

QUAKER ECO-BULLETIN

*Information and Action Addressing Public Policy
for an Ecologically Sustainable World*

Volume 7, Number 1

January-February 2007

The Ethical Implications of Modern Economic Theory

Leonard Joy

Modern economic theory is the rationale for contemporary capitalism. While it purports to be ethically neutral it is underpinned by a profoundly antisocial ethic and an immature values system. The values of the Religious Society of Friends as reflected in Friends testimonies express how we relate—to ourselves, to other humans, and the cosmos. The impact on these relationships that arises from the application of economic theory is largely ignored by economists, which makes economics at base amoral and in practice immoral. By assuming that human goals are expressed as the maximization of the market value of production, the prevailing economic theory fails to account for who bears the costs and who reaps the benefits, which generates poverty as it promotes material abundance. Our current economic system also fails to account for the impacts on living systems, so economic growth is pursued regardless of the consequences to the natural capital that sustains it. By disregarding both nature and persons, the fundamentalist application of economic theory violates Friends testimonies. Today it threatens life itself. In short, it is unethical.

Development of Modern Economic Theory

Economics originated as a branch of philosophy concerned with the attainment of the “good life,” especially through the husbandry of resources. As national economic systems developed, the field of economics became concerned, not only with the creation of wealth, but also with the distribution of wealth and the systemic management of economic activity. Under the influence of nineteenth-century scientism there were attempts to express the economic system—the relations between production, consumption, prices, savings, investment, wages and incomes—mathematically. The mathematicians built impressive models and a comprehensive mathematical framework emerged for the analysis of economic systems.

This framework gave new and powerful, though narrow, insights into how economic variables were related. However, it was based on several simplifying assumptions that were unsupported by empirical observation. Economists accepted these simplifying abstractions as valid approximations of reality even though the limitations of the analysis, the unreality of its assumptions, and serious challenges to the validity of its conclusions were profoundly apparent.

Not the least consequence of these simplifying abstractions was that they avoided consideration of social justice concerns that had been at the core of the nineteenth-century economics debates. This resulted in the notion that concerns about economic

exploitation, for example, were groundless because whatever wages resulted from a perfect market had to be fair. They represented the true value of labor to the producer and they were the best wages that laborers could properly find, claim, and justify.

In the middle of the Great Depression, English economist Lionel Robbins provided what became widely accepted as the justification for modern economics’ silence on social-justice issues. He argued that economics did not depend upon value judgments and that it had nothing to say about them. He thereby both rationalized the exclusion of social justice from the subject matter of economics, and ignored the underlying value premises on which its theories are based.

The role of the economist was not to pronounce on social values, but to accept the values of society in making calculations to determine optimum resource allocation given desired socio-political goals. The economist’s job was to determine optimum resource allocation given desired ends that were determined outside the science of economics. The agenda of the political economists—Ricardo, Marx, and others—to create a just and prosperous society, was thereby discarded as outside the scope of economics.

This view was supported by another English economist, John Hicks, who showed that optimum resource allocation (the distribution of goods and services among consumers that would maximize everyone’s satisfaction) could be determined without knowing just how much satisfaction was derived from any specific outcome. All that was needed was to assume that individuals had a consistent rank ordering of preferences. Hicks asserted that this was adequate not only for the understanding of individual choice, but as a basis for advocacy with regard to the social good.

Robbins had argued that the professional task of the economist was to present the economic and material consequences of alternative choices and allow society to choose. This effectively removed economists altogether from the advocacy of specific social policies. Applying the work of Hicks and others, some economists concluded that they could and should advocate for the promotion of free markets as the means of best expressing the social good, thereby eliminating the need for society to choose societal goals. This conclusion stemmed from the theoretical demonstration that, when in equilibrium, the market could be shown to produce a pattern of production and consumption that was optimal in terms of the sum and distribution of everyone’s individual level of satisfaction. This in turn was seen as the objectively desirable social goal.

Quaker Eco-Bulletin (QEB) is published bi-monthly by Quaker Earthcare Witness (formerly FCUN) as an insert in *BeFriending Creation*.

