Moral Markets

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THE CRITICAL ROLE OF VALUES IN THE ECONOMY

Edited by
Paul J. Zak

With a foreword by Michael C. Jensen

PRINCETON UNIVERSITY PRESS • PRINCETON AND OXFORD

Published by Princeton University Press, 41 William Street, Princeton, New Jersey 08540
In the United Kingdom: Princeton University Press, 3 Market Place, Woodstock,
Oxfordshire OX20 1SY

CIP [TK]

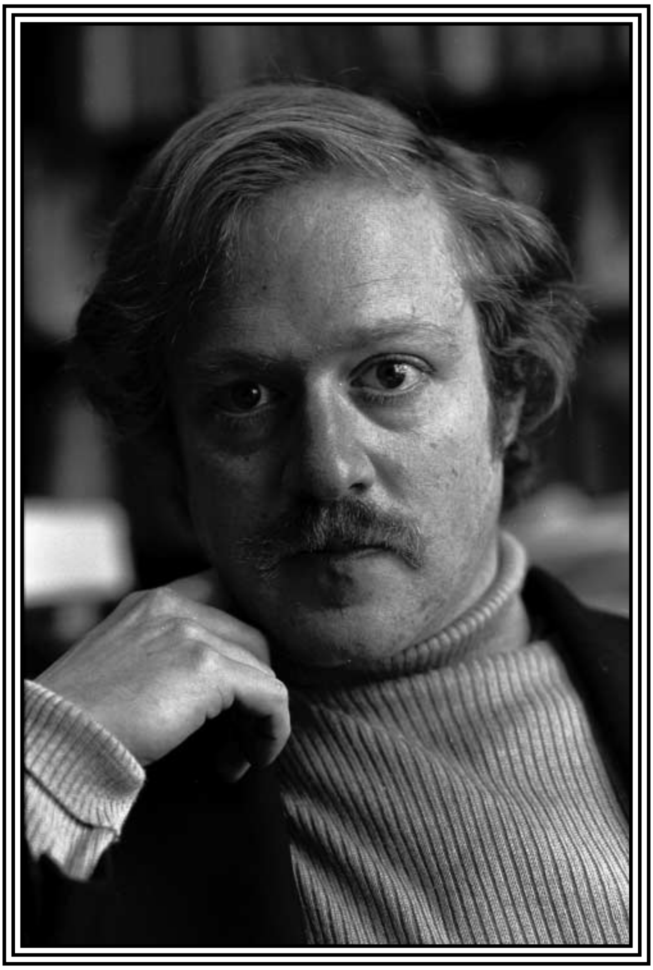
British Library Cataloging-in-Publication Data is available

This book has been composed in Goudy
Printed on acid-free paper. ∞
press.princeton.edu

Printed in the United States of America
10 9 8 7 6 5 4 3 2 1

This book is dedicated to my big girl,

Elke Liesl Zak



The contributors to this book dedicate it to the memory of our friend and collaborator, Dr. Robert Solomon. Bob was an essential part of this research team, an enthusiastic mentor to all, and invariably dispensed his good humor, good spirits, and good sense in liberal quantities. We feel honored to have known and worked with him.

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Foreword

Michael C. Jensen

My congratulations and admiration to the Gruter Institute for Law and Behavioral Research and the scholars who have evidenced the courage to tackle a subject as difficult and opaque as the Gruter Institute Project on Values and Free Enterprise. With the support of the John Templeton Foundation, the UCLA-Sloan Research Program on Business Organizations, and the Ann and Gordon Getty Foundation, the volume they have produced, *Moral Markets: The Critical Role of Values in the Economy*, promises to be a landmark effort in bringing scientific inquiry and analysis to the normative world of values. Economics, having traditionally focused on the positive analysis of alternative institutional structures, has far too long ignored the normative world.

By the term "positive analysis," I mean, of course, the analysis of the way the world is, how it behaves, independent of any normative value judgments about its desirability or undesirability. Such analysis leads to empirically testable propositions that are falsifiable in the sense of Karl Popper's revolutionary work "The Logic of Scientific Discovery."[1] By "normative," I mean establishing, relating to, or deriving from a standard or norm that specifies desirable or undesirable conduct or behavior, that is, what ought to be.[2]

The positive analysis of normative values may sound like a non sequitur, yet, in my opinion, it is among the major issues the world faces today. It does not take much reflection or study of history to begin to see the import of different judgments about normative values on the tensions and conflicts between human beings. There are, of course, many causes underlying the conflicts between humans in addition to those involving different value systems, including, for example, power, wealth, and so on. Nevertheless, the power of values, those deeply held personal beliefs about good versus bad behavior, desirable versus undesirable actions, right versus wrong, which cause, or at least encourage, human beings to commit the most horrific crimes against their neighbors is startling. Witness the multitudes of religious and civil conflicts ranging from the Crusades, the Holocaust, two world wars, and ethnic cleansing in Somalia to the brutal bombings, torture, and televised beheadings associated with the current conflicts involving radical Islam.

