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# **The Moral Economig Man\***

Műhelytanulmány

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Economic behavior is multifaceted and context-dependent. However, the so-called Homo Oeconomicus model states that agents are perfectly rational, self-interest-maximizing beings. This model can be criticized on both empirical and normative grounds. Understanding economic behavior requires a more complex and dynamic framework.

In the "I & We" paradigm developed by Amitai Etzioni, economic behavior is co-determined by utility calculations and moral considerations. Two major factors can explain the ethicality of economic behavior; namely, the moral character of the agents and the relative cost of ethical behavior.

Economic agents are moral beings, but the ethical fabric of the economy determines which face of the Moral Economic Man predominates.

## **1 Economic Behavior**

It is a common belief in our age that people are motivated by their *own material well-being* when taking economic actions. This is the well-known Homo Oeconomicus image that depicts economic agents as rational, self-interest-maximizing beings. However, economic behavior is much more complex than the Homo Oeconomicus model suggests. People have rather different motivations, which may determine their economic choices. (Jolls, C., Sunstein, C.R. & Thaler, R. H. 2000, Bowles, S. & Gintis, H. 2011)

Overwhelming empirical evidences suggest that

- (i) people care about their *own material payoffs*;
- (ii) people consider the interest of *others* they *know well*;
- (iii) people are willing to *sacrifice* their own material well-being to *help* those who are *kind* to them and to *punish* those *unkind* to them;
- (iv) people take into account the *well-being* of *strangers* whose interests are *at stake*;

- (v) people are interested in their *reputations* - what others think about their behavior;
- (vi) people care about their *self-conceptions* - what kind of persons they wish to be.

Some interesting experimental results aptly illustrate the above-noted behavioral features (i),..., (vi). The following famous studies provide strong *counter-evidences* for the Homo Oeconomicus model. They suggest that *people* are *moral beings* in their economic actions.

### 1.1 The Ultimatum Bargaining Game

The ultimatum bargaining game has two players, an *allocator* and a *receiver*. The allocator is given \$10 to distribute between the receiver and herself or himself. The receiver has two options: *accepting* the offer, in which case each player gets the *amount proposed* by the allocator; or *rejecting* the offer, in which case each player gets *nothing*. The players play the game only once.

The Homo Oeconomicus model presupposes that the allocator will propose \$9.99 for herself/himself and only \$.01 to the other player, and that the receiver will accept this offer on the grounds that the utility of one penny is greater than zero. But this is not what happens in reality. Offers usually average between \$3 and \$4. Offers less than \$2 are often rejected. Frequently there is a 50-50 division. These results cut across diverse cultures and the level of stakes. (Sunstein, C. R. 2000)

### 1.2 Choices in Prisoner's Dilemma Situations

The Homo Oeconomicus model predicts that people will always defect in a prisoner's dilemma game situation. Each player may believe that it would pay more if she or he were non-cooperative since the other player is also expected to be non-cooperative.

*Robert H. Frank* and his colleagues conducted their prisoner's dilemma experiment with real money several hundred times. The subjects met in groups of three. Each was told that she or he would play the game once only with each of the other two subjects. Confidentiality was maintained so that none of the players would learn how their partners had

responded in any play of the game. The rate of *cooperation* ranged between 40% and 62%. (Frank et al. 1993)

To refine their experiment Frank and his colleagues asked subjects whether they would cooperate or defect in a one-shot prisoner's dilemma game if they *knew* with certainty that their *partner* was going to *cooperate*. The answers for cooperation ranged between 42% and 66%. (Frank et al. 1993)

### 1.3 Lost Letter Experiment

*Anthony M. Yezer* and his colleagues conducted the so-called "lost-letter" experiment. (Yezer et al. 1996) The letter was placed in an unsealed, stamped, plain white envelope, with a single name and address on the front and no return address. Inside were ten \$1 bills along with a brief hand-written note indicating that the enclosed currency was for repayment of an informal loan.

