Is Economics Still a Branch of Moral Philosophy?

Reflections on the history of economic thought

Dr. Geoff Bertram
Victoria University of Wellington

Geoff Bertram holds degrees in geography, Latin American Studies, and economics, from Victoria University and Oxford University .He was until June 2009 a Senior Lecturer in Economics at Victoria University of Wellington. Since his retirement he has been Senior Associate at the Institute of Policy Studies and Adjunct Researcher at the Climate Change Research Institute. His research interests include regulation of public utility industries such as electricity, gas and telecommunications; economic and political development of small island societies with a particular focus on the Pacific; the design of policies to address climate change; and the long-run evolution of the New Zealand economy. He served on the Council of the International Association for Energy Economics from 2005 to 2007 and convened the Association's annual conference in Wellington in 2007. He has been a member of the editorial boards of a number of international journals including World Development 1992-97, Environment and Development Economics 1996-2006, and Asia Pacific Viewpoint since 1976. He speaks regularly at international conferences on energy, climate change and small-island issues. Geoff is a parishioner of St Anne's Church in Northland, Wellington and lives in Karori with his wife, Libby.

1. Raising the question

To set the scene, a passage from a recent Paul Krugman blog[1]:

> I was recently asked to give a talk on "capitalism and democracy"… I took as my starting point the famous Fukuyama thesis that liberal democracy — meaning basically a market economy plus democratic institutions — was an end state, a final resting point for state organization.
> I always had my doubts about that, largely thanks to the 1930s: what we saw there was that a severe economic crisis could put liberal democracy very much at risk. And it was a close-run thing: slightly better strategic decisions by the bad guys could have made totalitarianism, not democracy, the end state.
> It seemed to me even when Fukuyama first wrote that this could and probably would happen again, that there would be future crises that would put our system — which I agree is a very good system — at risk.

> But one thing I was sure of was that the next great crisis would be different. It would be environmental, or about resource shortages, or about runaway technologies, or something; it wouldn't be about a banking crisis and a collapse of aggregate demand, aggravated by bad monetary and fiscal policy. We'd learned too much to repeat that performance — right?
> Wrong. The amazing thing now is not that we're having a crisis, it's the fact that we're having the same crisis, and making the same mistakes.
> A lot of the blame goes to the economists…, who abandoned what they used to know — and many of whom are giving bad advice now, I firmly believe, based more on ego and political affiliation than on analysis. That is, I believe that we're looking at a moral failure as well as an intellectual failure.
> "Conscience of a liberal", http://krugman.blogs.nytimes.com/ September 20, 2011

Krugman's piece quoted here (along with a lot of other material he has written lately) focuses on wilful abandonment by a large segment of the economics profession of the study of the history of economic thought. History of thought has ceased to be taught in most major university economics departments, is accorded peripheral status at major economics conferences, and is not familiar to probably a majority of practising economists under the age of 35. In its place, many – possibly most - students of the subject are now taught doctrines that derive their authority from constant repetition and the endorsement of contemporary senior figures in the profession – not from careful study of past debates and the work of the old masters. These doctrines, generically grouped under the title "neoliberalism", include the beliefs that

- markets are efficient and can be treated as generally competitive;
- government and other public agencies are inefficient and generally incapable of improving market outcomes by regulation or intervention except in a few special cases;
- income and wealth distribution in a capitalist economy is determined by the market as impartial arbiter, and there is no basis in economics for redistribution to achieve greater equality – on the contrary, the main consequence of such redistribution would be to reduce social wealth.
- economic cycles (booms and slumps) involve fluctuations around a growth path that is fully determined by supply considerations (factor endowments, technology, some institutions) and that those cycles are driven entirely or mainly from the supply side, so that demand management policies are not useful or relevant;
- consequently, that the macro-economic theories of John Maynard Keynes and his intellectual heirs were, and are, mistaken.

In this age of neoliberal ascendancy, mainstream economics has ceased to worry about the distribution of income and wealth and has become tolerant of monopoly, speculation, and other practices which were abhorrent to previous generations. Leading economists preach fiscal austerity in response to recession and unemployment and write heavy technocratic critiques of the welfare state.

Economists do not, of course, all speak with one voice. So there are plenty of remnants of the economics that I learned back in the 1960s and 1970s – Keynesian and post-Keynesian macroeconomics, imperfect-competition microeconomics, welfare economics, development economics, and of course economic history and history of economic thought. There are lively debates in the blogosphere and in the peripheral economics journals, and an ongoing battle for the soul of the discipline. And this is not a new battle. Back on the nineteenth century Karl Marx pitted himself against bourgeois economists who served as the "apologists for capitalism". Much of the twentieth century was taken up with debates between Keynesians and anti-Keynesians in which the relative roles of the State and the Market were contested, while there was a parallel debate between socialists and anti-socialists over the possibility of efficient central planning, and another debate in microeconomics over what it means to talk about the welfare of a society as distinct from an individual.

The outcomes of these debates – rejection of Keynesian macroeconomics, of utilitarian microeconomics, of socialist planning, and of belief in government as the embodiment of the public good – has largely deprived economics of the moral compass that provided guidance for previous generations. Post-modern critics who pillory economists as mere puppets and spokespersons for wealth and power, instinctive defenders of the market and enemies of ordinary folk and the poor, have an easy target. But the neoliberal ascendancy is in an important sense a break from the past in economic theory, and the intense neoliberal hostility to any history of economic thought (other than parroting of selective quotations from Adam Smith and Friedrich Hayek) speaks volumes about the moral insecurity of modern economics.

