WHAT ROLE CAN MARKETS PLAY IN CREATING A GOOD SOCIETY?

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Preliminary and Incomplete

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1. INTRODUCTION

In 2011, the Royal Dutch Academy of Sciences, KNAW, published the "Nederlandse Wetenschapsagenda", containing a list of 49 grand questions to which the Dutch scientific community can be expected to make a considerable contribution in the medium term.[1] Question 36 of this agenda is: "Hoe moeten we markten inrichten en bewaken?" The project "Dienstbare Markten" that aims to contribute to answering this question was initiated in the spring of 2014. In this paper, I report on the progress achieved in this project so far.

The background for the project is a question that is both grand and old: what role can markets play in a good society? To answer this question, this project takes an *economic approach*. However, the scientific approach is not narrow: we *start* from economics, but note its limitations and enrich the economic approach by using insights from other disciplines (psychology, sociology, philosophy, ethics, law, political science) wherever possible.

The project aims to contribute both to science and to society. From the scientific point of view, we aim to provide an overview of what is known about the pros and the cons of the market, and to outline a research agenda related to the things that are still insufficiently understood. We hope and expect that such an overview will also be useful in societal and political discussions about the role of the market in reaching goals of public policy. In the past, discussions on topics like privatization, liberalization and competition have sometimes not progressed very far, or have not been very fruitful, as political parties and interest groups have adopted ideological positions, or have talked at cross purposes. It is noteworthy also that there has not been an intense dialogue between policy makers and academics, an important reason probably being that science has not

* I thank Lans Bovenberg, Saskia Lavrijssen and Siegwart Lindenberg for comments on an earlier versions. Errors, omissions and opinions are mine. I warmly welcome comments of all type, but prefer that people do not cite this very preliminary "progress report" to stimulate discussion and set things in motion.

[1] https://www.knaw.nl/nl/actueel/publicaties/de-nederlandse-wetenschapsagenda

been able to answer the questions within the time frame set by (or forced upon) policy makers. The project aims to establish such a dialogue, in particular, we aim to involve the scientific bureaus of political parties already in an early stage of this project; see Section 1.3. In a later stage, we want to involve the public at large.

1.1 Economics and other disciplines

Economics is silent on the question of what constitutes a good society: it is for the individuals constituting the society to decide upon this. Hence, different societies can provide different answers, depending on the underlying values of its members. Economics is not a normative science which dictates what should be done; it is a positive science that aims at understanding how (parts of) society work.[2] As such it aims to serve society. If the members of society can agree on what they want to achieve, then they can turn to the economist with the questions "Can we achieve what we want? If so, how can we achieve this?"

It should be clear that the economist will not necessarily have answers at hand, but at least he will agree that questions like these belong to his field. In trying to provide answers, the economist will, naturally, look at markets, hence, he will end up at our grand question. However, an economist should not be viewed as an advocate of markets, but as an expert who (hopefully) knows what markets can and cannot do. Economics is a social science, and other social sciences, and philosophy, also provide insights into the "grand question". In this project, we aim to integrate these insights in order to arrive at an overall assessment. Economics distinguishes it itself from the other social sciences not by its emphasis on markets (which are just one institution), but by its approach. Economists incessantly assume that people are goal directed, that they are rational. For us, this assumption provides an adequate starting point, but we are well aware of its limitations, and will deal with these.[3]

[2] There is discussion about this. For example, Thomas Sedlacek bluntly states that economics is (ultimately) about good and bad. As a positive science, economics can take in moral considerations; it can also inform ethical discussions.

[3] The most restrictive assumptions seem: (i) people know what they want, (ii) this does not change over time, and (iii) people know what to do in order to optimally satisfy their wants.

1.2 Market, State and Society

The market and competition are controversial and ideologically loaded concepts. On the one hand we find proponents (usually grouped under the heading of neo-liberalism, or identified with the EU and its institutions) which see markets and competition as a means to reduce costs, increase quality and foster innovation, this all leading to economic growth and increased well-being. On the other side, there is a wide spectrum of dissenters, pointing out that competition may change people's character, may make people selfish, may erode social norms and may undermine solidarity among the members of society. Concerns like these are old, but there are equally old (or even older) arguments that markets may have the opposite effects of shaping good character and making people more sociable. Traditionally, economists have focused mostly (and most recently perhaps even almost exclusively) on the efficiency aspects of the market, putting them in the "pro-camp". Opposition has come from philosophers and sociologists, who have focused on those aspects (such as justice, virtues and relations) that do not appear in standard neoclassical models, hence, about which economists had nothing to say. Forced to respond to authors like Michael Sandel,[4] more recently economists have revived their interest in these other aspects. We are now at a time in which we can make a more balanced assessment of the pros and cons of markets, although many questions are still unsolved.[5] Put broadly, we are more at the stage of "possibilities" than at that of "iron laws", although certain regularities have been discovered.

The discussion on the question "what can be the role of the market?" is naturally connected to the discussion on the question "what is the role of the state?" Both are part of the even grander question "how should society be organized?" Of course, when the question is posed this way, we realize –if we did not already do that- that there is more than state and market. The seminal work of Nobel Prize Winner Elinor Ostrom has shown "how common property can be successfully managed by user associations and that economic analysis can shed light on most forms of social organization."[6] In this project, the focus is on the market, as that is already a large enough topic in itself. We realize that this makes this project one-sided, and that it might be useful to have similar projects for the other main institutions of society.

[4] Michael Sandel: "What money can't buy; the moral limits of markets", 2012
[5] See also Johan Graafland: "The market, happiness and solidarity: a Christian perspective", 2010
[6] http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2009/ostrom-facts.html

To address the question of how society should be organized, a comparative institutional approach may be needed. In this project, we provide a nuanced view on the market, but we remain relatively silent on the state. Within economics, two approaches may be distinguished. On the one hand there is the "public interest approach" which sees the state as a benevolent agent of "society", and on the other there is the "private interest" approach that views the state as a collection of individuals that pursue their own interest or that are captured by powerful groups in society. The first approach may be too naïve and the latter perhaps too cynical. We do not have much to add here. There are just two comments:

(i) it would be useful to have more economic and empirical analysis of the actual functioning of the state, especially since much economic research in Europe adopts the public interest perspective;[7] and

(ii) economic science as such does not support the hostility to the state that is found in some versions of neo-liberalism; statements like "the state is bad", or "the state is too large" are normative statements that cannot be derived from a pure positive science; economics (as any scientific enterprise) forces to be critical both of markets and of governments.

The goal of this project is not only to provide an overview of what we know and do not yet know about the role of markets, but also to create and test new knowledge. In technical terms, the aim is to initiate a program of "behavioral mechanism design" in relation to some key policy areas in the Netherlands. In non-technical terms, the question can be phrased as: given a policy question, how should the institutions be designed in order to best achieve the policy objectives? The specific policy areas and questions still have to be identified. In order to answer these questions, we will not just develop theory and apply that theory, but we will also test it by means of experiments. The idea is that in these experiments, industry experts, public decision makers and the general public will all be able to participate. The results of these experiments can subsequently fuel the public debate.

1.3 How we would like to proceed

This paper is the first tangible result of the project. It provides (in the Sections 3-5) a preliminary overview of the pros and cons of markets. In Section 6, the paper turns to human motivation and

[7] We invite cooperation from scholars from law and government administration on this issue.

human behavior. The idea is that the ultimate goal is human well-being, which is different from material wealth or economic growth. Hence, we need to know how markets affect well-being. Clearly, in order to address that issue we also need to know what human well-being is. Conventional economics assumes that people are self-interested and care only about their own material consumption, and investigates how well markets do in order to meet these wants. In Section 6, we discuss "more realistic" forms of human motivation, how they can be modeled, how they influence behavior, and how they influence market outcomes and associated well-being. Conversely, we also address how markets (and other institutions) influence the motivation and the resulting well-being. This is where, at present, most of the academic activity takes place. We stress that the work is preliminary and incomplete; the intention is to expand the material while we go along. To make the project into a success, it is necessary for us, to cooperate with others. We need cooperation from three groups: scientists, political organizations and the public at large.

It is easy for us to arrange cooperation within the first group, of scientists. We will send a more complete version of this paper to colleagues and ask them for input and suggestions. We will invite them, and interested other colleagues to cooperate. The involvement of the public will only be later, and the modalities are still to be decided upon. Hence, our priority now lies with the political organizations. We approach the scientific bureaus of all large political parties in the Netherlands with the question whether they want to cooperate with us in this project by providing input. Specifically, we ask the cooperation in two domains:

i) (Before October 15) Can you provide us with information on the following issues:
   a. What is the view on human nature ("het mensbeeld") that guides the party, and what, in broad terms, is the party ideology, at least as far as it relates to the market?
   b. Who are the most important national and international intellectual thinkers[8] (or streams of thought) that have influenced, or are currently influencing the party (and that help shaping that answer to the above question)?
   c. What are the views, in broad outline, on the question "what is the role of the market in a good society?" that follow from the view of human nature and the ideology?

[8] We are only interested in the underlying ideas, not in the question of how to get these implemented; hence, we confine attention to intellectual thinkers (in contrast to strategic and/or political thinkers)

ii) Are you willing to engage with us in a discussion later this fall (at the premises of the KNAW) on the present document, and the information resulting from question (i)?

The remainder of this paper is organized as follows. Section 2 is an introduction to markets, to economics and (very briefly) ethics. It is included to avoid confusion. Section 3 is devoted to the pros of markets and Section 4 to the criticisms. Section 5 then aims at a balanced assessment. The area that is scientifically least understood is how markets influence persons and their values (or preferences). To make progress in that area, Section 6 describes several "economic" models of individuals. The idea is to capture human motivation in a tractable way in order to get a model of human action that can be used to analyze the functioning the markets and to evaluate market outcomes. The models range from *homo economicus* to models with endogenous preferences. Evolution of preferences (which is linked to preference formation) is also discussed. These models allow a structured discussion on the interaction between markets and values. Section 7 contains an incomplete list of "views of human nature" that we find in politics. We will work on this further after having received the input from the political parties. Section 8 (incomplete) discusses political views on the market. Section 9 offers a brief (preliminary) conclusion.

2. MARKETS, ECONOMICS AND ETHICS[9]

Markets are institutions in which goods and services are exchanged. They may be formal, or informal; they may, but need not involve money. Hence, there are many different types of markets. It follows that conclusions drawn from one type market, may not hold for another type. An important distinction is between markets with and markets without money as a medium of exchange. Michael Sandel's recent book is titled "What money can't buy; the moral limits of markets", but if I am not mistaken, he only discusses the moral limits of markets in which money is involved. "Money is the root of all evil", the saying goes, which Mark Twain changed to "The lack of money is the root of all evil". Markets should be distinguished from money and not all critiques on money are critiques on markets.

One example that Sandel mentions is friendship: friendship cannot be bought. The Beatles sang "Money can't buy me love". This is true, surrogates can be bought, but they are not the real

[9] The structure of sections 2-5 of this paper are based on (and the paper itself is clearly inspired by) Lisa Herzog, Markets, *Stanford Encyclopedia of Philosophy*. I use the same structure as she has, but I have freely inserted comments and opinions of my own.

thing. However, there are interesting new developments such as "Rent a Friend"[10], which is also active in the Netherlands. For sure, internet dating sites have become very important to establish friendships, and these are real friendships. Although it may not be possible to buy friendship, economists (and biologists) still talk about "the competition for friendships". Such competition is real. A question is whether using the language of the market ("the market for friendship") changes the nature of the friendship relation. If one views establishing friendships as a competition does that change the character of the resulting relation? If one views marriage as (also) a contract does that change the nature of the marriage? More generally, what is the effect of market rhetoric as opposed the effect of the market as such? Economists view language as neutral, but other scientists think differently about this. [Pinker has shown that it has less influence than is sometimes thought].

It is somewhat difficult to sharply delineate markets. How does one distinguish markets from other forms of exchanges? In fact, economics does not make such a distinction. Economists work with models, hence, also with models of markets; economics offers sharp definitions of models, but not of markets, nor of competition. Competition is closely related to markets, but one can have markets without competition (e.g. when there are natural monopolies) and competition without markets (such as in sports). One can have competition on a market (as in many industrial markets) as well as competition for the market (as in procurement). Long-term relations can be embedded in markets, with potential competition acting as a disciplining force. A relevant reference still seems Polanyi (1944) that makes the distinction between "market economies" and "market societies," with the main question being how far markets should be allowed to invade other areas of society. Markets are not specific to humans; there is competition also among animals and plants and the market concept has proved useful also in biology; indeed there is a literature on "biological markets". Interestingly, a recent overview of that area discusses markets as one of the five mechanisms for achieving cooperation, which is a different perspective from that of markets as a battlefield.[11] Biological markets are embedded (that is, the interactions are personalized); as far as we know, all of these are without money as a medium of exchange.

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[10] http://rentafriend.com/

[11] Ronald Noë: "How do biological markets compare to the markets of economics?" Draft for a chapter for the book "Markets and Marketization".

Lisa Herzog writes that "markets usually use money as a medium of exchange". No doubt, the "man in the street" thinks that way, but, from the economist's point of view, it is not so clear whether this statement is actually true. Markets in which money is involved may have particular properties; there is literature on the "corrupting effects of money". Kathleen Vohs and co-authors have shown that merely activating the concept of money influences the behavior of people and may make them less "social".[12] (The methodology (priming with money) has, however, come under severe criticism, among others from Kahneman, and at least on paper has been retracted). Al Roth has written on "Repugnance as a constraint on markets", addressing the question whether we can design markets (such as for human organs) with desirable properties that do not involve money.

