not wish to sell things. But the practice of these virtues is not excluded by participation in the free market either. Plenty of charitable donations are made, both by corporations and by individuals, and many people who run or work in private sector businesses give up their free time to help others. There is no reason to think that participation in the free market makes people uncaring.

There is also the point that if someone is allowed to keep his or her resources, or leisure time, but freely decides to use them for the benefit of others, that looks rather more virtuous than any compulsory transfer of resources or of time. Go back to the fourth century. St Martin of Tours, when a soldier, is famously supposed to have cut his cloak in half to give one half to an unclad beggar. Would this be cited as a virtuous act if St Martin had not volunteered half of his cloak, but had been ordered to give it up by his commanding officer?

We can apply the moral of the tale to the modern economy. Taxation is appropriation, not altruism. Less capitalism – more state activity – involves coercion rather than voluntarism, and could therefore be said to be less virtuous.



**Elizabeth Anscombe** (1919–2001)  
British analytic philosopher

<sup>7</sup> *Philosophy*, volume 33, number 124, January 1958, pages 1–19

Finally, it is worth noticing that the friendly co-operation that can be seen as virtuous in itself, but that one might suppose to be grounded solely in self-interest when it arises in the free market, may not be due solely to self-interest. Recent work has shown that the dispositions that are in play are a good deal more complex than that. In particular, many people are motivated by a strong form of reciprocity, and that fact is important to the functioning of the system as a whole.<sup>8</sup>

## RESPECT

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A strong theme in some ethical traditions is respect for other people, not because of their talents or other properties, but simply because they are human beings. Kant was particularly forceful on this point. He argued that human beings have dignity, which is beyond price, rather than the worth that things have in the market, and that we should treat other people as ends in themselves, and not merely as means to the achievement of our own ends.<sup>9</sup>

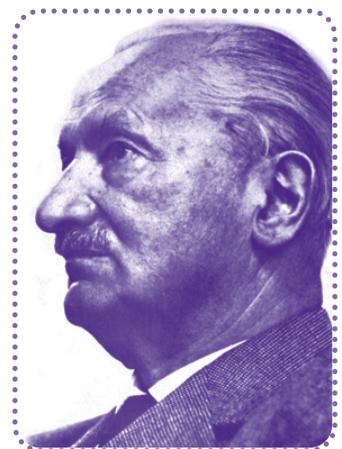
It would be tempting to accuse the free market of ignoring these points. After all, an employer simply wants his or her employees' time, skills and effort. The employer will pay a price for those things, and will see the value of the employees in crude monetary terms. Furthermore, one employee with given skills, strength and enthusiasm for work will be as good as another. Do we not here have the antithesis of respect for every individual? No, we do not.

First, many workplace cultures have moved far away from the view of employees as mere units of effort, to be hired, interchanged and fired according to whether the value of their effort exceeds or falls short of their wages. Employers have found that valuing employees as individuals can be good for business.

Second, the free market itself incorporates the idea of respect. Each person owns his or her time and money. Each person is free to allocate these as he or she sees fit. People are not coerced into transactions, and others have to respect their decisions – to work or not to work, to work for this employer or that one, to invest in this business or that one, and to buy this product or that one. The other party to a transaction, whether of employment, of investment or of consumption, has to respect the person's wishes, and must ensure that the other person is satisfied, otherwise there will be no deal.

Ensuring that the other party is satisfied can be seen as one way of meeting Kant's demand to treat each person as an end, and not merely as a means to one's own ends. People must of course live with the consequences of their choices. Those who choose to work shorter hours, earn less money. And there are many people who have little choice as to their employment. But no-one in the free market is literally enslaved.

The theme of the treatment of people as a mere economic resource was taken up by Martin Heidegger, in his 1953 essay *The*



**Martin Heidegger** (1889–1976)  
German philosopher

<sup>8</sup> See *Moral Sentiments and Material Interests: The Foundations of Cooperation in Economic Life*, edited by Herbert Gintis and others, MIT Press, 2005

<sup>9</sup> *Groundwork of the Metaphysics of Morals*, pages 429 and 434-435 in the Prussian Academy numbering

*Question Concerning Technology.*<sup>10</sup> Heidegger was ill-at-ease with the effects of technology, and in his own life he was happiest at his isolated lodge at Todtnauberg in the Black Forest. But even he, having raised the danger that human beings would become a mere resource, ended the essay by concluding that we could save ourselves by grasping the essence of technology, rather than falling into technology's grip. There is a certain parallel with the fact that the free market preserves our choice as to how, and to what extent, we should participate.

## OVER-MIGHTY CORPORATIONS?

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One complaint against the free market in general, and against the capitalistic system of large corporations in particular, is that too much power is concentrated in too few hands. Money becomes power, and not just market power, but the power to influence political decisions and to steer the development of society. Furthermore, the capital markets can look as though they were designed to facilitate precisely that result.

The central point in the response is that in a free market, people are free to make choices. If a large corporation acts in a way that many dislike, it can expect to lose customers, and even become the target of a boycott. At the same time, if only a proportion of the corporation's customers dislike its actions, those who consider its actions to be acceptable can carry on buying from it. One person's moral judgement is not imposed on others.

Similarly, capital markets do not just achieve economic efficiency by channelling capital to where it can earn a good return. They also give investors the choice as to where to invest. Furthermore, they can choose their investments on whatever grounds they like, for example, ethical grounds.

Secondary markets, which allow shares that have already been issued to be bought and sold, allow investors the option of withdrawing their capital from some businesses and transferring it to others, without directly affecting the businesses concerned. Indeed, without that option, few would invest in shares when they were first issued. And while secondary markets do expose companies to the risk of hostile takeover bids, that risk keeps directors on their toes, encouraging them to avoid waste. That incentive, like many other incentives in the free-market system, helps to maximise the wealth of the whole community.

## CONCLUSION

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The relationship between the free market and high ethical standards is complex, but it is assuredly not a relationship of opposition. There is no reason to apologise for the free market in general. And a great many people who run businesses within that market are fully justified in being proud of what they do, and of how they do it. **□**

<sup>10</sup> Available in *Martin Heidegger: Basic Writings*, edited by David Farrell Krell, 1993