In this paper, therefore, I review a couple of high points in the history of economic thought, focusing on the perennial tension between the technocratic aspiration to achieve the rigour and authority of a "science" and the inescapable challenge of bridging the gulf between moral philosophy and economic reality.

2. Smith and the Enlightenment

The traditional starting point for histories of economic thought is the eighteenth-century Enlightenment which involved, among other things, the elevation of Reason over simple Faith as the basis for human knowledge about the natural world and about social life. Both David Hume and Adam Smith, the two main British contributors to the emergence of Political Economy in that century, made the transition from moral philosophy to economics by pondering on how it could be that human behaviour, with all its moral failings, could throw up orderly and analytically intelligible outcomes in terms of prices, interest rates, wage rates, profit rates, growth rates, and the institutions of markets in general. Adam

Smith in particular was interested in starting from empirically-grounded hypotheses about individual behaviour and constructing, from these, models of the operation of the economic system of early capitalism (not that Smith used that term, of course).

Most people are familiar with the central themes of Smith's second book, *The Wealth of Nations* (1776). One of those themes was that the pursuit by individuals of selfish ends actually leads to orderly, and usually socially-desirable, outcomes. Many commentators erroneously assume that Smith was here praising selfish behaviour per se, and much modern neoliberal advocacy of naked self-interest and profiteering seeks to clothe itself in the authority of Smith. But that is to miss Smith's point: there is something unexpected and endlessly intriguing in the observation that market economies, filled with selfish individuals engaged in specialisation and exchange in pursuit of individual prosperity, turn out in real life to be productively superior to previous modes of social and economic organisation. *The Wealth of Nations* is not a work of advocacy, but of economic analysis, and the book is filled with insights that seem to me to have come as surprising discoveries to Smith himself. He pulls together some of his key conclusions right at the start, in his second chapter:

> …man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only. He will be more likely to prevail if he can interest their self-love in his favour, and shew them that it is for their own advantage to do for him what he requires of them. Whoever offers to another a bargain of any kind, proposes to do this. Give me that which I want, and you shall have this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. 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. We address ourselves, not to their humanity, but to their self-love, and never talk to them of our own necessities, but of their advantages. Nobody but a beggar chooses to depend chiefly upon the benevolence of his fellow-citizens. Even a beggar does not depend upon it entirely. The charity of well-disposed people, indeed, supplies him with the whole fund of his subsistence. But though this principle ultimately provides him with all the necessaries of life which he has occasion for, it neither does nor can provide him with them as he has occasion for them. The greater part of his occasional wants are supplied in the same manner as those of other people, by treaty, by barter, and by purchase. With the money which one man gives him he purchases food. The old clothes which another bestows upon him he exchanges for other clothes which suit him better, or for lodging, or for food, or for money, with which he can buy either food, clothes, or lodging, as he has occasion.
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> As it is by treaty, by barter, and by purchase, that we obtain from one another the greater part of those mutual good offices which we stand in need of, so it is this

> same trucking disposition which originally gives occasion to the division of labour.
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> *Wealth of Nations* Book I Chapter 2.

This passage is not an exercise in moral prescription; it is a lesson in what would later be called "positive economics". All individuals, and each individual human being, seem (to Smith) to possess a special propensity to "truck and barter". Exercising this faculty leads to exchange and the division of labour, which in turn are the basis of increased prosperity (the wealth of nations). A policy prescription certainly follows – that the market economy has earned the right to a presumption of innocence, and governments should interfere with the market only when they have good reason to do so. Much of Book II of the *Wealth of Nations* is correspondingly taken up with a frontal attack on mercantilism and French royal absolutism. But this support for *laisser-faire* in Smith is not a matter of basic moral or ideological principle: it is a pragmatic judgment reflecting his comparative analysis of different forms of economic organisation, and his realisation that an unregulated market economy tends not to chaos (as many before and since Smith supposed) but to order. Smith's primary question is how this comes about – how, in other words, the "invisible hand" actually works. That question is very much an Enlightenment question, with God (and his self-declared agents) no longer the prime movers in human affairs (though God was left responsible for endowing humans with the qualities and propensities that Smith observed and catalogued).

In the passage in which his image of the "invisible hand" appears, Smith points out that

> ...every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.
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> *Wealth of Nations* Book IV Chapter 2.[2]

To see why much in the *Wealth of Nations* was a surprise, one needs to look back to Smith's first book, the *Theory of Moral Sentiments* (1759). In *Moral Sentiments* we find Smith, an acute observer of human behaviour and manners, engaged in describing and codifying the ways in which humans are motivated to behave in matters involving moral values and social relations with each other. The book is an essay in sociology and social psychology. While certainly laced with offhand asides in which Smith allowed himself to comment critically on what he was observing, it is a work not of advocacy for any novel normative or ideological position but rather one which takes principles and propositions that were long-established in Smith's original discipline of moral philosophy, juxtaposes these with human behaviour as Smith observed it in the real world, and highlights the areas of compatibility and incompatibility between the two.

The book opens with the observation that[3]: "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it…." Human beings clearly do feel compassion for others in distress, and do empathise with other people's happiness, and these sentiments translate to social behaviour and action. As he would do later in the *Wealth of Nations* when analysing how selfishness plays out in social life, in *Moral Sentiments* Smith sets out to ask how, in practical terms, this plays out: how do individual humans appreciate and enjoy the happiness of others? He finds an immediate problem – one which we shall encounter later in twentieth century welfare economics[4]:

> As we have no immediate experience of what other men [sic] feel, we can form no idea of the manner in which they are affected, but by conceiving what we ourselves should feel in the like situation. Though our brother is upon the rack, as long as we ourself are at our ease, our senses will never inform us of what he suffers. They never did, and never can, carry us beyond our own person, and it is by the imagination only that we can form any conception of what are his sensations.

