Oh, the morality: why ethics matters in economics

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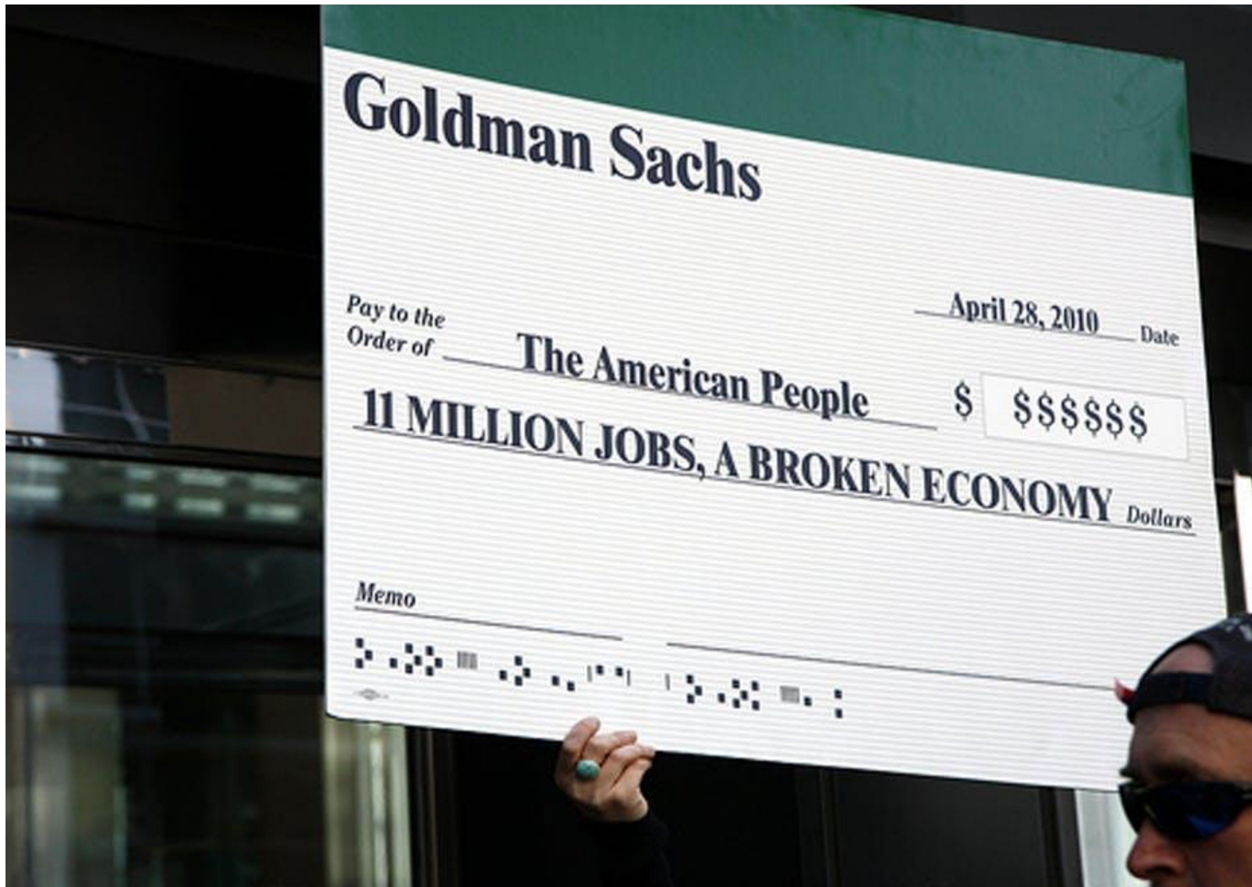

"Morally bankrupt" is how a recently departing Goldman Sachs executivedescribed the culture of the investment bank. As noted in Business Day, this view "is common among the bank's critics, many of whom see the firm as a symbol of Wall street's excesses and a culture of greed which has wreaked havoc on US business and global economy".

Margin Call is a new movie that depicts these tensions between economic interests and ethics. Movie fans may also recall the oft-quoted line in Wall Street when the infamous Gordon Gekko asserts that "greed is good". Proponents of extreme capitalism have long argued that its economic dynamism does not need – and can be impeded by – the intrusion of ethical considerations into business behaviour. According to this view, greed drives the pursuit of profit, and the market is the arbiter of outcomes that increase society's wealth and economic opportunities.

Writing four decades ago and seeking to give some respectability to this ideological perspective, the right-wing US economist Milton Friedmanposited that "the social responsibility of business is to increase its profits". "Maximising shareholder value" is how it would be described today.

It should be patently evident, however, that this is not a reliable route to a good society. Five big problems bedevil the strategy: instability, insecurity, inequality, monopoly power and unsustainability.