Markets can be studied from different perspectives. Academic disciplines that have studied markets are: philosophy, history, law, political science, sociology and, of course, economics. Being most familiar with the economic literature, this paper mainly takes an economic perspective. Before saying something more on economics, we briefly discuss economic markets.

2.1 Economic Markets

It is interesting to note that, in economics, the concept of the market does not play a central role. For example, Samuelson's "Foundations of Economic Analysis", which was the major textbook during the second half of the 20th century does not mention the term in the index. Economics has been defined as "the study of individually rational behavior interacting upon one another through a particular social mechanism, the market",[13] but the focus lies more on the rational behavior than on the market as such. In most of economics the market remains abstract, it is nothing more than a set of prices. Indeed as Coase has remarked: "Exchange takes place without any specification of its institutional setting. We have consumers without humanity, firms without organization, and even exchange without markets".[14] In the New Institutional Economics (NIE), these institutional elements are added to the neoclassical model.

In the simplest <u>neoclassical model</u> (which we briefly describe here because it is so important), we have consumers and firms who interact through an abstract and impersonal market. A

[12] Vohs et al: "The psychological consequences on money", *Science* 2005
[13] Hirshleifer: "Price theory and its applications"
[14] Coase: "The Firm, the Market, and the Law", p.3

consumer, or a household, has a budget and preferences for consumption. The consumer takes the prices of the various commodities as given ("they are determined by the market") and decides on how much of each to buy, guided by the desire to maximize his utility. Hence, each consumer is atomistic and interacts with an impersonal price system. On the other side of the market, we have firms that supply the commodities. In the model of perfect competition, also firms take the prices as given, and they decide how much to produce, where they are guided by the desire to make as much profit as possible. Out of all these individual decisions, there results a total supply, $S(p)$, and a total demand, $D(p)$, which, as indicated both depend on the price vector p. It can then be shown that there exists a price vector for which supply equals demand; in such an equilibrium ("the competitive outcome"), all consumers and all firms are satisfied; each gets the best he can have given the budgetary restrictions and those imposed by technology. In welfare economics, it is investigated under what conditions such a competitive equilibrium is also optimal from society's point of view.

This basic model is then extended to incorporate more real life features. For example, consumers have to acquire their budgets by working for the firms. This leads to labor markets which operate just as the markets for commodities. In equilibrium, now both labor markets and commodity markets have to clear, and welfare properties can again be investigated. Firms do not only need labor but also capital in order to operate. Consumers have savings that are channeled to firms trough banks and capital markets. That firms may have market power (the ability to directly influence the price) can also be incorporated. As can international trade, entry and exit of firms, technological development, etc. Important is that competition (at all levels) is a disciplining mechanism. Firms that perform less well (because they are inefficient or do not deliver what consumers want) go bankrupt; workers that don't have the skills that are needed are fired; consumers that need things that firms don't produce die. Competition rewards success, but punishes failure severely. The desire to avoid these drastic negative consequences is an important disciplining mechanism.

Within positive economics, it is investigated how this system operates, that is, what effect it has on the variables that are of interest. The normative branch of economics, welfare economics, is less developed. The economic criterion for evaluating the system, Pareto efficiency, is a weak one. Even according to this criterion is clear that markets are not ideal: when there are market imperfections (market power, externalities, information asymmetries) the system does not yield a Pareto efficient outcome. In these cases, the government could improve matters by stimulating the market (through an appropriate ordering) or regulating it. This is what Buchanan calls the productive role of government. Through its distributive activities, the government can also mitigate the undesirable inequities that result from the market.

2.2 Economics

Economists undertake detailed studies of specific markets (and also of non-market contexts) using a specific methodology: the economic approach. The economic approach is well described by Gary Becker, and it is worthwhile to quote extensively from his Nobel Prize Lecture "The Economic Way of Looking at Life":

> "Unlike Marxian analysis, the economic approach I refer to does not assume that individuals are motivated solely by selfishness or gain. It is a *method* of analysis, not an assumption about particular motivations. Along with others, I have tried to pry economists away from narrow assumptions about self-interest. Behavior is driven by a much richer set of values and preferences.
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> The analysis assumes that individuals maximize welfare *as they conceive it*, whether they be selfish, altruistic, loyal, spiteful, or masochistic. Their behavior is forward-looking, and it is also consistent over time. In particular, they try as best they can to anticipate the uncertain consequences of their actions. Forward-looking behavior, however, may still be rooted in the past, for the past can exert a long shadow on attitudes and values. Actions are constrained by income, time, imperfect memory and calculating capacities, and other limited resources, and also by the available opportunities in the economy and elsewhere. These opportunities are largely determined by the private and collective actions of other individuals and organizations.
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> Different constraints are decisive for different situations, but the most fundamental constraint is limited time. Economic and medical progress have greatly increased length of life, but not the physical flow of time itself, which always restricts everyone

> to twenty-four hours per day. So while goods and services have expended enormously in rich countries, the total time available to consume has not.
>
> Thus, wants remain unsatisfied in rich countries as well as in poor ones. For while the growing abundance of goods may reduce the value of additional goods, time becomes more valuable as goods become more abundant. Utility maximization is of no relevance in a Utopia where everyone's needs are fully satisfied, but the constant flow of time makes such a Utopia impossible."

What the quote makes clear is that economics starts from the individuals in the society, and their motivations, a starting point that is shared with (or derived from) liberalism. The quote raises two important questions: (i) What are the motivations of the individuals and (ii) what motivations does economics attribute to individuals? We will deal with these questions in detail in Section 6, but it is useful to already now say something about it. If we, as Becker, see *economics as a method*, then the answer seems clear: individuals are motivated to "maximize welfare *as they conceive it*", hence, to say something meaningful our starting point should be to take this as our input. This leads to the requirement of descriptive accuracy, as "garbage in, garbage out". On the other hand, economics is not just a method, but also a *body of systematized knowledge on the economy*; indeed, this is how economics has developed. Viewed in this way, we are not that much interested in the individuals, but rather in the economy as a whole. To understand the economic system, it may be useful to impute certain behavior or certain motives, such as maximization of utility derives from material consumption, on the individuals. After all, the criterion for judging research is not descriptive accuracy, but enhanced understanding, for example as tested through predictive accuracy.[15] A lot of confusion arises (and has arisen) as a result of an insufficient understanding of when the "as if assumption" is justified. In this paper, we follow Becker and take as our starting point that individuals aim to achieve welfare as they conceive it.

Consistent with its emphasis on the individuals, economics builds on methodological individualism.[16] Arrow (1994) writes:

[15] Friedman (1953); also see Aumann.
[16] Max Weber: "Economy and Society", Chapter 1, 1968 (First published, 1922)

> "It is a touchstone of accepted economics that all explanations must run in terms of the actions and reactions of individuals (…) in principle the behavior we explain and the policies we propose are explicable in terms of individuals, not of other social categories".

The individual is the starting point, and he is assumed to be autonomous. In mainstream economics, the preferences of the individual are assumed to fixed and considered exogenous.[17] Economists do not inquire about how preferences are formed, and they are assumed to be stable. This assumption (of immutable individuals) distinguishes economics from other social sciences. In recent economic literature, however, this assumption is dropped; see Section 6. As the quote from Becker shows, the economic approach allows for preferences to be social. Economics, however, assumes that individuals are goal directed: they have a clear goal and aim to achieve it. Mainstream economics also assumes that individuals are rational: they are effective in achieving this goal. This does not mean that the goal will be reached, but that the individual knows what to do in order to reach it as best as he can, and that he indeed will also follow that route. In brief, the individuals choose freely from the available actions by comparing the associated costs and benefits and have no difficulty in finding the optimal course of action.[18]

This rationality assumption, which is also often the assumption of the law, is relaxed in modern behavioral economics. Within economics it is assumed that such individual rationality produces an equilibrium in society, that is, there is no chaos. In modern economics, equilibrium means Nash equilibrium, each person does as well as he can, given the constraints and given the behavior of others. Equilibria need not be socially efficient as we know from the Prisoners' Dilemma. What outcome is reached, depends on the institutions that govern the interactions between the individuals, that is, it depends on "the rules of the game". In the mainstream approach, these rules are assumed to be exogenous, but in institutional approaches, they become endogenous and changeable through collective action. The basic question of economics can be

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[17] There is a small literature in which individuals are allowed to choose their preferences strategically (for example, by delegation). This can be useful to achieve commitment. This literature seems to originate with Robert Frank. I think this literature is more relevant for organizations than for persons. For example, a competition agency that wants to maximize total welfare can do better by adopting consumer surplus as a goal. As a second example: a principal that delegates to an intermediary will achieve more selfish outcomes; see Jason Dana et al.: "Exploiting Moral Wiggle Room: Experiments. Demonstrating an Illusory Preference for Fairness", 2007.

[18] Note that the terms costs and benefits are generic; we do not mean to say that they are located in the economic domain, or can be expressed in monetary terms.

then posed as: what outcome will result when goal directed individuals interact in situations of scarcity?

The quote from Becker shows that the economic method is extremely flexible, *in theory*. In practice, however, *additional assumptions* are made in order to make the complexities tractable. Frequently, these assumptions are extreme: people are fully rational, selfish, only interested in the material aspects of life, etc. Economics should not be judged by its use of these auxiliary assumptions. Critique on a specific model should not be confused with critique on economics as such. However, economists should be open about these auxiliary assumptions and should change them whenever they are inadequate to explain what is going on.

Markets may be studied from both a positive and a normative perspective. Economists usually confine themselves to the positive perspective. They focus on questions of the "what is?" variety, that is, questions of the type "what will happen if?", "what are the effects (consequences)? of" and "what explains that?". However, even from this positive perspective, the mainstream approach is rather narrow, both on the input side (what variables are taken into account) and on the output side (what effects we look at). The more sociological questions, about how markets influence, and are influenced by, other institutions, personal relations and social life have received relatively little attention. (However, there are approaches in Law and Economics, in New Institutional Economics, and in Political Economy that deal with some of these issues).

Coupled with a criterion to evaluate social outcomes, the basic question ("what social outcome will result?") naturally leads to two follow on questions: is that outcome socially desirable?; how to achieve outcomes that are more desirable? In contrast to what many outsiders seem to think, the normative branch of economics is quite underdeveloped. The reason is that economists only have a very weak efficiency criterion (the Pareto criterion) at their disposal to evaluate and compare social outcomes. Basically, this criterion states that an outcome X is better than the outcome Y if everybody in society agrees that X is better. Clearly, such unanimity will frequently be absent. Note that the Pareto criterion is welfaristic (Sen): the preferences of the individuals form the basis for the comparison of the social outcomes and only the outcomes count. (The question, however, is: what counts as an outcome? In this respect, the procedure that leads to the outcome may also be part of the outcome).

Note that, given the assumption that preferences are stable, economists are forced to adopt a narrow approach in their attempts to answer the question "what should be done to improve the social outcome?" Within philosophy and the social sciences, two broad approaches are available: change the individuals, or change the institutions. With immutable individuals, the first approach is impossible. Sam Bowles has reminded economists that Aristotle said "Lawgivers make the citizen good by inculcating habits in them." That behavior can be changed and that outcomes can be improved by making people "more moral" has long been outside of the economic domain, but recent approaches again consider this.

Whenever the measuring rod of money is available, the economist will use it to evaluate outcomes. In this case, outcome X is better than outcome Y if the "total monetary value" attached to X is larger than the corresponding value associated with Y. This is the basis for social cost benefit analysis. This approach, however, assumes that utility is interpersonally comparable, an assumption that has no <u>general</u> justification in economic theory.[19] We again come to the conclusion that the situation in which money is (or can be) involved is fundamentally different from situations in which it is not. Efficiency is a sharp criterion in a situation in which money can be used as a medium of exchange, but not in general.

2.3 Ethics

Our interest in this paper is in the larger question of the role of markets in a good society. The latter concept has been studied by philosophers for long, but in the last 50 years, the debate between economists and philosophers has almost been non-existent. [Frank Knight, the Chicago economist that is most known for his distinction between risk and uncertainty wrote extensively on the relation between ethics and economics. He saw only a small role for economics and did not accept Robbins' definition of economics. He seems to have influenced Hirschman].More recently, economists have again shown more interest in the morality of the market.[20]

The normative questions about how markets relate to basic values (liberty, justice and solidarity) and to "the good life" have been given relatively little attention by economists after World War

[19] The expression "a headache gives me more pain than it gives you" contains an interpersonal comparison, as does the statement "I enjoy Mozart less than you enjoy the Beatles", as does "I value this ice cream more than you do". Maybe the latter makes more sense than the former two; it can be tested by checking who is willing to pay most for the ice cream.
[20] See also the book of Johan Graafland, already mentioned above.

II. Recently, there is a resurgence of interest in these matters. For example, see Sugden. The methodology for normative science is, however, very different from that of positive science. Indeed: what is that method? In the project "Dienstbare Markten" we devote attention to both the normative and the positive aspects.

3. THE PROS OF THE MARKET

3.1 Four Values

Buchanan (1985) is a book-length treatment of arguments for and against markets.[21] On the positive side, four main elements can be distinguished:

(i) Liberty: markets free individuals from traditional ties;

(ii) Efficiency: markets reduce cost, lower price, increase quality and variety, and foster innovation;

(iii) Character: competition shapes good character and socializes;

(iv) Well-being: markets improve well-being.