The process by which an individual constructs in his or her own mind an emotional connection with what is going on in the mind of another Smith labels "sympathy", and it is clear that he regards this as a faculty which individuals use to gauge the well-being of others. Equipped with this faculty, not only can the individual be guided in meeting the demands of moral philosophy in everyday dealings with other individuals; the statesman similarly can intuitively grasp the impact of policies on the population affected by those policies, which is an essential step in applying moral principles of the public good to the art of government.

But as moral philosophers since Plato's *Republic* have pointed out, there is a gap between the moral principles of good government and the performance of actual governments. Specifically, there is a perennial tendency for government to be captured by the interests of wealth and power, and to fail in its moral duty to protect the powerless and the poor. To account for this failing, in Book I Chapter 3 of *Moral Sentiments* Smith writes of the "corruption of our moral sentiments" which flows from excessive deference to wealth and power and the tendency to despise poverty and powerlessness. The passage is worth quoting (*MS* 1976 pp.61-62):

This disposition to admire, and almost to worship, the rich and the powerful, and to despise, or at least, to neglect persons of poor and mean condition, though necessary both to establish and to maintain the distinction of ranks and order of society, is, at the same time, the great and most universal cause of the corruption of our moral sentiments. That wealth and greatness are often regarded with the respect and admiration which are due only to wisdom and virtue; and that the contempt, of which vice and folly are the only proper objects, is often most unjustly bestowed upon poverty and weakness, has been the complaint of moralists in all ages.

Note the structure of Smith's argument here. He begins with empirical observation of behaviour: he sees that in the real world, people are apt to admire wealth and power, and to despise poverty and weakness. He accepts (perhaps too readily!) a functional justification for the behaviour: it is arguably "necessary to establish and maintain the distinction of ranks and the order of society". But however functional the behaviour may be for the defence of social order, it cannot be mapped to traditional moral-philosophy views. On the contrary, it involves "corruption" of moral sentiments, since respect and admiration are truly due not to wealth and power, but rather to wisdom and virtue; and contempt is due not to poverty and weakness, but to vice and folly. This tension between socially-functional observed behaviour and the traditional ideals of moral philosophy through the ages is posed by Smith as an interesting paradox, which he does not resolve, though he takes it as the opportunity to make some general comments reminiscent of, for example, Plato before him and John Stuart Mill after him . The wise and the virtuous, who naturally respect and admire wisdom and virtue, are "a select, though, I am afraid, a small party" (p.62); while

The great mob of mankind are the admirers and worshippers …. of wealth and greatness"

Foreshadowing the passages in *Wealth of Nations* quoted earlier, Smith proposes that "in the middle and inferior stations of life, the road to virtue and that to fortune, at least, as men is such stations can reasonably expect to acquire, are, happily in most cases, very nearly the same. In all the middling and inferior professions, real and solid professional abilities, joined to prudent, just firm and temperate conduct, can very seldom fail of success … The good old proverb, then, that honesty is the best policy, holds, in such situations, almost always perfectly true." (p.63). Thus the forces of the competitive market operate to reward and promote virtue in the mass of humanity.

Nevertheless, these sturdy honest lower and middle orders of society are at the same time "the great mob", fawning on the wealthy and powerful. The corruption of moral sentiments, Smith argues, begins at the top, and occurs most dramatically at the top, of society: (pp.63-64):

> In the courts of princes, in the drawing-rooms of the great, where success and preferment depend, not upon the esteem of intelligent and well-informed equals, but upon the fanciful and foolish favour of ignorant, presumptuous, and proud superiors; flattery and falsehood too often prevail over merit and abilities. In such societies the abilities to please, are more regarded than the abilities to serve. …. The external graces, the frivolous accomplishments of that impertinent thing called a man of fashion, are commonly more admired than the solid and masculine [sic] virtues of a warrior, a statesman, a philosopher, or a legislator. All the great and awful virtues, all the virtues which can fit, either for the council, the senate, or the field, are, by the insolent and ignorant flatterers, who commonly figure the most in such corrupted societies, held in the utmost contempt and derision.

Having thus identified a group who do embody the ideals of good government – the statesman, the warrior, the philosopher and the legislator – and lamented the prevalence of unworthy types in actual positions of power, Smith embarks on a delightful assault on what today would be called celebrity culture (p.64):

> It is from our disposition to admire, and consequently to imitate, the rich and the great, that they are enabled to set, or to lead what is called the fashion… Even their vices and follies are fashionable; and the greater part of men are proud to imitate and resemble them in the very qualities that dishonour and degrade them…..There are hypocrites of wealth and greatness, as well as of religion and virtue…..

But all of this is anchored in a serious analytical point: that individuals are in part motivated by the desire for admiration and respect, and that the moral corruption of the higher orders of society reflects the unfortunate empirical fact that the mass of humanity are apt to give admiration and respect to behaviour that contravenes standard moral principles of virtue and wisdom.

The same tension surfaces in the *Wealth of Nations* when Smith, having acknowledged the remarkable powers of the market economy driven by pursuit of individual self-interest, turns to the dark side of human nature. Given the chance, he says, businessmen are always ready and eager to behave in ways that are socially destructive, by doing what today we call “exercise of market power”:

> 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.
> *WN* Book IV Chapter 8)

And he directly rejects the idea that businessmen are any better than politicians, let alone that they should should control government (*WN* Book IV Ch 3 Part II, emphasis added):

The capricious ambition of kings and ministers has not, during the present and the preceding century, been more fatal to the repose of Europe than the impertinent jealousy of merchants and manufacturers. The violence and injustice of the rulers of mankind is an ancient evil, for which, I am afraid, the nature of human affairs can scarce admit of a remedy. But the mean rapacity, the monopolizing spirit of merchants and manufacturers, who neither are, nor ought to be, the rulers of mankind, though it cannot perhaps be corrected may very easily be prevented from disturbing the tranquillity of anybody but themselves.