The problem of economic instability is all too obvious in the wake of the global financial crisis. Economic institutions pursuing profit without social responsibility gave us the most sharply pronounced financial

crash since the Great Depression began in 1929. The business practices of sundry mortgage-providers, investment banks and ratings agencies compounded into a maelstrom of business failures, unemployment and economic losses for superannuants and self-funded retirees. The root problem was – and still remains – structural, but the amoral economic behaviour of key participants became part of the destabilising processes.

Along with instability comes economic insecurity. Being constantly vulnerable to market forces beyond one's control is a recipe for personal anxiety. It is not conducive to increasing productivity and investment in skills, which require a more long-term perspective.

Businesses that value the services and loyalty of their employees know that it is ultimately counterproductive to treat workers only as items to be hired and fired according to changing market conditions. There is a human need for security as well as freedom – although it is always an uneasy dualism. Economic security is recurrently violated, however, where the emphasis is exclusively on market freedoms without social responsibility

The tendency towards monopoly exacerbates these socioeconomic problems. Where there are pronounced concentrations of economic power, the effect is to violate freedom as well as security. This is commonly the product of market arrangements, as the big businesses gain power relative to the small ones. The dominance of Woolworths and Coles in Australian retail grocery is an obvious case in point.

Milton Friedman (left) and Arnold Harberger: the forefathers of economic neoliberalism.DonkeyHotey

Milton Friedman argued that competition between big businesses suffices to safeguard the public interest, but in practice it is almost always insufficient, especially where there is collusion among the players to safeguard their market dominance – and their political influence. Legislation to limit monopoly and prevent restrictive trade practices is invariably needed to safeguard public interests.

Economic inequalities also predictably widen where self-interested market behaviours dominate. Capital makes capital, while those without capital often remain consigned to poverty. Certainly, the very rich have become notably much wealthier during the last three decades while neoliberal ideologies and policies have been dominant. In the absence of strong unions and governments committed to some degree of egalitarian redistribution, the unequalising tendency is inexorable. The result is predictably unhappier societies that experience a higher incidence of social problems, as empirical research complied by Richard Wilkinson and Kate Pickett clearly demonstrates.

Ultimately, the short-term self-interested economic arrangements are not sustainable anyway. As the US economist Kenneth Boulding once said: "Anyone who believes that exponential growth can go on forever in a finite world is either a madman or an economist". Free-market economists have an unwarranted faith in the capacity of price adjustments to produce technological changes in production and patterns of consumer demand. Their theories imply that the price system has infinite capacity to shape sustainable outcomes. Current carbon tax initiatives tend to share this faith to some degree. But if the self-interested market behaviours continue to seek an unchanged goal – more personal incomes with which to purchase more material goods – ultimately they cannot be fulfilled. Husbanding our collective environmental wealth and maximising personal economic wealth are incompatible goals.

Something has to give. An economic system that rewards amoral self-interest creates economic instability, fractures economic insecurity, fosters concentrations of economic power, exacerbates economic inequality and violates ecological sustainability. So much for the self-regulating market economy!

Could a "layering-on" of socially responsible personal behaviour, particularly in business, produce the necessary reconciliation? In my opinion, this is doubtful, notwithstanding the worthy intent. Already

some businesses practice a degree of philanthropy. However, this often seems to be part of a process of corporate image management. In aggregate, its effects are minor, especially in Australia, which lacks the stronger philanthropic tradition of the USA.

There is currently much talk of “social responsibility” in business and of “triple bottom line accounting” that emphasises the use of social and environmental criteria, as well as a financial criterion, in assessing business performance. This is welcome. Indeed, businesses developing reputations for responsible behaviours may reap benefits in the form of worker and customer loyalty. But unless and until ethical behaviours become integral to how markets function – by directly affecting ‘shareholder value’, for example – it is hard to see the overall effect as much more than window dressing for “business as usual”.

The necessary changes must ultimately be structural, such that it ceases to be profitable to act in ways that cause the anti-social and anti-ecological fallout described in this article. Directing the next generation of economics students in our universities to address these concerns wouldn’t be a bad start. The standard economics curriculum is currently dominated by neoclassical theories that purport to show how self-interested behaviours produce economically optimal outcomes (market equilibrium; efficient resource allocation; sustained growth). Instead, students could more usefully study the competing currents of heterodox political economic thought, which more explicitly consider the tensions and contradictions in the capitalist economic system.

A reformed economics education would expose the fallacious nature of Friedman’s reasoning. It could also help to show this systemic character of the behaviours exhibited by financial institutions such as Goldman Sachs. Economists might then stop being apologists for the current economic arrangements and become explicitly concerned with how ethical issues necessarily intervene between economic means and social ends.