Nowadays, economists mainly limit themselves to the second aspect. The pro-competition arguments of the European Commission fit entirely under this label. We know from academic research that the positive statements are not always true in the strong form that they are presented by the Commission. For example, we now think, and have some evidence, that too much competition may reduce the pace of innovation. Nevertheless, in many circumstances, it is true that competition improves static (productive and allocative) and dynamic efficiency. However, the effects do not always go in the same direction. For example, even if cost go up (hence, there is a decrease in productive efficiency), there may be an increase in allocative efficiency, a higher consumer surplus and a higher total surplus. The Commission has rightly recognized this in its policy concerning regulation of network industries. All in all, if one limits oneself to efficiency, there is a strong presumption in favor of markets (and competition).

Even in this restricted domain, however, several important questions remain. They all relate to the existence of market power in practice and, more generally, to the model of perfect competition ("free markets" as understood in some versions of neo-liberalism) being a bad guide

[21] Allen Buchanan: "Ethics, efficiency and the market", 1985.

to policy making. Real markets are characterized by market imperfections that have to be taken into account. Hence, once the pro-market decision has been made, the question is how we should institutionally structure the market in order to achieve the efficiency goals. Furthermore, how to take into account the (other) public interests? Clearly, these questions belong to the core of ordo-liberal thinking. There are no general recipes, and solutions will be sector dependent. Obviously, in order to get reliable answer, we should have a good positive understanding about how these specific markets work.

The first argument is the classical (18^{th} century) argument of liberalism. The modern economic literature no longer contains extensive discussions on this aspect. (However, there are important contributions of Sen, Sugden and others.)[22] Furthermore, "liberty as a value" has come up again in the literature on well-being: people that are freer, generally report to have higher well-being. [Reference?]

The starting point of liberalism is that individuals have the right to liberty, that is, to do what they want with their property. The fundamental liberal principle is that restrictions on individual freedom should be justified. This holds especially for limitations of freedom through coercive means. Hence, restrictions imposed by the state need to be justified. One justification that is accepted is if one interferes in the liberty of somebody else (negative liberty). Most liberals accept that the state has a role in ensuring that people retain their freedom from others. Liberals approve of the market as that allows people to make full use of their property. [I do not want to enter into a discussion on the varieties of neo-liberalism here.] [I also do not want to discuss here the question whether liberalism recognizes any responsibilities in addition to liberties. In *Justice for Hedgehogs*, Ronald Dworkin argues that each person has a responsibility to live his life well.]

I will discuss the second argument (on markets and character) in more detail below. Nowadays, outside of the economics profession, the Marxian view that markets degrade character seems more popular than the older view (popular during the Enlightenment) that markets shape good character. No doubt, the current crisis (blamed in part on the greed of Wall Street traders) and other corporate scandals have contributed to this view. I note that this line of thinking does not fit

[22] Amartya Sen: "Markets and freedoms: achievements and limitations of the market mechanism in promoting individual freedoms. *Oxford Economic Papers*, 45, (1993) 519-541.

well with modern economics. The 20th century literature assumes that preferences are fixed and given, hence, it assumes that "character" is fully shaped and cannot be influenced. In the most recent literature, there is again room for "endogenous preferences" and the shaping of character. I will discuss part of that literature below; see Section 6.

In a certain way, the fourth criterion (well-being) is all that matters, as the other ones can all be viewed as instrumental for well-being. With respect to this value, economists have focused mainly on (narrow) material welfare. Within this restricted domain, it is important to note, first of all, that we know that unrestricted competition may *lower* total (material) welfare (Mankiw and Whinston). Furthermore, there are also situations (cases in which there is incomplete information) in which competition may even reduce consumer welfare. Hence, even in this domain, the message is not unambiguously positive.

Equally important is that material welfare is not the only thing that counts for general well-being. We know that money cannot buy happiness, or more precisely, that the marginal return of money for subjective well-being (SWB) is rather low as soon as one has reached a certain threshold. Although money does not make one happy, having no money makes most people unhappy. There are also indications that more competition may reduce happiness. A question, however, still is whether the cause of reduced SWB is competition as such, or, more generally, that we are living in a modern society and long for things from the past. A fact that cannot be neglected is that, in the US, women currently are less happy than they were in the 1950s.[23]

The line of research on subjective well-being (SWB) and happiness has been revived in the last two decades; it is now quite influential. One general message seems to be that a more modern society may not have a (much) larger level of average happiness than a less modern one. Furthermore, development may reduce SWB for some people. Nevertheless, it seems intuitive that if a person could choose between the current society and the one from 100 years ago, he would choose the modern one. A second general message is that inequality in SWB seems smaller than inequality in wealth. [A reference?] Taken all together, the fourth argument ("markets improve well-being") may not be as strong as it usually is presented.

[23] Betsey Stevenson and Justin Wolfers: "The paradox of declining female happiness", 2009

3.2 A different classification[24]

Sen (1985) makes a somewhat different classification than the one (using four categories) given above. He distinguishes between two lines for justifying markets:

(i) rights and liberties, and
(ii) consequences.

The first line corresponds to the old ideas underlying liberalism. [The rest of this paragraph paraphrases the argument from above. It mainly shows that I do not know how to write that argument well.] This is that individuals have property rights and that they are free to do with these what they want. Restrictions on freedom are undesirable, while markets give a kind of maximal freedom to individuals. Individuals have a right to enter into a free exchange with others. There is a right to property and a right to contract. Libertarians take this to the extreme: they insist on a fully unhindered use of property. However, others will realize that unequal distribution of property may yield unequal distribution of "real freedom". Are people really free if they starve to death?

With respect to consequences, one can distinguish between material and non-material consequences. Modern-day economists take preferences as given and focus on the former: there is little room for the latter. However, classical economists (and other 18th century thinkers) argued that markets (and competition) make people more virtuous and more sociable; see the work of Hirschman. The argument that markets build good character have most recently been discussed in McCloskey (2006); see Section 4.

Markets are an allocation mechanism, they allocate goods and wealth. (However, markets are more than simple allocation mechanisms; see below.) Markets have strong distributional consequences. Many people view the consequences as being too extreme, as unjust. It is argued that the resulting distribution of goods and wealth is too unequal. However, there are also people (such as libertarians) that argue that the market 'just' delivers what people deserve. In their view, income differences are justified as long as they result from free choice. Libertarianism is more popular in the US than in Europe, which might be related to Europeans (possibly) having a stronger preference for equality. In any case, in all of the Western world, there is a lot of

[24] This material still needs to be integrated with that in Section 3.1.

discussion on wage inequality. In the Netherlands, there is much discussion about wages in the semi-public sector, and there is a wage ceiling (Balkenende norm). Note that, in this sector, wages are not set by the market, but by "rating agencies". (The same is actually true for the top level jobs in the market sector.) Hence, one can question whether the wages are deserved (or fair): is the salary equal to the added value? Obviously, the added value is hard to measure. In practice, salaries are related to size. Size and value added need not be related. A wage ceiling may make sense: most jobs are less important than the one of prime minister; they may have lower added value. However, if the ceiling is too low, public sector jobs may not be able to attract that the talent that they need.

The most important justification for markets is the efficiency argument: markets create high levels of (material) welfare. Markets provide individuals' incentives to work hard or to be creative (leading to cost reduction, innovation, etc.) and they provide price signals that allow for coordination of individual actions and efficient allocation of resources. Markets make use of the self-interest of individuals, hence, they tap into a source of motivation that also works beyond the small circle of family and friends, (Note again that self-interest is different from egoism. This point raises the question what motives people, hence, the link with psychology; see below.)

4. THE CONS OF MARKETS[25]

In Ancient times, markets and traders were frowned upon. Greek philosophers (including Artistotle) and early Christian thinkers viewed market activities and virtues to be in conflict. Commercial activity was thought to be driven by avarice and permeated by cheating and exploitation. Markets were considered to be based on greed and to attract and develop bad character. Markets were also considered to be disruptive and a threat to society; "creative destruction" was looked at with suspicion. [The arguments of conservatives against markets may still be based on these ideas.] Attitudes like these continued to exist throughout the Middle Ages and limited the development of the market. [This may need more nuance, and references.]

After the industrial revolution, the ugly face of capitalism showed itself. Distributional issues, and especially severe poverty, could no longer be neglected and *Laissez Faire* capitalism (with a limited role for the state in private affairs) could no longer be supported. The separation of work

[25] This Section is in clear need of editing.

from home and the need to sell ones labor gave rise to various concerns. Markets were considered to loosen social ties, to have alienating effects, and to have a degrading effects on the poor. (Marxists use the term alienation for the separation of the things that belong together, such as the worker and his work, which is said to be a reduction of (the value of) the self). Other social sciences came up, separated from economics. While the pros have been mainly developed by economists, the line of thinking related to the cons has been further developed by Marxists and sociologists. While Marxism lost its appeal, the general criticisms of sociologists remained, while the earlier philosophical arguments came back to the forefront.

The first criticism (in modern language) is that markets breed <u>opportunism</u>. Oliver Williamson, a Nobel Prize winner and one of the founders of NIE, defines the term as follows: "Transaction cost economics has proposed that economic agents be described as opportunistic where this contemplates self-interest seeking with guile. That has turned out to be a controversial formulation." Roughly, being opportunistic means that the goal (maximizing utility) justifies all means (including violations of the rules of the game or moral rules). A large part of the standard economics literature assumes that a basic legal infrastructure is in place and that players will obey all rules, including the informal ones. In effect, it is assumed that the legal system works perfect and costless. In practice, this is not the case; law violations occur, and there is behavior that may be considered immoral. Shleifer has shown that competition may crowd out ethical behavior.[26] He has a simple theoretical model in which more competition may lead to more corruption and/or fraud. There should be more work on this, as well as empirical research. (There is also experimental research on other forms of unethical behavior, such as lying.) There is literature that shows that concerns like these give rise to *relational contracts*, hence, traders avoid the impersonal market and form longer-term trading relations in which they behave morally in order to avoid being thrown market in the "immoral market".

There is a related argument that markets corrupt character. Character is not something that occurs in standard economics. Economics deals with behavior, not with the drivers of behavior. However, character can be modelled using incomplete information (as in the reputation literature). There is a small literature here (Benabou/Tirole). Another way of modelling this is by means of endogenous preferences (Bowles/Gintis.) Within this framework, the neutrally phrased

[26] Andrei Shleifer: "Does competition destroy ethical behavior?"

question is: “do markets influence preferences, if so how?” Can markets influence preferences in a way that is undesirable? A recent paper is by Falk and co-author. The paper (with the main message that animal life is valued less in a market context) is nice, but not completely convincing, I think. See Section 6 for more details.

A main criticism is that markets produce unequal outcomes and that the resulting inequality is unjust. This argument came up with special force after the Industrial Revolution and let to the “Social Question” and the shift away from liberalism in politics in the 19th century. Marx wrote: “the proletariat has nothing to lose but its chains”. On the other hand, one century later, JF Kennedy viewed markets as a “tide that lifts all boats”. The idea here is that the poor benefit from the expenditure of the rich, for example, the latter provide for work (there again is the question: what motivates people? What do they value?) Note also the link with markets limiting freedom: some people have (much) weaker bargaining power; they may lose their autonomy. They may also lose their dignity and self-respect. (See Friedman’s argument for a basis income). Some people become vulnerable; they may be exploited by others.

As we have seen already in the previous Section, markets also need not deliver efficient outcomes. Economists have discussed this extensively under the heading “market failure”. One important class of market failure is externalities. One example is “positional goods”, which are scarce by definition. (Only 10% of the schools can belong to the top 10%) What are the consequences of these? It has been argued that competition is bad when it concerns positional goods.

Markets destroy. They can destroy social ties, and they can undermine community and solidarity. They can destroy traditions. These arguments play a role in the communitarian critiques on markets (However, markets can also intensify social ties, as indicated in the story of the traders above). Is it true that markets make people more egoistic and selfish? Do markets crowd out intrinsic motivation? Recent (experimental) papers deal with questions like these.

An argument that has come up in the 20th century is that advertising can shift preferences. The argument is that advertising does not inform, but rather manufactures needs. Somebody referred to this as “polluting preferences”. There is some marketing literature dealing with this issue, but apparently most of that literature deals more with the narrow business perspective of the effectiveness of marketing than with the larger question of the social effects of advertising. Can people reflect on the preferences that they would like to have? How to define efficiency if preferences are endogenous? For which preferences?

A sociological question is whether individuals can restrict their "market attitude" to the economic domain, or whether they will take it to other domains (such as family life and the relations between friends). Are there different domains of valuation and is there a risk of commodification?[27] Does the market push people from the consumption of immaterial goods to the consumption of material goods? Will market attitudes changes personal relations? Does it influence the respect that people have for each other? What are the moral limits of markets? What is the proper domain for markets? See Satz (2010) and Sandel (2012).

A personal remark at the end. My impression is that the positive effects, as those in Section 3, have been better empirically documented than the negative ones from this Section. In part this is caused by the fact that philosophers are (or were?) less empirically oriented than social scientists. It would be especially interesting to have hard empirical information on the cons of markets, so as to know whether the drawbacks are real dangers or only mere possibilities.

5. A QUALIFIED "ENDORSEMENT" OF MARKETS

Both the pros and cons of markets cannot be neglected. However, the pros seem to have been better empirically documented than the cons. This does not mean that the cons are less important. On the contrary; perhaps we should devote more efforts to documenting the cons.