Thirty-two letters were left in upper level economics classes; an equal number of letters were left in upper level classes in other disciplines such as psychology, political science, and history. The Homo Oeconomicus model predicts that people will not return the lost letters. Contrary to this expectation, 31% - 56% of the letters were *returned*.

This experimental evidence indicates that people display *respect* for the *interests* of *strangers*. The returned envelopes also provided some qualitative evidence on student reactions to the lost letters. In two cases, students added messages indicating that they had made extraordinary efforts to locate the addressee, including checking the student directory, the telephone directory and the university registrar. (Yezer et al. 1996)

### 1.4 Contribution to the Public Good

In their pioneering study, *Gerald Marwell* and *Ruth Ames* designed an experiment where subjects were given some initial endowment of money that they were to allocate between two accounts, the "*public*" and the "*private*". Money deposited in the subject's private account was returned to the subject dollar-for-dollar at the end of the experiment. Money deposited in the public account was pooled, multiplied by a factor greater than unity, and finally distributed equally among all subjects. (Marwell, G. & Ames, R. 1981)

The Homo Oeconomicus model anticipates a subject putting the entire endowment into the private account. From a social point of view the optimal behavior is to put the entire endowment into the public account. Marwell and Ames found that subjects *contributed* an average of 20% - 49% of their initial endowment into the *public account*. Certainly subjects were "*concerned with fairness*" when making their decisions. (Marwell, G. & Ames, R. 1981)

## 1.5 Trust

In a game of trust, *Edward Glaeser* and his collaborators paired-off players, some of whom knew each other in real life. The first player received \$15, of which he or she could give any part to the second player, hidden from view. The amount transmitted was doubled by the researchers, and the second player then sent any part he wished of the new amount back to the first player. Here the trusting outcome is for the first player to send the full \$15 to the second. Then, provided that the second player is worthy of the first's trust, both can walk away with \$15. Nevertheless, the Homo Oeconomicus model predicts that the first player will keep the entire \$15.

The first players *sent* an average of \$12.41 to their partners, who *returned* an average of 45% of the doubled sum. The existence of a *previous acquaintance* affected behavior: both the amount initially sent, and the percentage returned by the second player, rose in proportion to the length of time the players had known each other. (Glaeser, E.L. et al. 2000)

## 2 Problems of Rationality

The *rational choice model* has been widely used in economics, political science and other social sciences as a basic model of human choice behavior. The model states that the *agent* should *maximize* her or his *utility function* to be considered rational.

Agents are considered rational if their *preferences* are *transitive* and *complete* and they choose what they most prefer among the available alternatives.

The rational choice model does not presuppose anything about the preferences people have. They may have self-centered, altruistic or even sado-masochistic preferences. The rational choice model represents a *formal theory* that says nothing about what people prefer or should prefer. Hereafter this model is referred as the *weak form of rationality*.

In economics and also in political science we can find a much stronger version of rationality where the assumptions of *self-interest* and *perfect knowledge* are added to the weak

form of rationality. Hence we get the already discussed *Homo Oeconomicus* model according to which individuals are rational, exclusively self-interested and have perfect knowledge about the consequences of their choices. The *Homo Oeconomicus* model does have *substantive assumptions* about what people want and the manner in which they want it. This model is hereafter referred to as the *strong form of rationality*. (Zsolnai, L. 2008)

## 2.1 Bounded Rationality

*Herbert A. Simon* has been a relentless critic of the rational choice model for decades. He states that the model has overly strong claims on human beings. Real people have *poor cognitive capacity* and the *information* available to them is rather *limited* in most cases.

Agents in the real world are not capable of maximizing their utility function. Instead of maximizing, they usually make "*satisficing*" decisions. They usually choose the first available alternative that is good enough for them in the sense that it satisfies their aspiration level. This is the main message of the *theory of bounded rationality* for which Simon received the Nobel Prize in Economics.

Simon writes, "Faced with a choice situation where it is impossible to optimize, or where the computational cost of doing so seems burdensome, the decision maker may look for a satisfactory, rather than an optimal alternative. Frequently, a course of action satisfying a number of constraints, even a sizeable number, is far easier to discover than a course of action maximizing some function." (Simon, H.A. 1987: p. 244.)