3. From Smith to the welfare state

In Smith's writings, thus, are found all the elements of the central problem with which economics has wrestled ever since. The market economy works, and surprisingly well, as a means of lifting the productive capabilities, and hence general wealth, of the human species. It is prone to several pathologies, all of which can be remedied or offset by well-designed policy designed and administered by a statesman, a philosopher, a legislator – but not, alas, by the ignorant, frivolous, proud and superior individuals who cluster in the upper reaches of society, government and business and whose self-serving self-promotion leads them to hold "the great and awful virtues" in contempt and derision. Since the easily-corrupted moral sentiments of the mass of humanity lead them to admire and respect the worst, one has to be sceptical of the chance of even democratic government acting virtuously and with wisdom; hence Smith's pragmatic advice to leave the market alone as much as possible – not because it can't be improved on in principle but because one cannot trust real-world governments to get it right.

Yet some things have to be done by government – for if they are not, then market outcomes slide far enough away from the ideal to make even Smith convinced of the need for some exercise of collective power against the forces of market self-interest. Smith's choice of legitimate areas for policy intervention is again driven not by ideology, nor by any argument from basic principle, but simply by commonsense and observation. In a key passage he outlines the proper extent of government:

All systems either of preference or of restraint, therefore, being … completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society. According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expence to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.

Wealth of Nations Book IV Chapter ix paragraph 51.

Start with those three legitimate positive roles of government – basically Smith's bottom-line minimum. The last involves provision of pubic goods and policies to correct for externalities – both key areas of twentieth-century economic thinking. The first is the familiar defence role for government – after all, the sovereign nation is the protagonist in international conflict and cannot, as a practical matter, get into the game without a government authority of some sort. The second is the area where the most difficult issues arise: the "exact administration of justice".

In neoliberal thinking, the "administration of justice" is stripped down to the barest minimum: protection of private property, punishment of crimes against property and persons, and enforcement of contracts. None of these appear in Smith as matters of fundamental principle – they are simply the institutional infrastructure without which the invisible hand and the market cannot operate effectively, and so have a straightforward pragmatic justification as necessary to secure the end of economic wealth. (Many neoliberals and other neoconservative voices, especially in the USA, are apt to elevate property, contract and personal safety as matters of basic principle, rather than simply practical necessities to make capitalism effective as an historical system.)

The neoliberal interpretation, though, is not the only possible reading of Smith's governmental charter. The words "protect every member of society from the injustice or oppression of every other member of it" extend almost inevitably to issues such as abolition of slavery, rights of women, regulation of monopoly, and redistribution of income and/or wealth.

And this brings me back to the opening words of Smith's paragraph: "all systems either of preference or of restraint being completely taken away". The modern welfare state is the logical end-product of the attempt in European and North American societies to achieve such a removal of "preference or restraint", in order that the "system of natural liberty" could flourish. The welfare state was thus, somewhat ironically, entailed philosophically by the Enlightenment at the same time as it was driven into existence historically by the aftermath of the Industrial Revolution.

To remove all trace of "preference", the income distribution across classes and across individuals must be in accord with some underlying scheme of justice in distribution. To remove all "restraint", it is necessary to prevent or countervail any exercise of market power which impinges upon the efficient allocation and productive use of resources, as well as to end those government interventions which are designed to benefit particular vested interests at the expense of the nation as a whole. Income redistribution and market regulation become preconditions for Smith's system of natural liberty in any setting where the existing distribution of wealth is unjust or where monopoly imposes allocative inefficiency on markets.

To achieve Smith's preconditions of natural liberty in the historical setting of nineteenth- and twentieth-century Britain turned out to require a remarkable expansion of the scope and powers of the state, both to redistribute income in pursuit of social justice and to regulate monopoly in pursuit of market efficiency as well as social justice.

In addition, Smith's identification of public works as one of the three legitimate areas of state activity opened up an ever-growing category of public goods which are more efficiently provided by the public sector than the private, because of the likelihood of undersupply if such works were left to private initiative, and the opportunity to reap economies of scope and scale by universal public provision. Smith's case for "public works" thus became, from the nineteenth century on, the basis for direct governmental provision in kind of education, healthcare, and sometimes housing, for the mass of the population.

Summing up to this point, the modern subject of political economy founded by Hume and Smith combined a long tradition of western moral philosophy, inherited and adapted to a secular world view in the Enlightenment, with the application of practical reason to issues of the creation of wealth, setting of prices, and consequences of particular policy interventions, in the context of a capitalist market economy. The platonic concept of a public good, aligned with and defined by precepts of wisdom and virtue, and pursued by "statesmen, warriors, philosophers and legislators", served as the benchmark against which market outcomes and individual behaviour could be evaluated. The defence of individual freedom, private property rights, and self-interested behaviour, relied upon the pragmatic functionalist judgment that these things were socially productive. The willingness to contemplate government intervention in economic matters was similarly pragmatic; Smith's tendency to lean against such intervention in general was not a matter of moral principle but simply a deep-rooted distrust of people in authority – those with "wealth and power". As one of the great twentieth-century economists, Jacob Viner, put it[5],