There are two questions:

1. Can we structure and regulate markets to "tame" them and avoid their negative effects?
2. Do we have alternatives for markets?

Given the focus of this project (see Section 1), we will not be able to say much on the second question, at least, not from an empirical point of view. From a theoretical viewpoint, we can say somewhat more. Economists refer to the area that addresses the question "how should institutions be designed in order to reach certain outcomes?" as the areas of mechanism design. This theory does not impose the restriction to markets; they may result as the solution to the

[27] See Elizabeth Anderson "Value in ethics and economics", 1993 and the review of that work by Ken Arrow.

problem, but they need not. As already argued at the end of Section 2.2, a restriction is that the current approach assumes that preferences are given and stable. Hence, it is assumed that only institutions can be changed; one can change the information that people have, but cannot change their attitudes. It is unclear how to extend the theory to allow for this. (There is a link with paternalism and influencing behavior by adjusting the choice architecture.[28]

5.1 The order of the market

Concerning the first question, on the structuring and the regulation of markets, we first of all note that this should be interpreted broadly. It includes not only the regulation of markets (that is imposing specific restrictions on certain players), but also the ordering, that is, the choice of the appropriate rules of the game. It should be acknowledged that the modern economic approach is more in line with ordo-liberalism than with *Laissez Faire*. Institutional (or game theoretic) analysis shows that the structure of the market can have an important influence on the outcomes that are obtained and that competitive markets may not arise spontaneously. Hence, it is acknowledged that the state may play an important role in ensuring the proper framework conditions for competitive markets. This still falls under the productive role of the state; appropriate rules of the game constitute a public good that the market may not be able to provide.

We write “may play an important role” as the stronger statement “has an important role” is not necessarily correct. It is frequently said that, for markets to function, other institutions (such as property law and legal institutions for enforcing contracts) need to be in place. Strictly speaking, this is not true: biological markets function without these institutions (at least as far as we know). In any case, markets can function without formal state involvement. Let us accept, however, that markets need a basic <u>infrastructure</u>. Whether that structure needs to be provided by the state is another matter, as has also been stressed in the work of Elinor Ostrom. Accepting the point, however, raises two other questions: what infrastructure do we need? Which infrastructure will lead to the best functioning market?

As has already been hinted at above, attention cannot be limited to state and market. The usual scheme (state infrastructure -> market -> government regulation) is incomplete or inadequate. The state may not be needed, the market may engage in self-regulation, the state and market may

[28] See Cass Sunstein and Richard Thaler: “Nudge”, 2008.

cooperate in regulating aspects of the market (co-regulation), the state may be influenced by market actors and/or it may use market mechanisms for its own organization (New public management). Especially Elinor Ostrom has called for attention to be paid to various non-state governance mechanisms. A society may regulate its markets without formal intervention of the state. An important question raised by this literature is whether mechanisms that work well on a small scale can also work at larger or higher levels. The point is that the reciprocity mechanism may function better at a smaller scale. Adam Smith already argued that the degree of altruism decreases sharply with social distance.[29] As far as I know, we don't know whether that also holds for reciprocity, but I think we can expect that. In any case, for reciprocity to work well, personal relations are important.

Not unrelated to the point above, sociologists have pointed to the importance of informal relations and trust in order to prevent transaction costs getting out of hand; see Granovetter (1985) and Arrow (1974). Markets will also need other rules and norms in order to deal with other forms of market failure.

5.2 Regulation

Regulation of markets may be needed to deal with market failures. Formally, market failure arises when (perfect) competition produces a (Pareto) inefficient outcome. The economic literature distinguishes various market failures (such as market power, public goods, externalities and information asymmetries.) Various laws and regulations can be understood as attempts to deal with such failures. Market failures give rise to another type of institution: regulators. The earliest study of these regulators (for the case of electricity) was by economists from the Chicago School. Stigler showed that regulators need not work in the public interest: they may be captured by the industry that they are supposed to regulate. Hence, regulation may worsen matters rather than improve them. This draws the attention to government failure more generally.

A point that is worthwhile mentioning is that, whereas regulation typically takes place at the national levels (and sometimes at that of the EU), many markets are global. Hence, the scope of the market does not match the scope of the regulation. In such situations, the question is: how to get effective regulation of market failures? Might regulatory competition lead to regulation at a

[29] Adam Smith, "Theory of Moral Sentiments", 1759

suboptimal level? This issue is especially important for (negative) externalities that play at the global level, such as global warming.

Some forms of market failure have not always been recognized. For example, market failure might result from the market being or becoming too complex, so that consumer sovereignty can no longer be relied upon. This might have played a role in the financial crisis. In the literature on behavioral economics, these aspects of bounded rationality play a role. Some of this literature has questioned the banning of paternalistic policies. (The crisis has shown that some players may become too large to be effectively regulated).

5.3 Competition Policy

It is recognized (but not accepted by economists of the Austrian School) that markets may need competition laws to keep them competitive. The earliest antitrust laws are those from the US; the Sherman Act from 1890. What economic thinking went into the establishment of this law? The antitrust laws were exported to Germany and Europe after the Second World War. The German and European Laws were also influenced by the ordo-liberal thinking of the Freiburger School. This School generally stresses the importance of an adequate infrastructure (order) for a well-functioning economy.

5.4 Distributional Issues

The main focus in the literature has been on the avoidance of the (negative) distributional consequence associated with markets. The point is that these are clearly visible and politically important, hence, they need to be addressed. This point (the trade-off between equity and efficiency) is now well understood. This does not mean that such issues are easy to solve, of course, or that they are solved in the best possible way. For example, already in 1951, Milton Friedman proposed a basic income in order to (a) minimize interference with the market so that it could function as well as possible, and (b) deal with the negative distributional consequences. Simple solutions like these do not seem to have been implemented widely.

5.5 Other Aspects

For the other negative consequences that were mentioned in the previous section, it is less clear to what extent these are more than mere possibilities. In addition, it is less clear how they could be handled, without going as far as banning markets completely. For example, Sandel (2012) only asks the (important) question of where we want to allow markets. However, he does not offer alternatives to the market.

As indicated above, we are interested in markets since they can be instrumental for what society wants. What society wants depends on what the individuals in that society want. Up to now, we did not look at these individuals. In the next section we will do that. Again, we will take a (theoretical) economic approach. We will describe how the individual is modeled in modern economics and we will also describe, or hint at, other possible models. The aim of the exercise is to show that a variety of models exists. It remains to be investigated which of these models are tractable. Recall that we defined economics as the study of interaction of purposeful individuals (under situations of scarcity). One may expect that the outcome of the interaction will depend on the "characteristics" of the individuals. With there being different models, one can expect different outcomes. Thus far, only a few models have been analyzed. There seems to be an interesting research agenda here.[30]

5.6 Conclusion

One conclusion is that we do not (yet) have real alternatives to well-ordered and regulated markets. A second conclusion is that the virtues of markets are not as absolute as sometimes claimed. Third, markets do have some negative effects. Fourth, we know very well how to avoid some of these negative effects, but we do not always act in the best possible way to that: government failures are as real as market failures. Fifth, some negative effects of markets are clear possibilities, but we do not yet know how important these are empirically. Sixth, context and details matter, so that grand claims cannot be made. Finally, we know that markets and competition may have negative effects on well-being, at least for some people. If individual well-being is all that counts, then especially this point should be taken seriously.[31]

[30] For example, see Camerer & Fehr (Science, 2006): "When does "economic man" dominate social behavior" and Haltiwanger and Waldman (JEBO, 1993). In both we have fixed preferences and the same combination of types, but the outcome depends on the nature of the strategic interaction (substitutes or complements.)
[31] We also know that women like competition less than men; see Gneezy, Niederle and Rustichini, 2004.

6. HUMAN NATURE: MOTIVATION AND BEHAVIOR[32]

Economics aims at explaining the outcomes (including the institutions) that arise when humans interact in order to relieve scarcity constraints. To do that, given methodological individualism, it builds on a specific "model of man". As argued in Section 2.2, it assumes that individuals are motivated to maximize welfare as they conceive it and that they according to this motivation, that is, to realize their goals. Within such a model, two aspects can, hence, be considered:

i) What motivates people?
   a. What do people value?
   b. What do people believe?

ii) What constraints limit people to reach their goals?
   a. Physical constraints;
   b. Biological constraints;
   c. Psychological constraints;
   d. Societal constraints;
   e. Moral constraints.

A "model of man" is a stylized model that contains answers to these questions, and that can be used to throw light on the phenomena that are studied.

For the first aspect (what motivates behavior?), economists have always looked to psychology for inspiration, but there has always been a tension between what psychologists consider realistic and what economists view as tractable and adequate for their purposes.[33] For example, it is interesting to read what Lionel Robbins wrote on this topic in 1935.[34] Robbins was writing at the time when economic analysis was exclusively devoted to the study of the economy, but was an extremely influential advocate of the position that economics should be viewed as the study of rational choice. He noted that, within a market context, there was already considerable tension between the models from economics and psychology. It is only a slight exaggeration to say that

[32] Some definitions and classifications in this Section are preliminary and subject to revision.

[33] In economic theories of rational behavior, preferences and beliefs are separated. Preferences describe how outcomes are evaluated; beliefs relate to the processing of uncertainty. Loosely speaking, these two categories correspond to judgment and choice in the psychological literature. Kahneman and Tversky have shown that real humans process information differently and evaluate outcomes differently than the rational person from economics does, see Kahneman "Thinking fast and slow", 2011.

[34] Lionnel Robbins: "An essay on the nature and significance of economic science", 1935 (2nd edition), Chapter IV.

the economist's model of *homo economicus* has remained essentially unchanged from 1935 until approximately the end of the 20th century. Given that economists have broadened their attention considerably over this period, it is clear that these tensions have grown considerably. It is only with the upswing of behavioral economics at the turn of the century that the two fields have gotten closer again. Later in this Section, however, we will see that there are still significant gaps between psychological theories of motivation and economic models of choice.

As far as the second aspects (the constraints) is concerned, we have made a distinction between five types of constraints. Traditional (neoclassical economics) only incorporates constraints of the first type. The field of evolutionary game theory (which has applications to economics) focuses on constraints of the second type. The models are rudimentary, as it assumed that the biological constraints (the genetic make-up) determine behavior completely, with genes that are more successful then spreading through the population in time. As in other areas of sociobiology,[35] there is discussion on how restraining the biological constraints are. Behavioral economics adds constraints of the third type: it includes cognitive constraints and builds on modern insights from psychology. We will discuss some models below. Modern economics starts from individuals that are atomistic, however, sociologists stress that humans are social or relational animals, hence, that humans are embedded in social networks.[36] There are relatively few (formal) economic models in which these constraints are taken into account. [Is that correct?] Moral constraints are constraints related to what is good or bad. They are stressed by moral philosophers. Conventional economic models either assume that constraints of this type are always observed, or that individuals neglect them completely. In other words, there are currently no deep links between economics and ethics. There is some relation between the last two constraints, for example, in the literature on social norms. Social norms have received attention in economics, among others in their capacity as mechanisms for coordination. More generally, there is some recognition that individuals might be influenced by social norms when making decisions.

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[35] Edward Wilson: "On Human Nature", Harvard University Press, 1978.
[36] Mark Granovetter: "Economic action and social structure: the problem of embeddedness", 1985.

It will be clear from this brief discussion here that a great deal of economics works with a rather impoverished model of man, usually called *homo economicus*. In the remainder of this section, we describe a variety of models, starting with rationality and *homo economicus*.

6.1 Rationality, Consistency and Self-interest

Most of current-day economics is based on three assumptions: humans are rational, consistent and self-interested. These three assumptions should be kept separate. Furthermore, it should be realized that being self-interested is not the same as being egoistic. Being self-interested means that one has a personal goal. A person who is interested in making the world a better place can still be called self-interested; his goal (self-interest) is to improve the world. Viewed in this way, the self-interest assumption does not seem to be a big restriction. In practice, however, self-interest is frequently modelled as being motivated by "narrow, personal material interest", hence, being egoistic. There is considerable evidence that rejects the latter formulation. Formally, in economics, having a goal is represented by a person being able to consistently order all possible outcomes, from the best to the worst. [37]

If we define being self-interested in such a broad way, is there room for altruism? I think the answer is affirmative, but that it may be better to talk about altruistic acts than about altruistic persons. The economist's second assumption is that humans are consistent, that is, their goal does not change over time. Formally, this is represented by the personal preferences (the utility function) not changing over time. A person that gives his life for another person, with which he does not have a personal relation, can be said to engage in an altruistic act. He could have been self-interested (motivated by the thrill of the event, or by the pleasurable feelings during life of thinking of how much honor this would bestow on him or his family after his death, or by beliefs in after-life). Alternatively, maybe he was not goal directed, doing things at the spur of the moment. An alternative is that the person was not consistent, that he deviated from his goal, triggered by the event. Yet another alternative is that he was not rational, and that he did not follow the best path to reach his goal at that moment. The point I wish to make is that the focus should not be (or not be exclusively) on the self-interestedness aspect. The three assumptions

[37] This makes clear that it is a bit stronger than having a goal. Having a complete ranking implies that one does not have to re-evaluate after being told that the 1st best is not available; the goal then becomes the best of the rest, the 2nd best in the original ranking.

should be looked at in combination. Furthermore, the real power and restrictiveness may lie more with the assumed consistency and rationality, than with the assumed self-interestedness.