The question arises of how a decision maker may set the level of criteria that define "satisfactory". "Psychology proposes the mechanism of aspiration levels: if it turns out to be very easy to find alternatives that meet the criteria, the standards are gradually raised; if the search continues for a long while without finding satisfactory alternatives, the standards are gradually lowered. Thus, by a kind of feedback mechanism, or 'tatonement', the decision maker converges toward a set of criteria that are attainable, but not without effort. The difference between the aspiration level mechanism and the optimization procedure is that the former calls for much simpler computations than the latter." (Simon, H.A. 1987: p. 244.)

During the last decades abundant empirical evidence has been produced by economists and psychologists that shows that bounded rationality is important in *real world situations*.

## 2.2 Myopic and Deficient Choices

Psychologist *Daniel Kahneman* criticizes the rational choice model on the basis of research findings, which indicate that people are *myopic* in their decisions, may lack skill in predicting their future tastes, and can be led to *erroneous choices* by fallible memory and incorrect evaluation of past experiences. (Kahneman, D. 2011)

Kahneman differentiates between experienced utility and predicted utility. The *experienced utility* of an outcome is the measure of the hedonic experience of that outcome. The *predicted utility* of an outcome is defined as the individual's beliefs about its experienced utility at some future time. Predicted utility is an *ex ante* variable, while experienced utility is an *ex post* variable in the decision-making process.

According to the rational choice model, decisions are made on the basis of predicted utility. If experienced utility greatly differs from predicted utility then this may lead to sub-rational, or even irrational choices.

The problem of predicted utility raises the question: "*Do people know what they will like?*" The answer is a definite "No." The accuracy of people's hedonic predictions is generally quite poor.

Experimental studies suggest two conclusions: (i) people may have little ability to forecast changes in their hedonic responses to stimuli; and (ii) even in situations that permit accurate hedonic predictions, people may tend to make decisions about future consumption without due consideration of possible changes in their tastes. (Kahneman, D. 2011)

Discrepancies between *retrospective utility* and *real-time* utility should also be addressed. This leads to the question: "*Do people know what they have liked?*" The answer is again a definite "No." Psychological experiments show that retrospective evaluations should be viewed with greater distrust than introspective reports of current experience.

The results of these studies support the following two empirical generalizations: (1) *The Peak & End Rule*: global evaluations are predicted with high accuracy by a weighted combination of the most extreme affect recorded during the episode and of the affect recorded during the terminal moments of the episode. (2) *Duration Neglect*. The retrospective evaluation of overall or total pain (or pleasure) is not affected by the duration period. (Kahneman, D. 2011)

Since individuals use their evaluative memories to guide them in their choices toward future outcomes, deceptive retrospective evaluations may lead to erroneous choices.

Kahneman identifies two major *obstacles* to the *maximization* of *experienced utility* required by the rational choice model. People lack skill in the task of predicting how their tastes might change. It is difficult to describe as rational agents who are prone to large errors

in predicting what they will want or enjoy next week. Another obstacle is a tendency to use the affect associated with particular moments as a proxy for the utility of extended outcomes. Observations of memory biases are significant because the evaluation of the past determines what is learned from it. Errors in the lessons drawn from experience will inevitably be reflected in deficient choices for the future. (Kahneman, D. 2011)

### 2.3 Rational Fools

Nobel Laureate economist Amartya Sen concluded that if real people behaved in the way that is required of them by the rational choice model then they would act like “rational fools.”

Sen criticizes both the weak and strong forms of rationality. He refers to the weak form as “internal consistency of choice” and to the strong form as “maximization of self-interest.”

He states “It is hard to believe that internal consistency of choice can itself be an adequate condition of rationality. If a person does exactly the opposite of what would help achieving what he or she would want to achieve, and does this with flawless internal consistency (always choosing exactly the opposite of what will enhance the occurrence of things he or she wants and values), the person can scarcely be seen as rational. (...) Rational choice must demand something at least about the correspondence between what one tries to achieve and how one goes about it.” (Sen, A. 1987: p. 13.)