"… [E]ven in his own day, when it was not so easy to see, Smith saw that self-interest and competition were sometimes treacherous to the public interest they were supposed to serve, and he was prepared to have government exercise some measure of control over them where the need could be shown and the competence of government for the task demonstrated. His sympathy with the humble and the lowly, with the farmer and the laborer, was made plain for all to see. …his prejudices, such as they were, were against the powerful and the grasping, and it was the interests of the general masses that he wished above all to promote, in an age when even philosophers rarely condescended to deal sympathetically with their needs. He had little trust in the competence or good faith of government. He knew who controlled it, and whose purposes they tried to serve, though against the local magistrate his indictment was probably unduly harsh. He saw, nevertheless, that it was necessary, in the absence of a better instrument, to rely upon government for the performance of many tasks which individuals as such would not do, or could not do, or could do only badly. He did not believe that laissez faire was always good, or always bad. It depended on circumstances; and as best he could, Adam Smith took into account all of the circumstances he could find."

Viner 1927 pp.231-232,

Insofar as modern economists are intellectual heirs of Smith, thus, their subject's moral dimension consists in a programme of assessing economic outcomes and policy proposals against a general conception of the public good, with no preconception for or against but with a pragmatic focus on the evidence of actual behaviour and outcomes. (The recent arguments for "evidence-based policy" thus align directly with Smith's vision.)

There is, however, another strand in the history of economic thought that lacks a firm basis in the philosophical tradition that inspired Smith, but which has a strongly moralising and moralistic flavour. In a real sense this strand can be characterised as pre-Enlightenment, in the sense that it relies upon a set of dogmas that are adhered to as a matter of faith rather than on the basis of pragmatically-evaluated evidence.

4. Pre-Enlightenment hangovers in economics

Economists are ordinary mortals, and they are prone to precisely the "corruption of moral sentiments" that so animated Smith in his *Theory of Moral Sentiments*. The general tendency that Smith saw in human nature to admire and respect power and wealth (rather than wisdom and virtue), and to hold in derision and contempt the poor and the weak (rather than vice and folly) has led to a perpetual tendency for part of the economics profession to become what Marx called "apologists for capitalism". From this tradition comes the ideological elevation of free markets to the status of infallible arbiters of economic affairs, and the consequent acceptance - as "optimal" - of whatever distribution of income and wealth the market throws up. From this tradition comes the unequivocal condemnation of regulation and intervention as bad, and the characterisation of interventionist economists and politicians as malevolent and anti-social. What appear here are ancient religious dogmas about sin and redemption, mixed with pre-modern medical ideas such as applying bleeding and leeches to cause disease. In this intellectual mix, the basic concept of the public good diverges from that of Plato and Voltaire, Bentham, Smith and J.S. Mill. Instead of being perceived and articulated by philosophers endowed with wisdom and virtue, the public good becomes identified with rigid adherence to dogmas which are given the same force, and much the same source of ultimate authority, as religious doctrines.

These dogmas, as a matter of practical observation, appear to have the same degree of embeddedness in human nature as Adam Smith's moral sentiments, and their ability to attract the support and votes of the mass of the population is a continual problem for the smithian tradition. For example, there is at present around the world a revival among economic commentators and policymakers of dogmatic claims about the healing powers of fiscal austerity in a situation of weak macroeconomic performance, dogmatic rejection of Keynesian economic thinking, and dogmatic assertions about the destructive consequences of government intervention and regulation. These arguments are advanced with the force of great moral certainty and with complete disregard for empirical evidence or the lessons of economic history. Many of the leading lights of the economics profession are protagonists of what has become a sustained propaganda offensive against the welfare state, against Keynes, against government in general, and against the poor and weak.

The soul of the discipline of economics is therefore divided. The discipline is inescapably morally implicated, in the sense that it confronts moral dilemmas and is obliged, in common discourse, to locate some moral basis on which to ground its analysis of policy questions. But it is at the same time morally incapable of building any such basis from within itself; all attempts to establish, by economic logic and theoretical analysis, some common core of shared moral intuitions, have ended in failure. Economists have no theoretical answers to moral questions – they are obliged to import the fruits of moral philosophy. Given their reluctance to do so wholeheartedly, much economic writing – especially that with policy recommendations - turns out to involve the promotion of one or another particular sectional vested-interest, and thereby falls foul of postmodernist critique

There was, however, a period when economics did aspire to contribute directly, on its own terms, to moral philosophy. So before I finish, a few words about twentieth-century history of economic thought and the *cul de sac* of "welfare economics".

5. Twentieth-century welfare economics

Whereas Adam Smith observed human behaviour and evaluated it against the inherited moral-philosophy criteria (wisdom, virtue, and the general good for humankind), Jeremy Bentham (writing at the turn of the nineteenth century) set out to develop a way of quantitatively measuring human welfare by calculating and aggregating individual utility. This again was a very Enlightenment project, in the emerging mould of scientific practice.

Bentham's utilitarianism became the dominant mode of thought amongst economists in the second half of the nineteenth century, in the neoclassical economics of Jevons, Walras, Menger and Marshall. In their hands, economics saw itself as the science of allocating scarce resources amongst competing ends, subject to diminishing returns – an application of Newtonian mechanics to economic phenomena. The new economics used calculus extensively, beginning the process of mathematicising that has eventually turned into a suffocating excess of rigour triumphing over commonsense in the last three decades.