The vision of **Quaker Earthcare Witness (QEW)** includes integrating into the beliefs and practices of the Society of Friends the Truths that God's Creation is to be held in reverence in its own right, and that human aspirations for peace and justice depend upon restoring the Earth's ecological integrity. As a member organization of Friends Committee on National Legislation, QEW seeks to strengthen Friends' support for FCNL's witness in Washington DC for peace, justice, and an Earth restored.

QEB's purpose is to advance Friends' witness on public and institutional policies that affect the Earth's capacity to support life. QEB articles aim to inform Friends about public and corporate policies that have an impact on society's relationship to Earth, and to provide analysis and critique of societal trends and institutions that threaten the health of the planet.

Friends are invited to contact us about writing an article for **QEB**. Submissions are subject to editing and should:

- Explain why the issue is a Friends' concern.
- Provide accurate, documented background information that reflects the complexity of the issue and is respectful toward other points of view.
- Relate the issue to legislation or corporate policy.
- List what Friends can do.
- Provide references and sources for additional information.

QEB Coordinator: Keith Helmuth

QEB Editorial Team: Judy Lumb, Sandra Lewis, Barbara Day

To receive **QEB**:

Email: QEB@QuakerEarthcare.org

Website: QuakerEarthcare.org

Mail: write to address below

Projects of Quaker Earthcare Witness, such as **QEB**, are funded by contributions to:

Quaker Earthcare Witness
173-B N Prospect Street
Burlington VT 05401

The practical application of this theorizing required rigorous and unrealistic assumptions, including:

- 1) The market is perfect with no monopolies or barriers to information or movement of goods or resources including labor;
- 2) The distribution of income and wealth created by markets is ideal.

These limitations of economic theory and its application have been played down and ignored by the advocates of privatization and free markets.

Economic Theory Denies Earth

One basic reality that is unaccounted for by current applications of economic theory is the limit to the capacity of the global environment to indefinitely meet demands upon it. The current economic theoretical assumption that continued growth is both necessary and possible is inconsistent with the limit of the finite world on which we live. The practical applications of current theory do not reflect concerns about the health of the global natural and social environments that sustain us. They fail to include the dynamic of the interactive relationship between people and the environment. There is no accounting in our economic system for the costs of the natural resources of Earth that are being exploited in current energy production, manufacturing, and transportation.

Free Market Economics Excludes the Common Good

The theoretical framework from which this free-market advocacy was derived excludes the concept of the common good by the assumption that all wants are independent. There is no need for social goals because they have been assumed not to exist. Thus, there is no need for a government to concern itself, for example, with the health of individuals. What it needs to concern itself with is the creation of a free market in health services.

Many economists have adapted to find a new role in this situation. They might argue that if society, through a political process, decides to support people whose incomes are so low that they cannot afford to buy health services in this free market, it may be desirable to supplement their incomes so that they can afford these services. Economic theory could then suggest ways of redistributing income that might do the least damage to the efficient working of the market.

Eliminating the concept of the common good in economic theory is profoundly significant in shaping contemporary society because this omission allows us to ignore how economic policies have a major influence on the way we relate to one another.

It isn't simply the economist's denial of the existence of a common good and dismissal of concerns for relationships and community that is so corrosive to society. There has been a triumphant marriage of the amoral economist and the libertarian philosopher that reinforces the denial of the need for common social values and purpose.

While economics espouses maximizing self-interest and freedom to trade in markets, libertarians espouse minimum constraint on the freedom of expression. These beliefs are grounded in the assumption of economic theory that if each person pursues his or her own tastes and values, and each seeks self-interested material gain by joining competing coalitions, the greatest social good will result. Thus, free market economists and libertarians both argue vehemently for individual freedom and against collective action for the common good.

Economic theory that claims to be objective is used to support the conclusion that free markets are preferable to social governance through the articulation and pursuit of shared social goals. Given a free market and perfect competition, social

problems are seen to arise because consumers and voters are not fully informed and therefore do not understand their true self-interest.

It is argued that assuring transparency (public access to information) and regulating monopoly power are important public policy goals though, in practice, they are less than rigorously pursued. When one party's pursuit of self-interest causes harm to another party or parties, it is assumed that the law would be invoked, but people and corporations should be free to do whatever is not against the law.