Sen uses the term “*correspondence rationality*” to describe the correspondence of choice with the aims and values of the agent. He states that this kind of correspondence must be a *necessary condition* of rationality, regardless of whether or not it is also the sufficient condition. Correspondence rationality might be supplemented by some requirements on the nature of the reflection regarding what the actor should want and value. (Sen, A. 1987: pp. 13-14.)

It might well be arguable that rational behavior must demand *some consistency*, but consistency itself can hardly be adequate to ensure the rationality of choice. Internal consistency is *not* a *guarantee* of a person’s rationality.

*Rationality as self-interest maximization* has additional problems. Sen asks, “Why should it be uniquely rational to pursue one’s own self-interest to the exclusion of everything else?” Sen argues that the self-interest view of rationality “involves inter alia a firm rejection of the “ethics-based” view of motivation. Trying to do one’s best to achieve what one would

like to achieve can be a part of rationality, and this can include the promotion of non-self-interested goals which we may value and wish to aim at. To see any departure from self-interest maximization as evidence of irrationality must imply a rejection of the role of ethics in actual decision making.” (Sen, A. 1987: p. 15.)

According to Sen, “universal selfishness as actuality may well be false, but universal selfishness as a requirement of rationality is patently absurd.” (SEN, A. 1987: p. 16.)

Rationality can be interpreted broadly as the discipline of subjecting one’s choice - of action as well as objectives, values and priorities - to reasoned scrutiny. In the light of this definition reasonable economic choices should not necessarily satisfy the criteria of “internal consistency of choice” or “maximizing self-interest”. Economic choices should be subjected to the demands of reason. (Sen, A. 2002)

## 2.4 The Strategic Role of Emotions

Behavioral economist *Robert Frank* developed a model that emphasizes the role of the emotions in making choices. Frank argues that *passions* often *serve our interest* very well indeed because we face important problems that are simply unsolvable by rational action. “Emotions often predispose us to behave in ways that are contrary to our narrow interests, and being thus predisposed can be an advantage.” (Frank, R. 1988: pp. 4-7.)

Human behavior is directly guided by a *complex psychological reward mechanism*. Rational calculations are the input for the reward mechanism. “Feelings and emotions, apparently, are the proximate causes of most behavior. (...) The reward theory of behavior tells us that these sentiments can and do compete with feelings that spring from rational calculations about material payoffs.” (Frank, R. 1988: pp. 51-53.)

The *modular brain theory* supports Frank’s ideas. According to the modular theory, the brain is organized into a host of *separate modules*. Each module has its own capacity for processing information and motivating behavior. Most of these brain modules do not “speak”; they simply do not have language capability. Even more importantly, these non-language modules are *not* equally well *connected* to the *central language module* of the brain. Perhaps this is the cause of the seeming disparity between different methods of assessing motivation.

Modular brain theorists view the *language module* of the brain as the *center* of our *rational consciousness*, obsessed with rationalizing all that we feel and do. However, there is a great deal of information that enters the central nervous system that cannot be accessed by the language module. The modular brain theory suggests, “that when economists talk about

maximizing utility, they are really talking about the language module of the left hemisphere, however, it does not account for all of our behavior. (...) The rational utility-maximizing language module of the brain may simply be ill-equipped to deal with many of the most important problems we face.” (Frank, R. pp. 205-211.)

Frank’s main conclusion is that persons *directly motivated to pursue their self-interest* are often doomed to *fail* for exactly that reason. Problems can often be solved by persons who have abandoned the quest for maximal material advantage. The *emotions* that lead people to *behave in irrational ways* can indirectly lead to *greater material well-being*. (Frank, R. 1988: pp. 258-259.)

## 2.5 Social Norms

After a decade-long preoccupation with the rational choice model, sociologist *Jon Elster* developed an alternative theory that he calls the *theory of social norms*. (Elster, J. 1989, 2007)

Elster contrasts rational action with norm-guided behavior. *Rational action* is *outcome-oriented*. Rationality says: “If you want to achieve X, do Y.” Elster defines *social norms* as devices that are *not outcome-oriented*. Social norms say “Do X” or “Do not do Y” or “If you do X then do Y” or “Do X if it would be good if everyone did X.”