In its original form, though, neoclassical economics held out the prospect of finding a "scientific" answer to the pressing moral issues in economics – in particular, the distribution of income and wealth in society. Smith's Classical successor David Ricardo, and his follower Karl Marx, had given a central role to social forces in determining distribution: Ricardo thought that the drive for profit by capitalists, combined with Malthusian breeding behaviour by workers, would continually tend to drive real wages down to an irreducible subsistence minimum – the "iron law of wages" – with profits and rent taking the balance of the product. Marx developed this into a sophisticated account of class struggle between capital and labour. The neoclassicals of the 1870s thought they had found an alternative approach more attuned to liberal middle-class sensibilities: under competitive conditions each factor of production will be paid its marginal product (what the last unit employed actually adds to total output), which means that the wage rate reflects worker productivity, not a subsistence floor; and capital commands a profit only to the extent of its productive contribution at the margin. At first sight this provided a moral justification for whatever income distribution the competitive market threw up, and this strand in neoclassical economics has been enthusiastically embraced by modern neoliberals, conveniently disregarding the necessary conditions that have to hold for the story to work (in particular, perfect competition in the labour market rather than employer oligopsony[6]).

However, the other side of the coin was that utilitarian theory applied not only to the distribution of factor rewards amongst wages, profit and rents, but equally to the personal income distribution, which is not necessarily the same thing, and here the implications were radical. Each individual's utility, in the neoclassical account, increases with income, but at a diminishing rate (diminishing marginal utility). If all individuals have the same utility functions, then a rich person gets less additional utility from a dollar than a poor person. Therefore, as Pigou pointed out in his 1920 *Economics of Welfare*, the maximum utility of society as a whole will be reached when the distribution of income is completely equal. Wages, profits and rents might be set by the market, but the resulting distribution of the social product would not be optimal if it involved inequality across individuals, unless the rich and the poor had very different utility functions. So unless each individual had an equal share of society's total land, labour, capital, and talent, and thus earned the same amount as every other individual, social welfare would be improved by taxing the rich and transferring the money to the poor until the income distribution reached full equality. From this insight flowed the twentieth-century welfare state, probably the most fundamental social project to emerge from economic theorising.

This conclusion was extraordinarily unwelcome to the rich. And, of course, for any economist inclined to admire and respect power and wealth (as distinct from wisdom and virtue) there was immediately an intellectual challenge: to restore the moral legitimacy of the possession of wealth by the rich, and for their resistance to taxation to finance a welfare state. The first blow against Pigou was struck by Lionel Robbins of LSE in 1933: not only do individuals not have the same utility functions, but it is in principle impossible to compare one individual's utility with another's[7]. Hence Bentham's original project is unattainable because the scientific measurement of utility, which it presupposes, cannot in fact be done. (Adam Smith's solution, in which the statesman and the philosopher are able by exercising "sympathy" to intuitively measure society's welfare, was not contemplated by Robbins as a substitute – that was left to later moral philosophers such as Rawls.)

John Hicks put the final nail in the welfare-economics coffin in 1939 when he pointed out that most of the scientifically-interesting neoclassical propositions abut demand and supply, resource allocation and relative prices, could be derived through mathematical reasoning without assuming that utility could be measured[8].

Robbins and Hicks did not go on explicitly to argue that the rich in fact differ from the poor in terms of their ability to extract greater pleasure from their one-millionth dollar than the poor can get from their first dollar, but the implicit message was there: no policymaker can with certainty undertake any redistribution of income within society in the name of raising social welfare, because there is no scientific way of measuring, and hence no way of proving, any such increase. So far as modern neoclassical economics is concerned, the rich are secure in their wealth because there is no scientifically-valid way of challenging the status quo.

There is, of course, a flip side to this. Under the Robbins rule, it is impossible to prove that a revolutionary overthrow of the ruling elite, and seizure of society's wealth by the poor, involves any reduction of social welfare; it may well increase welfare. Since economics cannot measure social welfare, one has to resort to other criteria to judge whether any particular income and wealth distribution is better than any other. Hence most economists from the 1930s until the 1980s (and most textbooks) adhered to the general view that judgments on matters of distribution were essentially political judgments, to be made through the political process, with economists stepping up to talk about efficient allocation of resources only after the preferred distribution has been struck. This enabled economics textbooks to dress economics up in logical-positivist clothing, in an era when that methodological position was hot.

The great intellectual defensive victory of the 1930s over the economic case for equality was followed by several decades during which economic theorists explored the limits of what could and could not be said using the tools of ordinal-utility theory. The eventual conclusion was that the core theory of neoclassical economics had in fact nothing to say about the optimal distribution of income and wealth. Yet at the same time the use of cost-benefit analysis was spreading around the world and policymakers were seeking economists' advice and demanding numerical answers to key questions: should the railways be expanded of contracted? Were cars better than trains? Did London need another airport? How should aid money be allocated across poor countries? What tax system is best?

Most of these important and interesting policy questions of the 1960s involved winners and losers, and hence changes to the income and wealth distribution. Economists who modestly said they had no way to give a full answer to cost-benefit questions, because they could not compare one person's losses with another person's gains, tended to lose out on consultancy opportunities to economist who were prepared to barge on regardless of their theoretical incapacity. At this point the moral compass was set aside in favour of the measuring-rod of money.

The key step into this moral vacuum was taken by the Chicago economist Arnold Harberger. In his seminal work on measuring distortions of resource allocation, Harberger noted that9 "I have discussed only the welfare effects of resource misallocations due to monopoly. I have not analysed the redistributions of income that arise when monopoly is present. I originally planned to discuss this redistribution aspect as well, but finally decided against it." He gave no reasons for this decision, but relegated the issue of redistribution to "my more metaphysically inclined colleagues".