Social Consequences of the Misguided Economics

Why is the current application of economic theory misguided? This theory of markets, and how choice is exercised, assumes that people act to maximize their material satisfaction, that they are rational optimizers and actually behave the way that economic theory postulates. It asserts that allowing freedom of choice by consumers and producers, and promoting free markets, will lead to optimal outcomes regarding the use of resources and the distribution of products.

For the theory to hold true, each person's satisfaction must be independent of others' satisfactions. It must be based purely on one's material self-interest, independent of any other concern. For instance, this assumes that you can be quite happy to feast while others are starving, even as a consequence of your own feasting. Thus, you can ignore the implications of your own behavior for your relations with others or the environment, so long as you do not materially suffer or are unaware of your suffering as a consequence.

These assumptions exclude the possibility of making common cause with others, except by competing groups formed to maximize material self-interest. The role of government is confined to mediating conflicts of interest among groups rather than finding consensus on a vision for society. It also attributes a motive of material self-interest to any groups formed for any purpose.

This makes profit the sole concern guiding producers' actions. Central to these theories is a concept of "economic efficiency." Economic efficiency is attained when it is not possible to re-allocate any resource in ways that would increase profit. Maximizing profits is assumed to maximize aggregate consumer satisfaction. The theories show how perfectly competitive markets result in economic efficiency.

Social Cost-benefit Analysis

Social cost-benefit analysis extends the theory of consumer, producer, and market behavior to a theory of social choice. It is acknowledged that there may be items of desirable public, not simply private, consumption that would not happen if the market were left to its own devices—roads and weapons research for example. From a free-market economist's perspective, this list might exclude hospitals, prisons, libraries, water supply systems,

perhaps airports, and even a public school system, which should all therefore be privatized.

Cost-benefit analysis assumes that the social value of a proposed item of public expenditure is the net market value of the increment of production arising from the expenditure. What, for example, would "consumers" be willing to pay to enjoy a national park maintained from public funds. This presumes, of course, that this function is not to be outsourced to a private business, in which case the question would not arise. It assumes that market values reflect true social values, although it attempts to take account of distortions in prices due to imperfect markets and to externalities (costs that are not included in the current system, such as the cost to clean up waters polluted by industry).

The application of cost-benefit analysis starts with the assumption that income distribution is satisfactory prior to the initiation of a project, and that income distribution will further evolve perfectly as the result of market operation. These are critical assumptions since the way the market distributes costs and benefits depends on existing income distribution and current purchasing power of consumers in different income brackets.

This analysis assumes that there is no interdependence of satisfactions. An action is socially desirable if someone is better off and no one is worse off. For example, people displaced by flooding from the construction of a dam should be compensated so they are not worse off for their displacement. In practice, compensation costs have hardly ever been fully provided and the theory ignores the reality that there are some losses for which cash payments cannot compensate.

Social cost-benefit analysis imputes dollar values to all outcomes, and uses these as markers of social value, rather than seeking social consensus on what we collectively find to be fair, sustainable, and socially nourishing. Weighing the tradeoffs that cost-benefit analysis measures is essential to decision-making if used in a process that expresses common good concerns. However, decisions based primarily on cost-benefit analysis are likely to lead to choices that conflict with expressed real social values. The dollar values chosen as a basis for calculating future costs and benefits can lead to predicted possible outcomes ranging anywhere from bonanza to disaster. Because values for prices and costs can be chosen to justify or condemn any investment proposal, cost-benefit analysis is hardly objective.

Application to Current Policy and Decision Making

Economic theory has particular and significant implications with regard to decision-making by corporations and by governments as they impact on the environment. Decisions that seem profitable to the corporation, as well as those appearing socially beneficial under the scrutiny of social cost-benefit analysis, fail to account for elements of reality and elements of collective concern. Thus, the clear-cutting of Amazon forests for major ranching programs might show a profitable prospect and might even appear socially desirable in terms of employment and income genera-

tion, but the social disruption and incremental impact on global warming are externalities that are not priced and accounted for. Gold mining in Papua New Guinea that flushes cyanide into the river on which people depend for their livelihoods can still be attractive even when the value of the lost fish catch and the cost of resettling those displaced as a consequence is accounted for. Calculations of the compensations required to those who suffer, on the assumption that in practice such compensation be paid, cannot but fail to take account of the destruction of relationships and the larger harm to society that ensues. Economic theory has developed in a way that underpins such narrow and closed systems advocacy and sometimes—generally?—supports socially disastrous ventures.

