Why traditional economics just won't do (again)

Jim Fetzer

Traditional economics, which dominates academic and business circles in the United States, depends upon at least three crucial assumptions, namely: that cost/benefit analysis is the most appropriate tool for decision-making; that the best solutions to allocation problems are induced by the "invisible hand" of the free market; and that economic success can be properly evaluated on the basis of measures of growth.

Ecological economics, by comparison, situates traditional economics within the framework of ecology and evolution, emphasizing the limited resources available on this planet and the importance of sustainability over growth. These are non-trivial differences, where which exerts the greater influence upon business and politics may well determine the fate of our species.

Whether or not such an approach may have worked in the past, regarding our future, traditional economics just won't do. There are even important reasons why, unless ethical aspects are taken into account, even ecological economics cannot provide an adequate basis for making decisions. But let's begin with the prevalent myth of the free market.

The free market

Proponents of "free market capitalism", such as George Will, the columnist and commentator, like to attribute the following position to Adam Smith:

> *The economic decisions of a person, driven only by his/her individual*

greed and self-interest, will be directed by the invisible hand of the free market towards the common good;

where "the invisible hand" is viewed as the crucial mechanism of economics. They offer Smith as the father of modern economic theory and recurrently advance his work to defend capitalism, the free-market and economic growth.

Smith, however, introduced a set of four crucial conditions that are necessary for market economies to produce outcomes consistent with the common good:

(C1) Perfect Competition: *The market should not be allowed to erode its own competitive foundations. No single firm should be allowed to grow so large as to control its market (no monopolies).*

(C2) Perfect Information: *All of the costs and benefits associated with the production and use of a given product or service must be made available to all participants (no trade secrets).*

(C3) No Externalities: *Sellers must bear the full costs of the products that they sell and pass those costs along to consumers in the selling price (no corporate welfare).*

(C4) Comparative Advantage: *Investment capital and labor must be rooted at home, where trade between nations has to be balanced and savings must be invested in the creation of productive capital rather than simply recycled and concentrated in global financial markets (no plutocracies).*

The Grim Reality

As the examples of ENRON, MicroSoft, and even Arthur Andersen display, in their relentless search for profits, modern corporations systematically violate these conditions by pursuing corrupt practices like the following:

(Not-C1) *Competition is eliminated by dominating markets with mergers and acquisitions and by collusion on prices (monopolies are promoted).*

(Not-C2) *Consumers are denied information by blocking and distorting its dissemination through the manipulation of the media and the manufacture of consumer demand via advertising (information is controlled).*

(Not-C3) *Social and environmental costs are externalized by opposing worker safety and environmental regulations as well as by insisting upon tax breaks and incentive programs (corporate welfare is encouraged).*

(Not-C4) *Global corporations exploit low wages, poor worker-safety laws, weak environmental regulations and high rates of return, concentrating vast sums of non-productive financial capital (plutocracies are nurtured).*

What this means is that the practices of corporations in the 19th and 20th centuries have contradicted or undermined the principles enunciated by Smith in the 18th century, in the absence of which free markets cannot exist. These corrupt practices have significant ramifications for politics, because they tend to promote the concentration of individual wealth at the expense of the community and the environment, while corporations subvert democratic processes by campaign financing and industry lobbying.

Cost/benefit analysis

This should come as no surprise to those who understand that companies like these operate on the basis of cost/benefit analyses in the pursuit of the maximization of profits. Potential profits (= benefits - costs) must be calculated in dollars and cents, including natural resources, human labor, (federal, state, and local) taxes, and marketing and distribution. Not only are inanimate objects, such as property and equipment, subject to these dollar-and-cents evaluations, but also animals, plants, and human beings.

The value of a human being, measured in dollars and cents, can be set as equal to their present net worth or extended into the future on the basis of their future expected earnings. The only problems with cost/benefit calculations based on dollars and cents are that they leave out every kind of factor that cannot be measured by means of dollars and cents, such as justice, fairness, and morality. [For a striking example, "Study Sees 6,000 Deaths from Power Plants", *The New York Times* (18 April 2002), p. A19.]

Indeed, any corporation committed to maximizing profits will necessarily degrade the environment, exploit labor, evade (federal, state, and local) taxes, and disregard pollution--all of which have vast negative impact on the quality as well as the quantity of human life on this planet--because they cannot maximize their profits any other way. Merely increasing their efficiency with regard to production, distribution, and management is not enough if other means for increasing prices and reducing costs are possible.

[For a perfect illustration, see "Companies scramble to move to offshore tax havens", *Duluth News Tribune* (27 April 2002), p. 10C.]

Homo economicus

That corporations motivated to maximize profits without concern for the common welfare are inherently corrupt should come as no surprise in turn for those familiar with the theory of rationality according to which everyone acts to promote his own personal interests without concern for the interests of others, which is known as *psychological egoism*. That this theory happens to be falsified every time anyone bases a decision on duty, love, or loyalty has not diminished its popularity.