“Rationality is essentially conditional and future-oriented. Its imperatives are hypothetical; that is, conditional on the future outcomes one wants to realize. The imperatives expressed in social norms are either unconditional or, if conditional, not future-oriented. In the latter case norms make the action dependent on past events or (more rarely) on hypothetical outcomes.” (Elster, J. 1989: p. 98.)

Not all norms are social. There are two requisite conditions for norms to be considered *social*. First, they must be *shared by other people* and second, partly *sustained* by their approval or disapproval. “In addition to being supported by the attitudes of other people, norms are sustained by the feelings of embarrassment, anxiety, guilt and shame that a person suffers at the prospect of violating them, or at least at the prospect of being caught violating them. Social norms have a *grip on the mind* that is due to the strong emotions their violations can trigger. (...) A norm, in this perspective, is *the propensity to feel shame and to anticipate sanctions by others at the thought of behaving in a certain, forbidden way*.” (Elster, J. 1989: pp. 99-100 and p. 105.)

Elster argues for the reality and autonomy of social norms. By the *reality of norms* he means that norms have independent motivating power. Norms are not merely *ex post*

rationalization of self-interest. They serve as *ex ante* sources of action. Autonomy of norms means their *irreducibility* to *optimization*. Norms are *partly shaped* by self-interest because people often adhere to the norms that favor them. However, norms are not fully reducible to self-interest. The *unknown residual* is a brute fact. (Elster, J. 1989: p. 125 and p. 150.)

## 2.6 The Communitarian Challenge

Communitarian thinkers criticize the *liberal conception* of the *self* that is at the heart of the rational choice model.

Philosopher *Charles Taylor* has argued that the liberal conception of the self is basically an *atomistic conception* of the person and that of human agency focusing exclusively on will and freedom of choice. Taylor defends a *relational, inter-subjective* conception of the self that stresses the social, cultural, historical and linguistic constitution of personal identity. By rejecting the voluntaristic conception of human agency he has formulated a cognitive conception that emphasizes the role of *critical reflection, self-interpretation, and rational evaluation*. (Taylor, C. 1985)

Catholic philosopher *Alasdair MacIntyre* defends a teleological and contextualist view of human agency. According to him, moral conduct is characterized by the *exercise of virtues* that aims at realization of the good. No agent can properly locate, interpret, and evaluate her or his actions except by participating in a moral tradition or in a moral community. (MacIntyre, A. 1988)

## 2.7 Feminist Criticism

In *feminist literature* the rational choice theory, and especially the strong form of rationality, is often criticized for presupposing an *androcentric, male-biased* conception of the human person, the so-called *separative self*. (Ferber, M.A. & Nelson, J.A. (eds.) 1993, Nelson, J. A. 2006)

In her book "Beyond Self-Interest" *Jane J. Mansbridge* offers an alternative theory of choice that is inspired by feminine values. She distinguishes three forms of motivation, namely *duty, self-interest, and love*. Starting with her own case she says, "I have a duty to care for my child, and I am happy by his happiness, and I get a simple sensual pleasure from snuggling close to him as I read him a book. I have a principled commitment to work for women's liberation,

and I empathize with women, and I find a way to use some of my work for women as background to a book that advances my academic career. Duty, love (or empathy), and self-interest are intermingled in my actions in a way I can rarely sort out.” (Mansbridge, J.J. 1990: p. 134.)

Mansbridge favors the *coincidence* of duty and love with self-interest. She says that both forms of non-self-interested motives (empathic feelings and moral commitments) are embedded in a social context, which makes them susceptible to being undermined by self-interested behavior on the part of others. Arrangements are required that generate some self-interested return for non-self-interested behavior to create an "*ecological niche*" for sustaining such behavior. Arrangements that make the absence of self-interested behavior less costly in self-interested terms increase the degree to which individuals feel that they can afford to indulge their feelings of empathy and their moral commitments. (Mansbridge, J.J. 1990: pp. 136-137.)