Rationality is the economist's specification of the individual being goal-directed and indeed being able to choose one's actions in line with one's ends: the person is able to choose the best means given the ends (the goal). In effect, the individual chooses from his available actions by comparing the associated costs and benefits and he takes the action that yields him the highest net benefit. Formally, the two assumptions combined (self-interest and rationality) lead to the individual having a utility function and him choosing that action that maximizes this function. A remaining question what are the arguments of the utility function: what does the person care about? Most models in economics are consequentialist; they assume that the individual is interested in outcomes, but they leave open what the outcomes are. Strict consequentialist models are rejected by the data: experiments show that intentions matter. Furthermore, the context in which the choice is made may influence the choice. The general models here are those of Von Neumann and Morgenstern (expected utility) and Savage (subjective expected utility).

6.2 Homo Economicus

The neoclassical economic model is a special case of the one sketched above. In the neoclassical world, individuals are assumed to be motivated to consume material goods and they only face physical constraints and constraints resulting from the behavior of other people (as in game theory). There are no moral constraints and no cognitive constraints. In this model, the behavior of individual i can be described as $Max_{c_i} U_i(c_i)$, where c_i is the personal consumption of individual i. Hence, *homo economicus* is materialistic and egoistic. As stated above, this model is empirically rejected.

A special case is the "greed model", $MaxW_i$, in which the individual is assumed to maximize his personal wealth. If I understand well, this model is also used in many models in macroeconomics, although in these there may be risk aversion or time preference. Richard Posner also used this model of wealth maximization in his earlier writings, and he also tried to defend it. In the movie "Wall Street" Gordon Gekko says: "Greed is good"; a normative statement. Neoclassical economists, however, do not judge preferences; they accept them as they are and investigate the consequences.

More generally, there is a link with materialism, the tendency to view material possessions as an important source of satisfaction in life. Hence, it is a system of beliefs, rather than a motivation. Research has shown that the belief is wrong, but this may not be enough to eradicate it. Research on subjective well-being (SWB) has shown that people that are more materialistic (or that attach more weight to the material things in life, hence, have a stronger preference for material things) have lower SWB, hence, they are less happy. [There is work on the link between watching TV (advertising), materialism and happiness].[38]

[There may also a link between greediness and morality. Are people that have a stronger desire for material wealth also more likely to violate laws and norms, are they more likely to lie and cheat? The question, hence, is: what is the relation between greed and opportunism?]

6.3 Changing Preferences

As seen in Section 6.1, neoclassical economics assumes that preferences are stable (hence, the utility function is constant over time), but there are some models that allow for adjustment. Two specific models, with specific relevance in the economic domain, may be mentioned:

i) Habit formation: if one consumes more of a product today, then the marginal utility for that product is lower tomorrow. The consequence of this is that tomorrow one needs to consume a larger amount of the product than today in order to reach the same utility level; hence, over time, one is "forced" to consume more and more.

ii) Keeping up with "the Joneses": the preferences depend on what the neighbors consume: an individual wants to have what they have. (Hence, in this case preferences are not given, but they depend on what others do. So in a sense, this is an example of endogenous preferences; see Section 6.8)

6.4 Expected Utility and the Neoclassical Repair Shop

As we indicated in Section 2, the economic method can also be applied outside the market domain. In the previous two subsections we limited ourselves to the economic context, but the discussion in Section 6.1 was more general. We can now add a bit more precision to what we said in that Section. In a general rational choice model, individuals still have a utility function,

[38] Richins: "Media, materialism and human happiness". Bruno Frey: "Does watching TV make is happy?", 2004. There are other papers on the topic as well.

which is defined on an abstract set of outcomes X. Hence, each person i can rank all outcomes and he considers x to better than y if and only if $u_i(x) > u_i(y)$. The individual may also be uncertain about certain things. In that case, he faces lotteries (probability distributions) over X. A rational individual will still be able to rank lotteries and, if certain consistency conditions are satisfied, then a lottery p will be preferred to a lottery q if and only if $E_p(u_i) > E_q(u_i)$, that is, if p yields a higher expected utility than q. A utility function with this property is called a von Neumann-Morgenstern utility function.

Note that this specification leaves open what the set X is. The von Neumann-Morgenstern specification allows for what is called "social preferences", such as a person caring about what another person gets. People care about outcomes, not necessarily just about their own share of the outcome. Werner Güth refers to models of this type (in which people care about outcomes, but the outcome includes more than personal consumption) as coming from the "neoclassical repair shop". Papers on fairness, such as those of Fehr/Schmidt fit into this category. These models are important, and quite popular, but they do not constitute significant deviations from the neoclassical model. Their big advantage is that they are easy to work with.[39]

Similar remarks can be made for models from behavioral economics that incorporate things like loss aversion. These models recognize that it is not final outcomes that matter, but changes in outcomes. Formally, it does not suffice to know the set of outcomes X; one also needs to know the initial state x_0. Hence, we have something like $MaxU_i(x, x_0)$.

6.5 Behavioral Economics and Bounded Rationality

Models fitting under this heading are somewhat more descriptively accurate than the ones discussed in the previous subsections. As Jolls, Sunstein and Thaler write in their influential article on Behavioral Law and Economics:

> "The unifying idea in our analysis is that behavioral economics allows us to model and predict behavior relevant to law with the tools of traditional economic analysis, but with more accurate assumptions about behavior, and more accurate predictions and prescriptions about law."

[39] See Joel Sobel: "Interdependent preferences and reciprocity", *Journal of Economic Literature*, 2005, for a survey.

The models that fall under this heading all share the following characteristics:

i) Each individual is goal directed, that is, there is a clear objective;
ii) The goal need not be to achieve a certain outcome, hence, the model may be non-consequentialist; and
iii) The individual might not be able to find, or implement, the best means to reach the goal.

The third aspect states that individuals might make "systematic mistakes", which may result either from "behavioral biases" or from "satisficing behavior" (Simon), with the latter arising because of the cognitive complexity involved in trying to solve the problem.

The distinction between models of behavioral economics and models of bounded rationality corresponds (at least in a first approximation) to whether or not the maximization assumption is kept: models in the first class do, those in the second class do not. Hence, those in the first class are closer to the models reviewed above; they trace the footsteps of Kahneman and Tversky. In this literature, several behavioral biases have been identified, but these will not be reviewed here. Models of reciprocity fall in this category. These models are not consequential, and there is a moral dimension. For example, in 2-player games, each player has a classification of the actions on the other player, some being good others being bad; each player plays a good action in response to a good action and a bad action in response to a bad one. Rabin (1993) [40] transforms the game such that it reduces to a standard one. It is not clear that this is the best way to model reciprocity, but it is tractable.

Models of the second type follow the footsteps of Simon, Selten en Gigerenzer. These models are further removed from conventional models and less tractable. On the other hand, these models may be more descriptively accurate. It is clear that problems might be too complex to be solved completely, hence, that the maximum cannot be found and that we will have to satisfy. In trying to solve problems, we run into cognitive constraints and use heuristics. I am not sure that we have good, convincing models of satisficing behavior. The literature is quite diverse; many things cannot be neatly described.

[40] Mathew Rabin: "Incorporating fairness into game theory and economics", 1993

6.6 Opportunism

Bounded rationality also plays an important role in the New Institutional Economics (NIE). Oliver Williamson has argued that bounded rationality implies that contracting necessarily is incomplete. Not all contingencies can be foreseen and ex post bargaining will be needed to fill in contingencies. The question is how to deal with these *ex ante*, a trader has to anticipate potential problems and has to be prepared. But how to prepare?

The opening paragraph of Williamson (1993) is: "Although there is growing agreement that bounded rationality is the appropriate cognitive assumption for describing economic organization, there is less agreement on how the self-interestedness of economic actors should be described. Transaction cost economics has proposed that economic agents be described as opportunistic, where this contemplates self-interest seeking with guile. That has turned out to be a controversial formulation."[41] Briefly put, opportunism implies that people will do everything they can to reach their goals; the end justify all means, including lying and cheating. In neoclassical models, there is no room for such "amoral" actions: the individuals don't make promises and interact with impersonal markets. In game theoretic models, there is room in principle, but also in these a certain type of honesty is traditionally assumed, or the issue of honesty is not addressed. (That, however, has changed in the more recent "behavioral" literature.) In any case, it is assumed in these models that the rules of the game are obeyed.

[Material to be added on NIE and the relation with embeddedness]

6.7 Modelling Respect: Adam Smith's Model of Man

Adam Smith did not think of man as a rational utility maximizer. As described in Coase (1976), his view (expressed in *The Theory of Moral Sentiments*) seems closer to modern psychology (as I understand it) and to the "two systems" model of Kahneman (2011). Coase stresses that Smith's view of man is almost entirely self-centered: people are driven mainly by how they think about themselves. It is true that Smith allows for some altruism (towards kin) and that he also acknowledges that people may rejoice in the pleasures of others. As a result of this, a person may treat others fairly because it makes him feel good. However, he mainly treats others fairly because he wants to be *perceived* as fair, and, even more important, he feels bad if he thinks that

[41] Oliver Williamson: "Opportunism and its critics", Managerial and Decision Economics, 14, 1993, 97-107

others think badly about him. Clearly, this falls all under the label of self-interest, as we have defined it. Note that Adam Smith's approach is non-consequential: it is feelings that count, not outcomes. In Smith's view, people derive pleasure and pain from *thoughts* (or beliefs): people care how other people think about them. His view is very game theoretic: being conscious, people can picture themselves in the shoes of the others; they can feel what they feel, and as such they can judge their own behavior. Ultimately, we care about what we think about ourselves.[42]

In Smith's "model", there are also moral and social constraints. Smith argues that behavior is determined by the struggle between the "passions" (including emotions) and the "impartial spectator". Behavior is under the direct control of the passions, but the internal spectator can intervene to control. The judgment of an act by the internal spectator (either ex ante or ex post) gives raise to feelings of pleasure and pain, which then guide behavior. The impartial spectator "subjects all the movements of our nature to what our own dignity and honor, and the propriety of our own conduct, require" (TOMS I, i, v, 26). In some cases, the passions may be so strong, however, that there is no control; in other cases, the impartial spectator is led astray. As it is more pleasurable to think about pleasures than about pains, we engage in self-deception; we engage more in the former, resulting in the follies of human behavior. However, others and society may benefit from such irrational behavior. The misguided belief that wealth brings happiness drives the market economy and enhances total welfare.

Adam Smith already discussed behavioral biases ("follies in human behavior"), although not in modern language. Ashraf et al (2005) show that, in the *Theory of Moral Sentiments* (TOMS), one can find discussions on loss aversion, present-day bias, and overconfidence. Hence, it seems that Smith considered people to be goal directed (motivated to obtain respect and self-respect), but as not knowing (or misunderstanding) what is the best way to achieve that goal. Relevant for our discussion here, Smith argues that money is an instrument to obtain respect, but that people get so focused on the instrument that they lose sight of their final goal. In addition, people also overestimate the marginal increase in well-being resulting from improvements in wealth.

The "impartial spectator" adds a moral element; what he likes to see is what is proper in the situation to do. Formally, let his views be represented by $M(x)$, then (neglecting the behavioral

[42] There is something like this also in Aristotle: "Dignity consists not in possessing honors, but in the consciousness that we deserve them."

biases and mistakes), Smith's model may simplistically, be represented by $U_i(x, M)$. Morality is a constraint on behavior. Hence, people are guided by norms and (material) preferences. One can imagine that if one couples this with present-day bias, people get too focused on the short term goals, not realizing the long term ones. There should be models doing precisely that, but I do not know at the moment. (Somewhat related is work by Uri Gneezy (people lie more when they benefit more from it) and Ariely (about dishonesty).

There is some recent literature that models players caring about how they are viewed by others. Hence, here the preferences depend on what is observed by society. This literature allows one to model respect (Manning; Ellingson; Tirole), and possibly also self-respect.

Geanakoplos, Pearce and Stacchetti introduced psychological games. In such a psychological games payoffs depend both on what players do (as in standard game theory) and on what they think. GPS define a 'psychological equilibrium' as a profile in which each player best responds and beliefs are correct. Rabin (mentioned in the previous subsection) builds on this idea to construct a model that incorporates considerations of fairness.

6.8 Weber's View on Puritan Protestantism

Extremely interesting is Weber's work on the protestant ethic. I know it has been extensively discussed and refuted in parts, but I am just interested in the logical core of the argument and the view of Calvinistic man that underlines it. Put it in its most simple form, Weber "assumes" that capitalists live to accumulate wealth (hence, $MaxW_i$), however, without ever consuming it (consumption should be just sufficient to survive), while workers live to fulfill their duty to work (and work as hard and diligently as they can.) Clearly, in such a world, there will be a lot of capital accumulation and productivity can be high. The interesting part (at least for the present purposes) is that Weber also addresses why people come to adopt such preferences, which many people would classify as "stupid" or "weird". Indeed, Weber himself seems to view it like this. Why do workers change their traditional attitude, which is represented by "work until you can survive the day" and why do capitalists not consume more of their wealth? How do we get to acquisition as a goal in it itself, and not as an instrument for well-being or to live a good life?