When he finally turned to the issue of the effect of wealth redistributions, Harberger was concerned not with theory but with practical issues of implementing cost-benefit analysis. His 1971 paper[10] was "an open letter to the profession" pleading for the adoption of three ad-hoc assumptions to be used in applied welfare economics. The third of these was that (p.785) "when evaluating the net benefits or costs of a given action (project, program, or policy), the costs and benefits accruing to each member of the relevant group (e.g. a nation) should normally be added without regard to the individual(s) to whom they accrue". Harberger's aim was pragmatic: to encourage economic analysts to press ahead with the task of estimating empirically the consequences of various alternatives, setting aside difficult and complex issues such as distribution which might otherwise bog the analysis down.

This involved abandoning any claim that economics could answer moral dilemmas. Harberger's most fundamental line of argument for assuming that income redistribution could appropriately be set aside was that economists have nothing to say on distributional matters that cannot be said equally well by laypersons (1971 p.785):

> "… any program or project that is subjected to applied-welfare-economic
> analysis is likely to have characteristics upon which the economist as such is not

> professionally qualified to pronounce, and about which one economist is not professionally qualified to check the opinion of another. These elements – which surely include the income-distributional and national-defense aspects of any project or program, and probably its natural-beauty aspect as well – may be exceedingly important, perhaps even the dominant factors governing any policy decision, but they are not a part of that package of expertise that distinguishes the professional economist from the rest of humanity. And that is why we cannot expect to reach a professional consensus concerning them. If we are to take a (hopefully justified) professional pride in our work, we must also have the modesty and honesty not to claim for our profession more than we are particularly qualified to deliver."

Harberger thus argued that even though redistributive effects might well dominate the final policy decision, economists had nothing to contribute professionally to that aspect of the decision. He nowhere suggested that economists should press upon policymakers a professional view that distributive effects are unimportant, or that policymakers ought to ignore distributive matters simply because economists had no means of reaching a professional consensus. He just thought that "giving equal weight to all dollars of income is mathematically the simplest rule." (1971 p.787) and that economists should stand back and allow others to reach informed judgments on matters of redistribution. Adam Smith could have lived with this[11]. Economists have, however, ignored or forgotten Harberger's point. Thus the New Zealand Commerce Commission in 1994[12] argued that "a transfer of wealth from suppliers to consumers would constitute a net benefit to acquirers, [but] the increase in consumers' wealth is matched by a reduction in suppliers' wealth (resulting in zero net public benefit)".

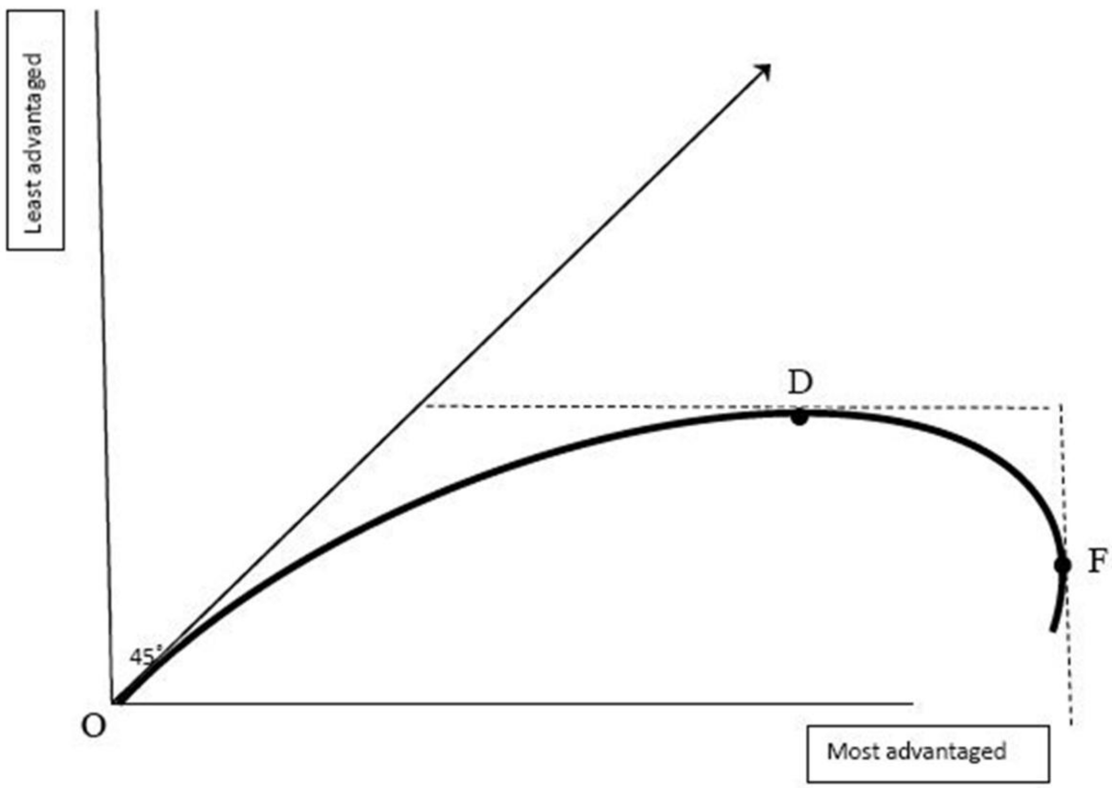
In a 2004 paper I argued that[13]

An important part of the economics profession has allowed itself to become caught in the intellectual cul de sac of the impossibility of interpersonal welfare comparisons; but the new-welfare-economics impasse is simply bypassed by arguments derived directly from long-run dynamic economic efficiency and from the sort of contractarian constitutional arguments to which economists are easily drawn. The underlying fallacy to which the neoliberal argument falls prey is the assumption that long-run social production is independent of income and wealth distribution and of the procedures by which that distribution is established and altered (the "separability argument").