Values of the Free-Market System

Economists have been grossly cavalier about testing the correspondence between postulated behavior and actual behavior. Recently there have been attempts to demonstrate that postulated behaviors of the market, while not invariant, tend to predominant in reality. Observed exceptions to the underpinning assumptions are discounted to make the case for market fundamentalism. Most significant is the implicit and explicit advocacy for unfettered growth as the basis for, and measure of, societal development that the logic of free market, profit maximizing, economic theory promotes.

Economics no longer addresses the question, “How do we advance the good life?” It is assumed that the good life is in the attainment of economic efficiency and material aggrandizement. Entirely discounted is the notion that the most socially desirable outcome of economic decisions may have anything to do with the relationships engendered between people, for it is assumed that there is no interdependence of interests other than competition or collusion. Thus, the possibility that the market itself may be an impediment to right relating is not even considered as potentially relevant. The impact of private and corporate economic behavior on relationships is not considered.

Ultimately, what makes contemporary economic theory so insidious is that it discounts the impact of economic decisions on relationships, and endorses the idea that, subject to what is legal, it is acceptable and even desirable to relate to other humans (not to mention animals and the environment) for purely personal self-interest and profit. In spite of denials, contemporary economic theory does embody a values system.

Alternative Paradigms

Yet, this values system is not the only possible basis for economic theory. There are alternative paradigms that would answer the questions legitimately asked of the current paradigm, and address questions that should be asked—questions about justice and the pursuit of the good life that economics embarked on centuries ago. Ethics and religion are about relationships. Meaning and values are about relationships. The economy is a domain of relationships. Economic theories that deny the significance of relationships, that reflect immature values, that embody no

sense of societal development other than simple growth, are not adequate for advancing the good of society.

Friends Concerned for the Economy and Earth

Quaker Eco-Bulletin (QEB) originated in the Environmental Working Group of Philadelphia Yearly Meeting as part of an effort to address these concerns about our current economic system and its impact upon Earth. *QEB* is now under the umbrella of Quaker Earthcare Witness (QEW). Several initiatives were generated at a gathering at Pendle Hill in June of 2003. QEW now works closely with Friends Committee on National Legislation (FCNL) to lobby for legislation for “an earth restored.” The Friends Testimonies and Economics team (FTE) has developed an adult study curriculum on economics and the environment.

Another spin-off from the Pendle Hill gathering is the Quaker Institute for the Future (QIF), which aims to develop “a Spirit-led, Quaker ‘think tank’ to live, work and practice research as a community.” QIF is planning a conference, *Toward a Moral Economy*. “This conference and its associated publications will deal with overarching questions like: What would a moral economy look like? How would it be different from our present economy? How might we make progress towards it? It will include areas of focal concern such as: In the light of Quaker testimonies, what would humane, “good citizen” economic institutions look like? What needs to change? How might change happen?”

Leonard Joy is a member of Strawberry Creek Friends Meeting of Pacific Yearly Meeting. He has taught economics and development at University College of East Africa, Cambridge, London School of Economics, and University of California at Berkeley. He has consulted to and for the World Bank, the United Nations Development Program, and major United Nations agencies in many countries, most recently focusing on governance and human rights.

References

John Hicks, *Value and Capital* (1938)

Karl Marx, *Das Kapital* (1867)

David Ricardo, *Principles of Political Economy* (1817)

Lionel Robbins, *Essay on the Nature and Significance of Economic Science* (1932)

What Friends Can Do

- 1) Educate yourself about the economic system under which we live.
- 2) Organize an adult study series using the curriculum developed by the Friends Testimonies and Economics (FTE) team <<http://www.fgcquaker.org/library/economics/seeds/index.htm>>.
- 3) Support the work of Friends Committee on National Legislation <fcnl.org>.
- 4) Participate in the seminars sponsored by Quaker Institute for the Future <quakerinstitute.org>.
- 5) Discuss the basic assumptions of the current economic system with others.
- 6) Write letters to the editor of your local newspaper.