[Note that the traditional attitude of workers has survived: see the Camerer paper on taxi drivers in New York City].[43]

Weber turns to religion for the explanation. He starts from the concept of "the calling" and the idea of predestination. God has determined the chosen, those who will salvaged, and human action cannot influence that. This is extremely inhumane, as Weber calls it. This leads to a feeling of inner loneliness. Weber argues that from this torment, the capitalist spirit was born. To me, this seems the core of the argument, but I do not understand its logic. Weber refers to two developments at pastoral level. The first is that people need to view themselves as belonging to the chosen. Lack of certainty is viewed as lack of faith: if you start to doubt, you cannot belong to the chosen. Secondly, performance of "good works" in worldly affairs is viewed as a signal of such certainty. Hence, doing well (in business) is not an instrument for becoming salvaged, but it is a signal that one belongs to the chosen. It is this part that I do not understand: how can it be that this is rationally believed?

Weber also notes that accumulation of wealth is accepted, as long as it is not accompanied by idleness, luxury and self-indulgence. Perhaps, the ability to resist the use of wealth, to endure the pain, to have the strength to have it, but not to use it, is another signal of being chosen.

I do not yet completely understand the argument. I understand predetermination (God already has decided what our ultimate fate will be, Heaven or hell, and there is nothing in what we do that can change that), but I do not see why the torment leads to the preferences. Formally, people are of two possible types, h or H, and a person does not know what type he is. I assume it is believed that those people that are of type H are more likely to be successful than those of type h. People are assumed to be risk averse: they want to know what type they are. So the assumption is that people will act to get an as precise posterior as possible. Being successful increases confidence that one is of type H. If I understand well, Weber claims that working hard is the best way to reduce uncertainty, hence, that people will work hard. I am currently reading his text to construct a full, coherent model, so as to understand the argument.

[43] Colin Camerer: "Labor Supply of New York City Cabdrivers: One Day at a Time", 1993

6.9 Endogenous preferences

6.9.1 Introduction

As stated in Section 6.1, the second main assumption in economics is consistency: the preferences are given, fixed (stable) and exogenous. Economists do not inquire where the preferences come from; traditionally they do not study the formation of preferences. They consider that to be outside of their domain and have left the study of preference formation to other disciplines such as psychology and sociology. Etzioni (2014) writes "Ultimately, individuals' preferences are, broadly speaking, the product of socialization and of individual reflection and desires" and "the noneconomic disciplines have not yet presented a consolidated theory of preference formation".[44] Lacking such a theory, many economists have been content with assuming fixed preferences.

The assumption that preferences are immutable implies that policy makers only have a limited set of policy instruments at their disposal. If people's behavior is guided solely by costs and benefits, then the behavior can only be changed by changing either the costs or the benefits. Many people think that there are other instruments, that people can be *persuaded* to do other things. Aristotle already noted:

> "Lawgivers make the citizen good by inculcating habits in them, and this is the aim of every lawgiver; if he does not succeed in doing that, his legislation is a failure. It is in this that a good constitution differs from a bad one."

One can incorporate such an aspect only if one allows for changing preferences. In this subsection, I discuss other reasons for not taking preferences as fixed or exogenous, as well as some models with endogenous preferences.

Hirschman (1985) argues that the economic approach is too parsimonious: too many important things have been left out. He criticizes the economic model of man both on the demand side (the consumer) and on the supply side (the worker) and also argues that economics needs to incorporate ethical norms (or morality, civic spirit, trust). The moral aspect needs to be treated as an input, but how? It is a depletable resource, or is it a skill that improves with use? That you are

[44] Amitai Etzioni: "Crossing the Rubicon, Including preference formation in theories of choice behavior", *Challenge*, March/April, 2014

nice to one person does not mean that you can no longer be nice to another.[Sandel has come back to this]

Hirschman argues that what distinguishes humans from other species is the ability to reflect. A human can think: "Do I really want this?" and can change his "wants" if he is not satisfied with them. Hirschman proposes to distinguish between preferences (or tastes) and meta-preferences (or values). Important points in time are those when a person realizes that his preferences and meta-preferences are in conflict. People can change their values and policies can work by changing values.

Hirschman also notes that economics is instrumental and assumes that people do things because of the resulting outcomes. However, he also observes that people seem to do many things without a specific reason, simply because they like doing them, and that we do spend considerable time on these activities. This is the topic of intrinsic motivation to which we will return in later subsections. In this connection, Hirschman mentions research: we cannot do research for the outcome it yields, because we cannot know the outcome, which is fundamentally uncertain. [I guess his comes back to Frank Knight]. Hirschman argues that we do these things because we want to get to know ourselves (which indeed was a main point also made by (the Chicago economist!) Frank Knight). We strive, and we like to strive even if it may be painful. We engage in these activities because it makes us feel more human. (Hirschman notes that this is an instrumental way of thinking about the non-instrumental). But how to model this? We will return to this below, when we discuss the work of Scitovosky and the psychological theory of self-determination.)

6.9.2 Endogenous Preferences[45]

In a survey paper (JEL, 1998), Sam Bowles observes that markets do more than allocate goods and services; they also influence values, tastes and personalities. He gives five channels through which markets (or other institutions) can influence preferences or values:

1. Framing. A situation that is framed, or perceived as a market setting, may elicit a different set of values than a non-market setting;[46]

[45] This subsection is mainly based on Sam Bowles: Endogenous preferences, *Journal of Economic Literature*
[46] This is why the rhetoric of the market may be important and may have undesirable consequences.

2. Intrinsic and extrinsic motivation. The market relies on extrinsic motivation. But people are also driven by the desire for "self-determination" (see the remarks on Hirschman above, on Scitovsky below, and those on self-determination theory, also below);
3. Effects on social norms, and the evolution of such norms. Markets are short-term, they may destroy long-term relationships, or they may make it more difficult to maintain or create these. (For example, think of reputation building);
4. Task performance effects. Markets influence the tasks that a person does, and, hence, they might influence the psychological functioning of people through that channel;
5. Effects on process of cultural transmission. The market influences learning and learning processes.

The next paragraphs provide some details on how the first four effects might work. The fifth is only indirectly related to markets; it focuses on child rearing and schooling. Clearly, questions like "What skills and values do schools teach?" and "Are these the most relevant or right ones?" or "What should be taught at school?" are very important (and maybe even more important than the ones discussed here), but they are outside the scope of this project. Note that the first two points relate to psychology, while the third relates to sociology and the fourth to learning. In the subsections that follow this one, we will take up these things in more detail.

Framing

The way a situation is <u>framed</u> may influence the resulting behavior. Different institutions induce different choices and different outcomes. (See Section 6.11 for how framing might work; probably it would be good to say a bit more about the psychological theories underlying the framing effect. It is related to the processing of information). Markets stress certain aspects, and other aspects less. Is it true that they invite a certain type of thinking processes? Is this related to the need to justify choices? Examples that are mentioned are Roth and Ochs on bargaining in markets and Hoffman et al (1994). The latter concerns the ultimatum game. If you win the proposer position by means of a competition, then you make offers that are less fair. Similarly, communication decreases social distance. Bowles writes:

> "The more the experimental situation approximates a competitive (and complete contracts) market with many anonymous buyers and sellers, the less other-regarding

> behavior will be observed (…). These results are consistent with the view that market-like situations induce self-regarding behavior, not by making people intrinsically selfish, but by invoking the self-regarding behaviors in their preference repertoires."

Framing means that the way the problem is perceived (framed) influences how it is solved and, hence, the solution that is obtained. Neoclassical economics abstract away from the framing problem. Indeed, if a problem is trivial to solve, as the theory assumes, framing may not have an effect. However, if it is not clear what to do, then framing may suggest analogical, but simpler problems, or similar problems that have already been encountered. In their work on the experiments with the ultimatum game in different cultures, Henrich et al. write:

> "A highly plausible interpretation of our subjects' behaviors is that, when faced with a novel situation (the experiment), they looked for analogues in their daily experience asking "What familiar situation is this game like?" and then acted in a way appropriate for the analogous situation."

There are some papers in economics that model reasoning by analogy, but there do not (yet) seem that many, certainly there are not many papers that focus on the topic that we are interested in: does framing the situation as a market influence the outcome?

Intrinsic and Extrinsic Motivation

Given that preferences are assumed to be fixed, economics relies on extrinsic motivation to change behavior: by changing prices, or explicit reward or punishment, behavior can be steered in a desired direction. One justification for doing so is that this will change the behavior of those who do not automatically do the "right" thing, while it will leave the behavior of those that are self-motivated to do the "right" think unaffected. Hence, when the incentives are correct, the aggregate behavior can only improve. The assumption is that internal and external motivation are independent, that external rewards are additive to internal motivations. Research (originally in psychology, and later also in economics) has shown that this assumption may be incorrect. Extrinsic rewards may crowd out or crowd in intrinsic motivation. In situations of "crowding out", extrinsic rewards or penalties may be completely ineffective and even steer behavior in the wrong direction.

The question, hence, is: in what circumstances will extrinsic incentives complement intrinsic motivation? When will they be counterproductive? One channel that economists have identified is that external incentives may make it more difficult to signal to others what is the "own self". If one plays a game in which also selfish types cooperate, then cooperation does not show that one is not selfish; hence a person that is motivated by reciprocity (do onto others as others do to you) cannot know whether or not the other is of the same type and if he is pessimistic of the type of the other might decide not to cooperate. (See also below).

In addressing the above question, psychologists have focused more on extrinsic incentives interfering with personal autonomy. Research in (social) psychology shows that contracting explicitly to engage in an activity will undermine the intrinsic interest in that activity. Hence, paying people reduces their intrinsic motivation. (An analogy: studying is viewed as instrumental, not valued for the activity as such). The converse also holds: when something is not paid, we might come to value it. For example, we might view it as a way to develop ourself. For the underlying psychological mechanisms, see Deci (1975): there is a fundamental desire to feel good about oneself, to have self-esteem and to get confident. The literature on this point seems unsettled. For more details, see the Sections 6.10 and 6.11.

Social norms

The market is a system in which "bad men can do least harm" (Hayek, 1948). However, the market cannot function without norms, at least, it cannot function well without them. (Also see Arrow). Important are reputations for trustworthiness, generosity and vengefulness. Markets lack the personal element of non-market interactions. Thus, markets may reduce the incentives to invest in traits that are good for non-market interactions. Markets may reduce investment in "nice traits"; see Rose-Ackerman (1997). See also Bowles and Conlisk for formal models. Similarly, the work of Ernst Fehr: contract incompleteness leads to reciprocal behavior. In this regard, also see the research on trust (Huck, Kollock (1994)), with trust emerging endogenously. More complete contracting (which can be interpreted as: making more use of markets or have more markets) may produce worse outcomes. Here also the link with the work of Avner Greif. Also see the work on commodification, also Ballant and Plateau (1995).

Learning

By what we do, we learn our preferences and our values. A plausible mechanism is that strategies found successful in coping with the tasks within one domain of life are generalized to other domains of life. Lane (1951, p. 11) reasons that "an economy based on transactions teaches self-attribution", the belief that one is effective in influencing one's own fate. Hence, markets teach personal efficiency. Hence, success in the market (for example, as evidenced by high income) implies success as a person. Similarly, non-success (for example, being unemployed) is viewed as personal failure. The experience of occupational self-direction has a profound effect on people's values, orientation and cognitive functioning" (Kohn et al, 1990). People who exercise self-direction on the job also value self-direction in their other areas of life. Important is the link of jobs to other activities. People who have less challenging jobs (or those who are moved to less challenging jobs) are (respectively: become) less engaged also in other domains of life.

In the subsection on framing, we remarked that, when confronted with a novel situation, people may reason by using analogies to similar situations. Some situations may offer more opportunities to learn "moral" behavior than others. A very interesting example is provided by Frohlich and Oppenheimer (1995). They consider a 5-person Prisoners' Dilemma game (PD) which is played repeatedly (about 8 times, the exact number being unknown to participants). In such a game, one has to learn first that it is <u>not</u> the best strategy to always play Defect (D). With communication (game CPD) it is easier to learn this, which is not surprising. A "social planner" who is afraid that people might not learn it, might change the incentives; for example, he could ask the players to play the game behind a veil of ignorance (PDVI): make the choice as if you are player i, but we will assign you the payoffs of a randomly selected player j. This converts the PD in a common interest game in which the dominant strategy is to cooperate; PDVI is a game in which there is no moral conflict and in which there is little to be learned. The same is true if communication is allowed, as in CPDVI. The interesting question now is what will happen in the repeated PD, after players have first played either CPD or CPDVI? The answer is that after CPD, players will cooperate much more: they have learned to face (and to a certain extent resolve) the ethical dilemma. Or, perhaps equally important, they know that other players realize that there is a dilemma and that these understand how to deal with it.

6.10 Tibor Scitovsky: The Joyless Economy

In his book *The Joyless Economy*, Tibor Scitovsky raised the question “Will consumer capitalism make us happy?”, which he answered in a largely negative way. In his view, capitalism is good in producing “comfort goods”, but this is not all that we want. It is not that we want more of these, but we want other things. We also want goods (and other things) that stimulate us, “stimulants”. As Scitovky sees it, the market is not very good in producing “stimulants”, partly because the things that we find pleasurable are personal and different between various people. The market is good in producing goods that are standardized. “Comforts” are standardized, but the pleasure they bring is short lived. Having comfort makes us bored; we need novelties, challenges.

Next, and at least as important, “things” that are not provided by the market, such as friendship (or more generally, relational goods) may produce more pleasure than the “comfort goods” that the market provides. Hence, the market may not be the best institution to deliver what we actually value most. In this connection, Scitovsky remarks that it is actually not the possession of things that makes us happy (although losing these things may make us unhappy), but the process of acquiring them. He notes “struggling to achieve [needs or goals] may actually be more satisfying than actually achieving them”.[47] Clearly, once one has the money, the market usually does not make it too difficult to achieve the things that we want.

