

A match made in heaven: morality and the free market

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A commonly held view asserts that it is impossible for free markets to foster both morality and solidarity. To the general public, it seems hard to fathom that profit-seeking might breed morality since the latter is understood to involve selflessness while the former evokes selfishness. On one hand, any argument made that may support the morality of markets confronts this widespread view and predisposes the tenant of the opposite view to dig in his heels. On the other hand, proponents of free markets do not make their task any easier when they make their case. By asserting that free markets breed morality, they put themselves immediately at odds with the aforementioned belief.

The case to be made is the following: morality is the most necessary condition for a market economy to operate. In turn, free markets may generate morally desirable outcomes but they may not appear or be sustained without morality. Without morality, trust, social norms, civility and solidarity, leaving markets free of regulatory and fiscal burdens won't matter much.

Game Theory and Biology versus Thomas Hobbes

If one seeks profit at any cost, it is believed that one must constantly betray, plot and deceive. Selfishness requires such behaviour. However, in such a world, how could we be able to trade or accumulate wealth without resorting to theft and murder? In such a world, there is "no place for industry; because the fruit thereof is uncertain (...) and the life of man [is] solitary, poor, nasty, brutish and short" (Hobbes [1651], 1909), Civilization as we know it right now would not have seen the day. However, this need not be. If a mutually beneficial relation between two individuals is to develop, it must be repeated many times in order to virtually eliminate the incentives to steal, defect and murder.

In the *Evolution of Cooperation*, Robert Axelrod (1984: 27-54) relates how he organized a tournament between different computer programs designed academics of all sorts to compete for points. The winning program was the simplest of all and was aptly named "tit-for-tat" The wonder of "tit-for-that" was that it always sought to cooperate first and imitated the previous move of the opposite player. It would cooperate if cooperation had been observed in the past or would retaliate if defection had been observed. Moreover, "tit-for-that" would also be forgiving in order after retaliation in order to restore trust and mutual cooperation. In short: it won because it managed to build a "reputation" for trust and for retaliation in case of betrayal that allowed it to gain from repeated exchanges.

Developing a good reputation doesn't only work for human beings, it has also been observed in animals. Case of point: biologist Gerald Wilkinson observed in 1983 that vampire bats in Costa Rica harvested more blood than they needed, shared the

surplus with other less successful bats – regardless of kinship. If a bat had shared in the past, the other bat would reciprocate when the luck of the first bat turned sour. Like human beings, they were able to develop self-interested reciprocity.

The birth of markets: economics and history to the rescue

If, as previously mentioned, selflessness requires virtues of cooperation, trust, solidarity and reciprocity, why is it that we find all of these in the process of serving one's self-interest? It is because, they are necessary to the pursuit of self-interest. The more we dive into the pages of history, the more this becomes evident.

In situations with unclear property rights and a high level of uncertainty, human beings have found innovative ways to cooperate by creating institutions that encouraged trust and ensure that the fruits of trade and industry can be reaped. For example, Maghribi traders of the 11th century were hard-pressed to enforce contracts because of slow communications, high risks and the inability to punish the defectors. However, they conceived a coalition which enforced a multilateral punishment mechanism: if someone defected, every member of the coalition would punish him and he would lose the stream of future revenues from these trading relations. The incentives of every member – and outsiders dealing with them - was to develop a reputation for civility and trustworthiness if they wished to profit in the long run (Greif, 1993)

Another example is that of the American “Wild West.” In order to ranch and mine, farm, the settlers of the American West established land clubs, cattlemen's associations and mining camps. The land clubs were voluntary associations of landowners who adopted constitutions that established the rules with elected officers to enforce them. Each member knew that he could safely reap the fruits of his lands because he trusted his fellow members – as they trusted him – to protect him from encroachers. Cattle ranchers and miners adopted similar mechanisms to allow trade. No governments were involved; they relied solely on mechanisms that encouraged civility (because *de facto* property rights were enforced) in order for trade to flourish. (Anderson and Hill, 1973).

However, such informal arrangements are not necessarily the most efficient on larger scales because they grow costlier due to enforcement difficulties.

“Law, Order and Trust” or “How to Sustain Free Markets”

Vast societies require formal institutions that enshrine the value of property rights. Otherwise it would become difficult to have joint-stock companies, corporations, insurance companies, bills of exchanges, enclosures, prizes and patents. In short, we would be deprived of the tools necessary to realize economies of scale (which in turn allow us to specialize), improve the efficiency of capital and labour markets, encourage innovation and reduce market imperfections (North and Thomas, 1973). To these ends, a formal and impartial judicial system must be built.

This does not mean that as a result, we must discard trustworthiness, civility, solidarity, honesty and integrity. In fact, smaller institutions (of the kind that enhance trustworthiness and civility) must cohabit with larger institutions. This cohabitation is crucial since without these smaller institutions, society would be crushed while without the larger ones, society would collapse (Hayek, 1988).

To illustrate this, we can think about contract law in the United States which includes a lot of room between contracting parties to adapt and build trust while avoiding opportunistic behaviour from all the contracting parties (O'Hara, 2008). This makes it easier for contracting parties to meet and conclude their exchanges without resorting to costly legal means to solve differences.

It is imperative to understand that while institutions like courts, police and judges may allow trade to become specialized and complex, they can also be ill-suited to solve minor differences because of their heavy-handed nature. Smaller institutions – like in the case of contract law – that promote civility and trustworthiness avoid the problems inherent to the larger and coercive governmental institutions. They are complementary to the larger institutions.

Conclusion

Economic Nobel laureate, Elinor Ostrom explained it best when she said that “social norms are needed to instantiate and maintain enough [warm glow (in the sense of trustworthiness)] to sustain a stable free market society” (Ostrom and Schwab, 2008: 209). As we have seen, game theory, economics, biology and history make this point very clearly. So the question of whether or not free markets run contrary to “morality” broadly defined is irrelevant when we consider that free markets might not even exist without “morality”.

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