Based on the criticisms reported above we can say that the rational choice model is *empirically misleading* and *normatively inadequate*. For understanding economic behavior, a more complex and dynamic framework is needed.

### **3 The "I & We" Paradigm**

Amitai Etzioni developed a theory that he calls *socio-economics*. He introduced the so-called *I & We paradigm* that “sees individuals as able to act rationally and on their own, advancing their self or ‘I’, but their ability to do so is deeply affected by how well they are anchored within a sound community and sustained by a firm moral and emotive personal underpinning - a community they perceive as theirs, as ‘We’.” (Etzioni, A. 1988: p. x.)

Etzioni presents a new model of decision making in which people typically choose means largely on the basis of emotions and value judgments, and only secondarily on the basis of logical-empirical considerations.

In Etzioni’s model two irreducible sources of valuations play a role, namely *pleasure* and *morality*. “Individuals are, simultaneously, under the influence of two major sets of factors - their pleasure, and their moral duty (although both reflect socialization). (...) There are important differences in the extent each of these sets of factors is operative under different historical and societal conditions, and within different personalities under the same conditions.” (Etzioni, A. 1988: p. 63.)

The relationship between pleasure and morality is that while both affect choice, they also affect one another. However, each factor is only partially shaped by the other; that is, each factor has a considerable measure of autonomy. This *co-determination model* is shown by *Figure 1*.

Figure 1      Etzioni' socio-economic model

**u t i l i t y    ⇔    e t h i c s**



**b e h a v i o r**

Etzioni states that “people do not seek to maximize their pleasure, but to balance their service of the two major purposes - to advance their well-being and to act morally.” (Etzioni, A. 1988: p. 83.)

#### **4      The Ethical Fabric of the Economy**

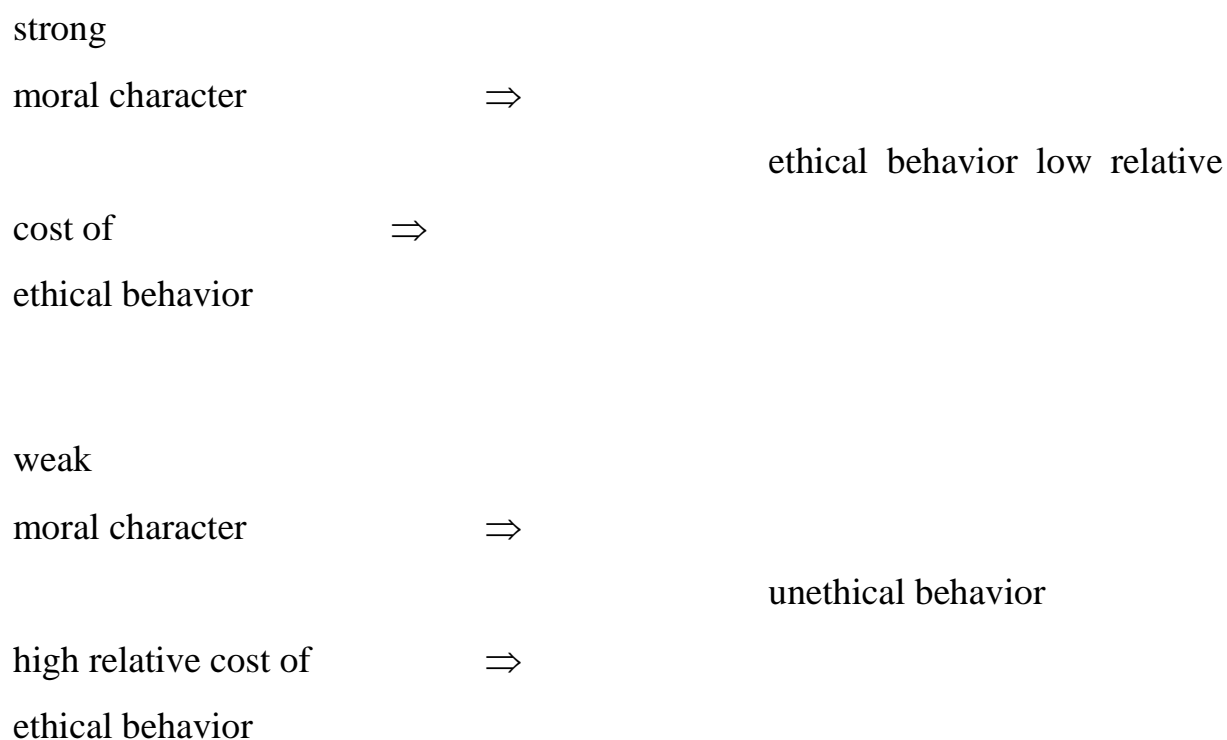
Economic behavior is co-determined by utility calculations and moral considerations. The *major factors* that can help in understanding behavior can be identified:

- (i)      the *moral character* of the *agents*;
- (ii)     the *relative cost* of *ethical behavior*.

*Moral character* refers to the strength of the moral beliefs and commitments of the agents. In a given situation the relative *cost* of *ethical behavior* is determined by the cost of an ethical option compared against the cost of the unethical option in terms of transaction cost and opportunity loss.

We can predict the ethicality of economic behavior by combining the moral character of the agents and the relative cost of ethical behavior. If the *moral character* of the agents is *strong* and the *relative cost* of ethical behavior is *low*, then *ethical behavior* can be *expected*. If the *moral character* of the agents is *weak* and the relative cost of ethical behavior is *high*, then *unethical behavior* can be expected. (*Figure 2*)

Figure 2 Determinants of the Ethicality of Behavior



The level of *corruption* in different countries is a good illustration. *Transparency International* produces the corruption ranking of countries year by year. Their ranking for 2011 is shown in *Table 1*.

Table 1            Corruption Indices of Selected Countries in 2011

Rank	Country	Score
1	New Zealand	9.5
2	Denmark	9.4
2	Finland	9.4
4	Sweden	9.3
5	Singapore	9.2
6	Norway	9.0
7	Netherlands	8.9
8	Australia	8.8
8	Switzerland	8.8
10	Canada	8.7
...		
24	United States	7.1
25	France	7.0
...		
50	Oman	4.8
50	Seychelles	4.8
54	Hungary	4.6
...		
177	Sudan	1.6
177	Turkmenistan	1.6
177	Uzbekistan	1.6
180	Afghanistan	1.5
180	Myanmar	1.5
182	Korea (North)	1.0
182	Somalia	1.0

Source: Transparency International 2011: Corruption Perceptions Index 2011.

A corruption index measures the likelihood that a particular economic transaction involves corruption in a given country. New Zealand, Denmark, Finland, Sweden, Singapore, and Norway are countries where corruption is virtually nonexistent. In these countries, economic agents have *high moral expectations* and at the same time, it is *easy to behave ethically*. In the most corrupt countries - such as Sudan, Turkmenistan, Uzbekistan, Afghanistan, Myanmar, North Korea and Somalia - economic agents have *low moral expectations*, and at the same time it is *difficult to behave ethically*.

## 5 Conclusions

Economic agents are moral beings. The context determines which face the Moral Economic Man predominates. Some hypotheses can be generated about the conditions, which mitigate the behavior of the Moral Economic Man for better or worse.

(i) The stronger the *collective belief* in the *ethical norms* by the economic actors, the *less* one can expect *unethical behavior* from them.

(ii) The stronger the *pro-social orientation* of the economic actors, the *more* one can expect *ethical behavior* from them.

(iii) The greater the *social costs of transgression* by the economic actors, the *less* one can expect *unethical behavior* from them.

(iv) The greater the *transparency and accountability* of the economic actors, the *more* one can expect *ethical behavior* from them.

Collective belief in the ethical norms, pro-socialness of agents, high cost of transgression as well as transparency and accountability are all major conditions for the proper functioning of the *Moral Economic Man*.

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