Why then do people not consume more of the relational goods (or other stimulants that provide more durable pleasure)? Several answers may be advanced:

i) There are coordination problems: the relation ij of i and j can only be consumed if both i and j want it and if both of them are available;

ii) Because time is scarce, relation goods might be perceived as being more expensive than the “comforts” that the market provides;

iii) Relational goods are investment goods and as such the usual bounded rationality problems play a role. We are short-sighted (or hyperbolic discounters): we do not invest

[47] We have seen this idea also with Hirschman. It originates (?) with Aristotle and also appears in the work of Deci and Ryan, to be discussed below. The main critique of economics might be that it has not taken into account this crucial aspect of human nature and eudaimonia.

enough in the setting up of relations (which is costly), while the benefits of the relation only materialize with time;

iv) We really do not know what we want (although we may realize that we are missing somewhat) and do not realize how much benefit relations would yield.

All but the last aspect can be taken into account in relatively standard economic models, but it seems that the literature has not done that up to now. Note that the market caters to the desires as we express them. If we do not express what we want, we will not get what we want.

6.11 Psychology: Self-determination theory[48]

A basic assumption underlying self-determination theory (SDT) is that people have a natural desire to develop themselves. Furthermore, all humans are assumed to have three basic needs: autonomy, competence and relatedness. Autonomy is not the same as independence or individualism; it means the desire to be decide yourself. You can decide to work (cooperate) with others, but it is your decision whether or not to do that. Autonomy does not mean selfishness, it means valuing individual freedom. Competence is the feeling that one can accomplish the task; it is related to self-esteem. Relatedness is related to feeling secure, for example, by having a secure environment with others on which you can fall back. If you feel secure, you are more eager to explore. More generally, the three basic needs have to be satisfied, they are necessary conditions for the individual being able to further develop himself. One can imagine three independent reservoirs, which, as long as they are adequately filled, allow the person to explore and grow (flourish). One can also imagine that the person enjoys growing and that he enjoys growing as such, as long as he can grow in self-determined directions. This description is not too far from a mathematical model, although it may not be completely faithful to Deci and Ryan.

Within SDT, the tension between intrinsic and extrinsic motivation has been studied. It is clear that the theory provides a framework for doing so: externally imposed targets limit autonomy (which is perceived negative), but they may push in directions that are novel, hence, contribute to novel experiences and enhance feelings of competence. External incentives may crowd out intrinsic motivation, but well-designed incentives can lead to crowding in. SDT also takes into account that personal relations are an essential for a flourishing life. Furthermore, if the three

[48] This is a very brief description; see Ryan and Deci "Self-determination theory", 2000 and "On happiness and human potentials: a review of research on hedonic and eudaimonic well-being", 2001 for more details.

"reservoirs" are non-commuting, it is clear why the marginal return for happiness can be so small: money can contribute to autonomy, but it cannot buy friends.

Ryan and Deci (2001) links SDT to well-being. It argues that within the "happiness literature" two perspectives can be distinguished. The first hedonistic stream (following Kahneman, Diener, Veenhoven and others) "focuses on happiness and defines well-being in terms of pleasure attainment and pain avoidance". The second, eudaimonic approach, which follows Aristotle, "focuses on meaning and self-realization and defines well-being in terms of the degree to which a person is fully functioning". The hedonic stream focuses on subjective well-being (SWB), which is frequently equated with happiness. In comparison, the eudaimonic approach is broader. It focuses on psychological wellbeing (PWB), which combines happiness with meaningfulness. It is clear that SDT fits in the second stream. On the topic that is of interest to this paper, Ryan and Deci write:

> "In sum, work in both the hedonic and eudaimonic traditions converges on the point that money does not appear to be a reliable route to either happiness or wellbeing. The relation of wealth to well-being is at best a low positive one, although it is clear that material supports can enhance access to resources that are important for happiness and self-realization. There appear to be many risks to poverty but few benefits to wealth when it comes to well-being. Furthermore, studies show specifiable eudaimonic hazards for those who overly value wealth and material goods."

To conclude this subsection, I note that Bruni (2010) makes very much the same points, but then from a more economic perspective.[49] I conclude that it should be possible to construct economic models consistent with Artistotle's views on human nature and the good life and that incorporate essential elements of self-determination theory.

[49] Luigino Bruni: "The happiness of sociality. Economics and eudaimonai: a necessary encounter", *Rationality and Society*, 22, 383-406, 2010.

6.12 Sociology: Social Rationality

Siegwart Lindenberg has argued that SDT is incomplete and seems to have run out of steam. He has developed a slightly (?) different theory that is briefly reviewed here. [50]

A key idea in Lindenberg's work is that an individual may have different goals and that the situation, or the way in which the situation is framed, may influence the goal that becomes most salient and that is adopted. A goal focuses the attention, hence, it directs the scarce cognitive resources in a certain direction. The resources are devoted to certain tasks, and not to others, which influences the deliberations and the resulting decision. Goals and frames are related; one goal pushes other goals to the background, but they do not vanish completely.

Lindenberg distinguishes between two hierarchies of goals: substantive goals and operational goals. The first aims at overall well-being; the second is addressed at improving one's condition. (One notices a similarity with SDT here.) At the top of the hierarchy of substantive goals, we have SWB. (It is somewhat unclear to me, whether it is indeed SWB, or PWB instead). Below this top, there are physical well-being and social well-being. One needs to do well on both of these in order to experience SWB. To be physically well, one needs to have comfort, that is, one needs to be free from pain, hunger and fatigue. But, as Scitovsky also argued, comfort alone is not enough. Social well-being relates to the desire to be well-regarded by others. Status, behavioural confirmation (the feeling of having done the right thing), approval, etc., can all contribute to social well-being. Note that this is related to what we discussed about Adam Smith.

In addition to the substantive goals, there are the operational goals. At the top of the operational goal hierarchy is the desire to improve one's condition. Frequently, one compares to a reference group. Below this top, the three most important operational goals are: (i) improve the way one feels; (ii) improve the functioning of one's own production function[51]; (iii) act in appropriate way.

Importantly, these three latter goals are related to three frames:

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[50] Siegwart Lindenberg: "Intrinsic motivation in a new light", Kyklos, 2001, and "Social rationality, self-regulation and well-being", 2013

[51] The self is viewed as an organism that produces its own SWB from satisfaction of the various (non-commuting?) goals; this is the production function that is referred to here. It is the maintenance of the organism: I guess it is similar to Steven Covey's "Sharpen the Saw".

i) the hedonic frame, triggering the desire to enjoy;

ii) the gain frame; triggering the desire to improve;

iii) the normative frame, triggering the desire to behave appropriately.

The hedonic frame is usually the strongest, with the other ones being pushed to the background. In particular, the normative frame is very vulnerable. In his empirical work (together with co-authors), Lindenberg has shown the relevance of this model. In particular, he has demonstrated the vulnerability of the normative frame, and how it may be triggered or may move to the background. One message that has come out of this is the crucial role of leaders leading by providing the good example. A difference with SDT is that Ryan and Deci neglect obligations; they seem to start from individuals in "the natural position", that is, individuals that are fully autonomous. Lindenberg's theory allows for individuals to be embedded; for example, people face obligations, but, in the normative frame, the desire to fulfill these obligations can still be intrinsic.

In my view, in broad terms, this model is not very different from the one discussed in the previous subsection, although there is no doubt that it differs in important details. The same remark as in the previous Section applies: I conclude that it should be possible to construct economic models consistent with Artistotle's views on human nature and the good life and that incorporate essential elements of this "sociological" theory.

6.13 Evolutionary approaches

There are various approaches that can be mentioned here:

The first line is that of indirect evolution. This line of research was initiated by Werner Güth and Menachim Yaari: given preferences, players choose strategically, but some preference types do materially better than others and these are selected by nature. Hence, we have "survival of the fittest preferences". There is a sharp distinction between whether preferences are observable or not. At the moment, I do not have a good overview of what this line of literature has established. A relatively recent paper dealing with the evolution of preferences for altruism is Dekel, Ely and Yilankaya (Rev Econ Stud 2007). For two-person games, the paper shows that:

i) If preferences are perfectly observable, efficiency is a necessary condition for evolutionary stability;

ii) If preferences are imperfectly observable, NE is a necessary condition for evolutionary stability (and strict NE is a sufficient condition),

A second line of research deals with direct evolution of preferences. Models of this type assume that there are various preference types in the population and that types are matched randomly to play the game, with the type that does better spreading in the population. Recent work by Jörgen Weibull and Ingela Alger ("Homo Moralis", Econometrica) shows that, in two-person games, the "degree of altruism" that evolves in a population is the same as the "degree of assortative matching".

Three other lines of research are:

- Cultural transmission: Bisin/Verdier and Boyd/Richardson
- Evolution of social norms: many papers
- Evolution of institutions: work by Peyton Young, among others.

7. HUMAN NATURE, IDEOLOGY AND POLITICS

The aim of this Section is to describe the "mensbeelden" as they appear in several political philosophies and those that are used by Dutch political parties. This Section is very incomplete.

7.1 Liberalism

There are many different forms of liberalism and all (or almost all) Dutch political parties accept at least some liberal principles. Consequently, it is a natural place to start, also since there are obvious links between economics and liberalism.

The starting point of liberalism is the individual and that the individual has the right to liberty, to do as he wants, at least as long as he does not limit the freedom of others. The fundamental liberal principle is that restrictions on individual freedom (especially limitations through coercive means) should be justified. This does not mean, of course, that these cannot be justified. Liberals split on what is required for justification, with libertarians being most extreme. Liberals approve of the market as it allows people to make full use of their property and since trade is voluntary.

Hence, restrictions on the market need to be justified. We can go even further: as the state has coercive powers, actions of the state do need to be justified. Again, this corresponds closely to how mainstream economics proceeds.

Liberalism focuses mainly on negative liberty (free from interference) and less on positive liberty (the right (to be given the means) to develop yourself). The main responsibility that liberalism assigns to individuals is to develop themselves. In *Justice for Hedgehogs*, Ronald Dworkin argues that each person has a responsibility to live his life well, which has a normative connotation. Liberalism views the individual as being in large part autonomous. It is not clear to me what model from the previous section corresponds most closely to the "liberal man"; probably different streams will have different models.

Classical liberals (18^{th} and first half of the 19^{th} century) believed that individual freedom will allow individuals to develop themselves optimally, to bring themselves as close as possible to what they can be. Liberty allows the development into perfection; liberty produces the good life. This is the liberal virtue ethics. According to this view, markets help in creating good character. (Hirschman, Sugden). As a result of the "social question" liberalism split in various streams as of the end of the 19^{th} century and this argument seems to have become less prominent.

Neo-liberalism emerged after World War II in response to Keynesianism and totalitarianism. Within neo-liberalism, there are again different streams of thought, with some (such as ordo-liberalism) seeing a larger role for the state than others (such as libertarianism). It seems important to note that mainstream economics has never been hostile to the state: economists have never been advocates of *Laissez Faire*.[52] This holds for Adam Smith, but also for, for example, Milton Friedman, who wrote about neo-liberalism in 1951 and essentially took an ordo-liberal point of view.

7.1.1 VVD

It is not clear to me to what stream of liberalism this party belongs. It seems to be partly also conservative? Is it?

7.1.2 D66

[52] For example, see Jacob Viner: "The intellectual history of Laissez Faire"

From the slogan “sterke markt, sterke overheid”, I infer that it subscribes to ordo-liberalism.

7.1.3 Groen Links

It is not clear to me whether it belongs under the heading “Liberalism”. It seems to subscribe to ideas of “libertarian paternalism”.

7.2 Christianity

In McLellan (an article I found on the internet), I read:

“The Christian scriptures present a very different understanding of the human person and society, and, flowing from this, a different understanding of economic life, than that offered by capitalism.[53] Rather than an autonomous individual, the scriptures present the human person as embedded in a series of relationships with others: with God, with other persons, and with the rest of creation. (…) Personhood is found in relationship with others and, hence, a person cannot be understood apart from society, nor society apart from the individual person, thereby avoiding the extremes of individualism, on the one hand, and collectivism, on the other.

God has commanded humans (…) to “make something of the world”, humans should be *stewards*: to take the gifts that have been entrusted to them by God and, through the effort of work, to cultivate these gifts so that they become more productive. Hence, there is a normative task. A Christian vision for economic life must ultimately reject the notion that the human person is comprised of unlimited wants that can never fully be satisfied. (…)Therefore, the human person cannot be reduced to a "consumer".” The table below is taken from that paper. Is it useful?

[53] He writes capitalism, and not liberalism, but I assume he could also have written the latter. Weber writes that capitalism is not the pursuit of gain as such, as the desire for wealth has always existed. He states that capitalism is related to the systematic pursuit of profit, by using economic exchange and rational methods. It is the rational organization (the managing) of formally free labor, also involving the rational use of, and investment in capital.