Indeed, there is even a sophomoric misconception that, since anyone who acts from some sense of duty, love, or loyalty is acting on their own motives, those motives must be selfish. The motives that move us are always "our motives", but that does not make them selfish. Duty, love, and loyalty may be motives that are ours, but they are far different in character than personal enrichment, self-aggrandizement, and power acquisition. There are significant differences between the motives of Mother Theresa and of Kenneth Lay.

Psychological egoism has a counterpart, known as *ethical egoism*, moreover, which maintains that, even if we sometimes act from unselfish reasons, we should always act to promote our own interests. Traditional economics thus assumes that we all act as if we were ethical egoists, driven by greed and self-interest, where consequences for others simply do not matter. This is the model known as *Homo economicus*. That groups of individuals who are ethical egoists run corrupt corporations necessarily follows. [For example, see “Enron Avoided Income Taxes In 4 of 5 Years”, *The New York Times* (17 January 2002); and, in particular, "Enron Paid Huge Bonuses in '01; Experts See a Motive for Cheating", *The New York Times* (1 March 2002).]

Ecological Economics

Some of the basic assumptions that underlie ecological economics move far beyond the limitations imposed by cost/benefit analyses based on dollars and cents and transcend traditional models by incorporating considerations rooted in the realization that Earth provides only limited resources that can be exhausted if they are not conserved. The existence of resources that are finite imposes boundaries on economic growth, since their consumption can only be sustained if they can be replenished.

Models of economics that do not take ecology and evolution into consideration cannot possibly be adequate. As a front-page article in *The New York Times* (10 April 2002) has observed, the Gulf of California is about to run out of fish. "There just aren't any fish anymore," said Teresa Lopez, a villager. "Less and less every year for many years. Now we haven't enough to eat." For too long there have been too many fishermen and not enough fish. "Overfishing is a global problem. People are taking marine life faster than it can reproduce."

Ecological economics not only insists that traditional models be embedded within corresponding ecological and evolutionary contexts but also insists that resource consumption and pollution control be explicitly considered in economic calculations. This can be characterized as returning to principles of Smith, where corporate welfare is discouraged and the full costs of the products they sell or the services they provide are reflected by their selling price. But that is only a small part of what ecological economics represents.

The Tragedy of the Commons

Advocates of traditional models might respond by observing that situations of this kind are hardly unknown to traditional economics, where the difference is that between *short-term* (or unenlightened) and *long-term* (enlightened) planning. Overfishing in the Gulf of California displays what is known as "the tragedy of the commons". When resources appear to be unlimited and free, everyone tends to assume that they can take all they want without regard for the consequences for others.

But that is precisely what we should expect from individuals who satisfy the requirements of ethical egoism by acting to advance their interests without regard for others. Perhaps if they knew enough to understand that fishing cannot be sustained without allowing the fish to reproduce at a rate that is at least equal to the rate at which they are being consumed, they might act in concert to preserve their livelihood. But that would mean the surrender of short-term profit maximization.

The capacity to consider long-term as well as short-term consequences, not just for yourself but for everyone, and to strive for sustainability rather than growth entails abandoning traditional models. It requires both the rejection of *Homo economicus* for individuals and the goal of profit maximization for corporations. The tragedy of the commons represents an intractable problem for traditional economics. When every man is out for himself, no one is left to promote the general welfare--not even the government! [For example, "Bush Proposes to Shift Burden of Toxic Cleanups to Taxpayers", *The New York Times* (24 February 2002).]

The Future of the Species

Indeed, it appears to be difficult if not impossible to understand the basic premises upon which this country was founded, including the Constitution and its Bill of Rights, without appreciating an alternative theory according to which the essence of morality is treating other persons with respect. This *deontological conception* holds that morality requires always treating other persons as ends and never merely as means. Adam Smith's own principles, properly applied, promote mutual respect rather than mutual exploitation, which is why they can serve the common good.

No one who exemplifies *Homo economicus* and no corporation dedicated to maximizing its profits would be inclined to forego the competitive advantage that promoting monopolies, controlling information, externalizing costs, and exploiting workers affords, precisely because they contribute to maximizing profits. The nation and the world need more corporations with conscience, who care about the quality of life of their employees, the sustainability of their operations, and their effects upon the survival of the human species.

It doesn't take a rocket scientist to understand that sustainability ought to be our goal, not ongoing growth. By ignoring ecology and the natural limits to growth, traditional economists perpetrate a fraud on the American people. By neglecting the moral dimension of conducting business, they function as propagandists in political debates over limited resources. The time has come --and none too soon--to renounce *Homo economicus* as our theory and profit maximization as our goal and to recognize that "growth" is a four-letter word.

Jim Fetzer, a professor of philosophy at UMD, is the Director of the Master of Liberal Studies Program, which has recently introduced a new track in ecology, economics, and ethics. He has benefited greatly from discussions with Andy Klemer and Mike Mageau, who teach in the program with him.