Arrow’s Responses

How does Arrow answer arguments such as Friedman’s? Well, Arrow argues five things:

1. The forces of competition are not always so strong, and firms may be able to exercise *market power*, in the limit as a monopolist.

2. Even if perfect competition exists, and no firm can exercise market power (facing a downwards-sloping demand curve), there is no guarantee that the market allocation of income and wealth will be *equitable*, even if the market is extremely *efficient* in transforming inputs into outputs.
3. We may be unhappy and uncomfortable about an appeal to our selfish, self-centred natures — where is a rôle for other-centred altruism?

4. Further, market externalities, such as pollution and congestion, mean that firms and individuals may not be paying for all costs they impose on others.

5. And information asymmetries may lead to bad decisions and to deceit: the “lemon” new car, the new pharmaceutical drug.
Means to achieve changed corporate behaviour?

Arrow goes on to suggest four ways to change corporate behaviour:

a. legal regulation, e.g., of polluting behaviour
b. taxes
c. common-law legal liability — firms can be sued
d. ethical codes

We shall examine these.
Reputation.

Further — and here is game theory — firms value their reputations — when interactions are repeated or when people talk.

Although Adam Smith, of the “invisible hand”, has been taken up by people who think of the market process as ethics-free, in fact Smith (author of *The Theory of Moral Sentiments* in 1759, before his 1776 *Wealth of Nations*) was very aware of the ethical content of markets.

Smith speaks of virtue as the “fine polishing” on the wheels of society, and vice as the “rust” on the wheels.
In 1968 Ken Boulding’s presidential address to the American Economics Association was on the theme *Economics as Moral Science*.


The 1998 Nobel laureate Amartya Sen wrote in *On Ethics and Economics* that value judgements are pervasive, that ethics doesn’t subvert economics as a science, that ethics is part of economics as a science.
**Game theory and the evolution of fairness**

Is it rational to be ethical?

Would we really all be better off if we looked after Number One?

Plato, Kant, and John Stuart Mill — and most recently John Harsanyi, another Nobel laureate — have tried to show that there is more to life than selfishness.

Darwin’s evolutionary biology was used by others (such as Herbert Spencer, who coined the phrase “survival of the fittest”) to argue that altruism was unnatural and weak.
And recently ...

In the past twenty years, however, game-theoretic models have been used by Robert Axelrod and others to show that altruism can evolve even in the repeated Prisoner’s Dilemma.

In fact, we are social animals and evolved in societies where cooperation conferred some fitness on our ancestors and those of other mammals.

There has recently been evidence of the concept of “fairness” among monkeys in the lab, which suggests hard-wiring via evolution in the brain.
Utilitarianism

Includes two doctrines:

1. The *right* action: actions are right if they maximise the good for the majority. (The greatest good for the greatest number.)

2. The *good*: happiness/satisfaction is good.
Criticisms of utilitarianism:


2. But “the end doesn’t justify the means” (Kant)
   — It’s possible to justify greater inequality of good, against fairness or equality or **redistributive justice**
   — or to punish the innocent for maximum gain, against **retributive justice**
   — or against duties of **truth-telling** or **promise-keeping**
Rights?

3. What of *rights*? 
If A injures B, for the good of the majority, but may violate B’s rights.

4. A is on a bus party which is captured by bandits. The (honourable) bandit chief promises to release A + the rest if A agrees to shoot any member of the party.
If A refuses, then the bandit chief will shoot all. Should A shoot 1 → the rest set free?

Utilitarianism missing a link to *morality of the person*. 
### Efficiency v. Equity

<table>
<thead>
<tr>
<th>Status Quo Ante</th>
<th>Efficiency</th>
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</thead>
<tbody>
<tr>
<td>Less efficiency, less equality.</td>
<td>Greater efficiency, less equality.</td>
</tr>
<tr>
<td>Smaller cake, less even slices.</td>
<td>Larger cake, less even slices.</td>
</tr>
</tbody>
</table>

- **A**
- **B**

**Efficiency v. Equity or Fairness**

(lexicographic ordering)
Vilfredo Pareto (1848–1923) —

Proposed a limitation on utilitarianism:

*The Pareto Improvement Criterion:*

An action should be undertaken if it improves the welfare of at least one person, while making no-one worse off.

Consequences?
Confucian Ethics

Kong Zi or Confucius (550–479 B.C.) has influenced over 2000 years of thought in China and beyond.

Master Kong developed the three principles of *Li*, *Jen*, and *Chun-Tzu*.

**Li**: the ideal standards of conduct: religious, moral, and social

**Jen**: the virtues of goodness and benevolence; a recognition of value and concern for others

The Silver Rule:
“Don’t do unto others what you would not like them to do to you.”

Li provides a structure for social interaction
Jen makes it a moral system.
Chun-Tzu

Chun-Tzu (or Junzi, ruler’s son):
the true or virtuous gentleman or person
he who lives by the highest ethical standards,
and displays the five virtues:

1. self-respect
2. generosity
3. sincerity
4. persistence
5. benevolence
Chun-Tzu

Relationships:

- as a son: loyal
- as a father: just and kind
- as a husband: righteous and just
- as an official: loyal and faithful
- as a friend: faithful and tactful

Note: Confucius held that we are inherently good creatures.

Against Christianity: ? Original sin.

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see http://www-chaos.umd.edu/history/ancient2.html for discussion of his disciples Meng Zi and Xun Zi and the schools of Literati and Legalism and of yin-yang and of Mo Zi.