Table 1: Capitalism and a Christian Understanding of Economic Life

	Capitalism	A Christian View
Fundamental orientation to the world	Scarcity	Plenitude
Assumptions about the human person	Autonomous individual	Interdependent person
	Motivated by self-interest to fulfill unlimited wants	Motivated by self-interest and benevolence to fulfill the limited needs and wants of oneself and others
	Finds fulfillment in (material) consumption and leisure	Finds fulfillment in relationships (friendship): with God, other persons, and the rest of creation
Virtues required to find human fulfillment	Virtues: prudence and, to some extent, fortitude and justice	Virtues: prudence, temperance, fortitude and justice (cardinal); faith, hope and love (theological)
Assumptions about society	A collection of individuals who voluntarily agree to enter into a social contract with one another	A creation reality: humans are embedded within societies. The human person cannot be understood apart from society, and *vice versa*. Human societies (and, therefore, the human person) are embedded in particular places and have unique histories and traditions
	Social, economic, and political institutions are designed to maximize the consumption of goods and leisure. Maximizing economic growth becomes the overriding societal goal	Societal institutions are designed to promote social, economic and political 'goods' that contribute to enhanced relationships
Societal values	Freedom from others	Freedom for others
	Competition	Competition and cooperation
	Mobility and the global	Rootedness and the local
	Material Wealth	Well-being

7.2.1 CDA

This subsection is a summary of Section 6 of “Mens; waar ben je?”, a publication that can be found on the internet.

Wat wil de mens? Hij wil een leven leiden dat betekenisvol is, dat er toe doet. Dit is niet hetzelfde als het meeste uit het leven halen. Gewaakt moet ook worden voor een instrumentele visie, d.w.z. de doelen op een efficiënte manier behalen. Levensbeschouwelijke en morele aspecten spelen een rol; dat blijft de CDA-er tegen een liberaal zeggen.

In tegenstelling tot het liberaal individualisme legt de Christendemocratie er de nadruk op dat mensen geen losstaande individuen zijn, maar ingeweven zijn in verbanden. De mens heeft de verantwoordelijkheid een menswaardige samenleving te creëren; in ieder geval om die mee op te bouwen en te onderhouden. Die verantwoordelijkheid onderscheid de Christendemocraten van de Sociaaldemocraten (die deze verantwoordelijkheid bij de staat leggen) en van het Liberalisme, waarbij iemand alleen verantwoordelijkheid voor zichzelf heeft.

Het mensbeeld van het CDA heeft vier belangrijke kenmerken.

1. ***De mens is een geroepen wezen.***

Dit betekent open, religieus. Mensen streven ernaar zin te geven aan hun leven. Die zin is niet zozeer materieel, maar wel spiritueel. De mens is verantwoordelijk, maar precies voor wat? Het gaat ook om menselijke waardigheid. Die waardigheid is niet volledig in rechten te vangen. (Onderscheid met het Liberalisme (negatieve rechten) en met de Sociaaldemocratie (met haar nadruk op sociale rechten, zoals het recht op gedeeld eigendom); er is ook een verantwoordelijkheid.

2. ***De mens is een relationeel wezen***

De mens is een individu, in een web van relaties. Hij kan niet zonder die relaties worden gezien. De relaties tussen mensen zijn belangrijk. Er is geen recht op zelfbeschikking. Je kunt niet zonder toestemming van je directe relaties tot euthanasie beslissen. Er is op dit punt een groot verschil met het Liberalisme en met GroenLinks. GroenLinks blijkt te voelen voor vrijzinnig paternalisme. Welke rol speelt moraal in het liberalisme? (Er worden verwijzingen gegeven op p. 104).

3. *De mens is een maatschappelijk wezen*

Het is me niet geheel duidelijk wat het verschil is met het tweede kenmerk. Wat is het verschil tussen relationeel en maatschappelijk? Hier wordt bedoeld maatschappelijk geëngageerd. Je moet beantwoorden aan je relaties en aan de maatschappij. Het CDA is daarom tegen de verstatelijking van sociale voorzieningen: dit ondermijnt de gemeenschapszin. In dit stuk wordt verwezen naar allerlei nieuwe verbanden die ontstaan: de *civil society*. Zie ook de verwijzing naar het VK: Blond. Maatschappelijk middenveld; subsidiariteit. Verantwoordelijkheid en maatwerk [De rol van verantwoordelijkheid in het Liberalisme?]

4. *De mens als kwetsbaar wezen*

De mens is zondig, maar dat woord wordt niet gebruikt om dat het belast is. Het wordt wel bedoeld. Mensen maken fouten, maar dat moet hun vergeven worden. De Sociaaldemocratie legt teveel verantwoordelijkheid bij de staat; die moet alles regelen. De overheid kan echter vervreemding niet oplossen. De samenleving is niet maakbaar. Kwaad laat zich niet uitbannen, maar het kwaad kan wel benoemd worden. De menselijke persoon moet geaccepteerd worden.

7.2.2 ChristenUnie

The following is copied from an article in *Trouw* in 2007[54]:

In de visie van de ChristenUnie is ieder individu verbonden met God, de naaste en de schepping. Het is een <u>relationeel en christelijk-transcendent mensbeeld</u> dat het karakter van de ChristenUnie bepaalt. Het leven is heilig en komt tot zijn doel als het ingebed is in die relatie met God, de naaste en de schepping. De overheid heeft tot taak om het leven te beschermen en te bevorderen dat mens en schepping tot hun recht komen. Vandaar ook de nadruk op de waarde van het gezin.

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[54] Johannes de Jong "ChristenUnie verdient een eerlijke kans", 12/01/07

Dit mensbeeld betekent nadrukkelijk ook dat de overheid zich niet inlaat met de persoonlijke levenssfeer maar alleen verantwoordelijk is voor het publieke terrein. Kortom: een verbindende, optimistische en tegelijk realistische visie, die een kans verdient zich te bewijzen.

Het mensbeeld van de partij is gefundeerd op een orthodoxe interpretatie van het christelijk geloof en de bijbel. Overigens is ’orthodox’ in dit kader beslist iets anders dan ’fundamentalistisch’. De ChristenUnie blijkt dan ook een verzamelpunt van zeer diverse denominaties; van rooms-katholiek tot vrijgemaakt-gereformeerd, van pinkstergemeente tot PKN. Met deze visie kan de partij een ’modern’ ecologisch en sociaal gezicht combineren met ’traditionele’ opvattingen over zaken als abortus en euthanasie. Overigens is het opmerkelijk dat altijd vergeten wordt dat deze standpunten in grote delen van Europa gemeengoed zijn. Wat dat betreft kent het Nederlandse provincialisme, waarbij eigen land tot norm en gidsland verheven wordt, schijnbaar geen grenzen.

Het relationele mensbeeld betekent ook ’goed bestuur, dichtbij de burger’. Dus niet meer taken op EU-niveau regelen dan noodzakelijk is. Maar de partij is geen club van navelstaarders en staat open voor de wereld. De ChristenUnie heeft een snel groeiend Europees netwerk opgebouwd (de European Christian Political Movement, om de christendemocratie in Europa weer op de kaart te zetten. Ook de nadruk op milieu en ontwikkelingshulp benadrukt de openheid voor de wereld.

7.2.3 SGP

I received a lot of information from Jan Schippers (Thanks!), which I still have to digest. Johan Polder has written a paper on Weber and Calvin. The paper is interesting and nice to read, but it does not address the question that interests me most.

7.3 Communitarianism

Communitarianism is a line of thinking that arose in the 1980s as a critique on two schools of thought: modern liberalism and libertarianism. The first aims to protect and enhance personal liberty and individual rights, in part through active involvement of the government. The second aims to achieve personal liberty through strict limits on the government. Communitarianism can also be seen as a response to the universalism and individualism of John Rawls’s book “A Theory of Justice”. Rawls puts individuals in the original position, but this starting point (individualism and universalism) is rejected by communitarians. They argue that context (which includes culture, conventions and society more generally) is important. Communitarians dispute that the role of the government is solely to ensure that individuals can live their freely chosen lives. They argue that there is another variable that is important: the common good. People do not only have rights; they also have responsibilities for the common good.

Communitarianism links up with Judean and Christian thought, Confucianism, Roman Catholic thought, and social democracy. It is a response to extreme individualism, this leading to disrespect for traditional institutions, and leading to excesses: people becoming selfish or egocentric. On the drawbacks of individualism; see “Bowling Alone”. I have not seen economic models based on communitarianism, but I have not yet read Etzioni’s “The Moral Dimension”

I am not sure whether there are any communitarian parties in the Netherlands. GroenLinks seems to have adopted some of the ideas. It also seems that, under David Cameron, the British conservatives are influenced by this thinking. Etzioni writes that also Jan-Peter Balkenende was influenced. [55]

7.4 Social Democracy and Socialism

I do not know and did not have time to write about it (with apologies).

7.4.1 PvdA

Wim Kok argued that the party should do away with its ideology, but since then, the party has not been doing well. Apparently Willem Witteveen (who died in the crash of MH17) advised on the new ideology, but I have not been able to find much on the “view of man”. The following piece is copied from Jola Jakson “In tradities schuilen kennis en ervaring; Lessen van het conservatisme”, *Socialisme & Democratie* 10/11/2010:

“Wie de mens primair als een rationeel wezen ziet dat, met het oog op het eigenbelang, kosten en baten afweegt, zal financiële prikkels toepassen door bijvoorbeeld ongezond voedsel extra te belasten of ziektekostenpremies te differentiëren op basis van individuele leefstijl. Wie daarentegen veronderstelt dat de mens vooral deel uitmaakt van een (moreel) waardesysteem, zal een voorlichtingscampagne starten die burgers probeert te overreden met morele argumenten en

[55] See also “De fluisteraar van JP Balkenende”, *Trouw*, 14 juni 2007

die goede praktijkvoorbeelden toont. Hoewel de PvdA zelden expliciet aangeeft van welk mensbeeld zij uitgaat, pendelt zij al sinds haar oprichting tussen bovenstaande visies - zie onder andere de discussie tussen Willem Banning en Jacques de Kadt. Bij lezing van verschillende PvdA-beleidsstukken en -programma's valt daarin soms de eerste, liberale mensvisie en dan weer de tweede, communitaristische visie te herkennen. Bij onderwerpen als het mengen van scholen, de bevordering van arbeidsparticipatie van vrouwen of het verhogen van de pensioenleeftijd neigt de PvdA er soms naar om burgers met financiële prikkels in de gewenste richting te sturen en verder met rust te laten, dan weer wil ze hen bestoken met een morele boodschap, waarin een beroep wordt gedaan op hun verantwoordelijkheid voor de gemeenschap. In het huidige verkiezingsprogramma wordt bijvoorbeeld gezinspeeld op actieve deelname van burgers ('Onze samenleving draait op die betrokkenheid, op vrijwilligerswerk en mantelzorg die mensen, dag in dag uit, onbaatzuchtig voor elkaar over hebben'), maar tevens worden ouders financieel aansprakelijk gesteld voor door hun kinderen veroorzaakte schade. In dit artikel wil ik een derde visie op de mens onder de aandacht brengen: het conservatieve mensbeeld. Ik zal laten zien waarin deze verschilt van de liberale en de communitaristische visies op de natuur van de mens. Hoewel het conservatieve mensbeeld de meeste sociaal-democraten gevoelsmatig waarschijnlijk niet aanspreekt, of zelfs afkeer inboezemt, zal ik aan het slot betogen dat de sociaal-democratie niettemin haar voordeel kan doen met een dergelijke visie. Hiermee geef ik een aanvulling op de aansporing van Willem Witteveen in een bijdrage aan s&d in 2005 om het conservatieve denken meer serieus te nemen binnen de PvdA."

7.4.2 SP

On the internet, I found: "Paul Rosenmöller interviewt Emile Roemer over zijn mensbeeld en zijn idealen" (28 May 2010). I guess it is an interview on radio or TV

I also found[56]:

"Maar er is nog iets dat irriteert. Het mensbeeld van de SP. Dat gaat ervan uit dat er vooral twee categorieën mensen bestaan. Of ze zijn slachtoffer (oude mensen), of ze doen hun werk niet goed (werknemers in de thuiszorg). In het eerste geval wordt niet alleen een hele groep als zielig

[56] Agnes Wolbert: "SP verdraait feiten over de thuiszorg", Volkskrant 06/02/2008

weggezet, maar wordt ook voorbij gegaan aan de grote bijdrage die ouderen aan de samenleving leveren. In het tweede geval doet de SP al die mensen tekort die zich met hart en ziel inzetten om ouderen te ondersteunen in hun eigen leefomgeving."

7.5 Populism and Single Item Parties

I don't think we need to consider these.

8. IDEOLOGIES, HUMAN NATURE AND THE MARKET

From what was written in Section 7, we can draw some inferences about the views on the market. For other parties, it is clear from their actions. For example, the SP has taken strong position against the market. At the moment, I do not know precisely how to link their objections to what was written in the Sections 2-5. I guess it is the view that markets undermine solidarity and against viewpoint that markets provide deserved rewards.

Most interesting seem to be the positions of the Christian and communitarian parties. In the paper of the CDA that I summarized, there is little discussion on the role of the market, nor on the role of the state.

[To be completed]

9. CONCLUSION

This still needs to be written.

At the present stage, I can only apologize for the paper being too long and not yet being clearly focused. For me, writing is the way to structure my thoughts. For me, the writing process was useful, as I now better understand what I would like to accomplish and what we can expect of the project. If I would start anew, the paper would be shorter, clearer and more to the point.

But we have to move on. The project imposes deadlines and if I would have to complete this paper first, we would not be able to make them. The paper, hopefully, is clear enough to show that this is an exciting project and that it will benefit from the cooperation of all those that are interested.

Suggestions are most welcome.