> That society's resolution of "distributional" issues (including most importantly the allocation of property rights and the limitations placed upon the exercise of those rights at the expense of fellow-citizens) has no role in the maximization of wealth is too improbable a notion to provide even a satisfactory provisional premise for a hypothetical argument – let alone a major plank of antitrust policy.

6. A final word: from Smith to Rawls

Where does this leave economics in relation to the great moral issues of our age? Essentially, the failure of the neoclassical welfare-economics project to build a basis for normative policy judgments from the ground up, on the basis of utility theory, forces economists to return to the ground occupied by Adam Smith two hundred years before, taking moral principles from the philosophers and juxtaposing them against observed economic behaviour, thereby enabling the policymaker (assuming he or she is a Smithian "statesman") to determine when the outcomes of market forces are morally unacceptable, and to seek advice on how those outcomes can most effectively be modified by policy (whether legislation or regulation).



Hence a crucial part of a contemporary economics education should, in my view, be the work of John Rawls and the recent critique of his philosophy by (economist-turned-philosopher) Amartya Sen[14]. On matters of income distribution, Rawls has memorably laid down, in the form of the maximin principle, a means to apply the measuring rod of money to the issue of income and wealth distribution. Rawls' diagram above[15] has a clear message for our age of financial oligarchy and escalating inequality.

Here as society's access to "primary goods" increases (moving northeast from O) the benefits are shared by the least-advantaged up to point D, beyond which the maximin principle would bar further gains for the rich because those gains are at the expense of the poor (movement southeast from D). At F the situation of feudalism is reached, where the rich have maximised their income by exhausting all possibilities for predation on the poor.

Obviously, there are some important potential policy guidelines here. Steepening the upward-sloped part of the curve is good, as it delivers more to the least-advantaged for each gain to the most-advantaged. Pushing the maximin point D up, and out to the right, can be justified.

Policy rhetoric of the past decade in New Zealand about tax cuts for the rich has, explicitly or explicitly, been located in this space, with advocates of cuts claiming that they lie on the OD segment of the curve, or will shift the curve itself upwards. Critics have seen the tax cuts as moving us down from D towards F. Here moral philosophy provides economics with something to chew on. (Needless to say, the maximin principle has copped a fair amount of criticism amongst economists, but no clear alternative.)

To conclude: economists have, indeed, no special advantage over other human beings in forming moral judgments. But that is no excuse for philosophical and ethical illiteracy. All economists ought to be familiar with the history of their discipline, including its encounters with moral philosophy at various stages. All economists ought to be able to participate in moral discourse, and to articulate the relevance of moral principles to their work. It is a matter of regret, therefore, that such a large group in the profession have descended into what Smith would have identified as corruption of their moral sentiments.

Endnotes

1 Krugman is a prominent economist at Princeton University and a *New York Times* columnist.

2 As Keith Rankin has pointed out, the promotion of the society's good that Smith has in mind in this passage is that of the national economy, in a world where capitalists could invest overseas rather than at home – so that the "invisible hand" here is turning to national advantage an instinctive economic nationalism which runs counter to pure profit-seeking "rationality". ("What Adam Smith Really Said about the Invisible Hand", http://pl.net/~keithr/rf98_InvisibleHandQuote.html .)

3 Adam Smith, *The Theory of Moral Sentiments*, edited by D.D. Raphael and A.L. Macfie, Oxford: Clarendon Press, 1976, p.9.

4 Ibid. p.9.

5 Jacob Viner, "Adam Smith and Laissez Faire", *The Journal of Political Economy*, Vol. 35, No. 2. (Apr., 1927), pp. 198-232.

6 An important empirical trend in the past couple of decades in New Zealand as elsewhere around the OECD has been the tendency of wages to lag behind productivity growth. This empirical observation is inconsistent with perfect competition if the other neoclassical necessary conditions are satisfied.

7 Lionel Robbins, *An Essay on The Nature and Significance of Economic Science*, Macmillan, 1933.

8 In the jargon, this meant a shift from the "cardinal utility" of Bentham and Pigou to the "ordinal utility" of Hicks and later neoclassicals. For Hicks' rejection of utilitarianism see *Value and Capital*, Macmillan 1939, pp.17-18.

9 Harberger, A.C. (1954), 'Monopoly and Resource Allocation', *American Economic Review* 44(2): 77-87, May, p.87.

10 Harberger,. A.C., "Three Basic Postulates for Applied Welfare Economics: An Interpretive Essay", *Journal of Economic Literature* 9: 785-797, 1971.

11 The issues are reviewed, and the arbitrariness of one-for-one weighting re-emphasized, in Slesnick, D.T., "Empirical Approaches to the Measurement of Welfare", *Journal of Economic Literature* 36(4): 2108-2165, December 1998.

12 New Zealand Commerce Commission (1994), *Guidelines to the Analysis of Public Benefits and Detriments*, October 1994 (revised December 1997).

13 Geoff Bertram, "What's Wrong with New Zealand's Public Benefits Test?", *New Zealand Economic Papers* 38, 2, (December 2004) pp.265-277.

14 John Rawls, *A Theory of Justice* (1971) and *Justice as Fairness: A Restatement* , Harvard 2001; Amartya Sen, *The Idea of Justice,* Belknap Press, Harvard, 2009.

15 From Justice as Fairness p.62. This develops on the original Figure 8 in *A Theory of Justice*.