In the last two decades, we witnessed the end of three-quarters of a century of conflict and violence between the normative views of socialist and communist philosophy and those of capitalist philosophy over how the means of production in a society should be owned, directed, and coordinated, and how the output of that production should be distributed. Currently we are seeing the beginnings of what will likely be the next three-quarters of a century of conflict roiling civilization, in this case between radical Islam and most of the rest of the world over whether the very roots of modernity, the separation of church and state, will be overturned.

A potentially valuable source of knowledge in learning the source of these tensions, and therefore in learning how to manage and reduce them, is a much deeper understanding of the role of values in shaping and guiding human action and interaction. Clearly, this calls for a positive analysis of values: how they arise, how they change, how they interact across cultures, how they can be changed, and so on. Understanding how values are reflected in markets, and how markets either reduce or increase their positive or negative effects on human welfare, is obviously important. The work of the scholars represented in this volume contributes significantly to these issues and adds substantially to the foundations of analysis that will eventually lead to a richer and more complete understanding of these issues.

I look forward to seeing the creation of an entirely new field of inquiry in economics, and in its sister social sciences, focused deeply on the positive analysis of the role of values in elevating the possible outcomes of human interaction. This means understanding how values create, as well as facilitate, the management of conflicts between human beings. This does not require a discussion or debate about which values are better or worse but rather calls on us to examine the effects of differing values and how intentions diverge from actual results. A great start lies in creating a rich body of knowledge of how the values reflected in moral, ethical, and legal codes for standards of good versus bad behavior affect human interaction in families, groups, organizations, social cultures, and nations. The role of values is a purely positive question for economics and the other social sciences, and this volume begins that journey toward creating such a science.

Michael C. Jensen
Sarasota, Florida
February 2007

Notes

1. Karl Popper, *The Logic of Scientific Discovery* (New York: Basic Books, 1959).

2. See John Neville Keynes, *The Scope and Method of Political Economy,* 4th ed. (New York: Macmillan, 1917 [1891], pp. 34–35, 46; and Milton Friedman, *Essays in Positive Economics* (Chicago: University of Chicago Press, 1966), p. 3.

Introduction

Paul J. Zak

Just as nature is "red in tooth and claw," so is market exchange. All market participants—from business owners and managers to their employees to the grandmother shopping at her local grocery story—must eke out every possible efficiency or be crushed by the capitalist machine . . . or perhaps not. This book hopes to convince readers that both Alfred Tennyson's characterization of competition in nature, quoted above, and an uncritical reading about selfish competition in markets in Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* are not so much wrong as incomplete and, in the view of the contributors to this volume, woefully so.

The intertwining of biology and behavior is the leitmotif of this book. A biologically based approach both constrains and informs the analysis. The constraint restricts analyses that connect morals and markets to be consistent with evolution and behaviors in closely related species such as apes. Conclusions violating this constraint are fundamentally suspect. The biological approach is novel, as it elucidates variation along the continuum of behaviors, permitting one to extract that which is both relevant and amenable to policy. The rationale for this approach is to provide *convergent evidence* that modern market exchange is inconceivable without moral values. Although this idea is not new—scholars from Aristotle to Adam Smith have made related arguments—the revival of this idea and the modern evidence for it is controversial.

The controversy arises from the Marxist residue that invades our daily thought and language, as seen in the oft-repeated lines "Big business runs the economy" or "The little guy can't make a decent living." This economic victimization, however, is belied by the failure of large established corporations such as AT&T and the flourishing, world-changing success of businesses, such as the semiconductor-based computer industry, that began in a garage. How, one might ask, is any of this "moral," and, in fact, do moral values even exist?

The book begins by addressing the fundamental issue of whether moral values are identifiable, consistent, and real. Part 1 shows that they are. Once we have established that values can indeed be studied, we trace their emergence in certain species of monkeys and apes. We then look at the evolution of cultural norms and market institutions that reinforce virtuous propensities. This leads us to examine how current laws and public policy promote or inhibit our innate sense of values. Not everyone is virtuous in every circumstance, so exchange must occur in the shadow of enforcement. The book culminates by using these insights to directly examine how markets function when values are present and when they are in short supply.

The encompassing theme of *Moral Markets* is that human beings, are a highly social species and gauge our own and others' behaviors against social expectations that manifest as values. Adam Smith, in his *Theory of Moral Sentiments* (1759), called this having "sympathy for others"; a more apt term today is "empathy," responding emotionally to another's needs. Emotional responses, in Smith's view, are the social glue that binds us together as a species and are the basis for moral behavior. Modern neuroscience research supports Smith's intuition.

Research on Morality

Understanding the basis for moral behavior is a topic of heightened academic and popular interest based on the spate of recent scientific articles and trade books on the topic.[1] Why do we care what makes others behave in good or evil ways? At one level, we cannot help it. We are hypersocial apes. We live and work among those to whom we are not closely related, strangers constantly in our midst. We are inveterate consumers and producers of gossip about others. We simply need to know the whats and whys.

Aristotle, Plato, Jesus, Buddha, and Mohammed all recognized that values are the foundation for happiness, and their wisdom has stood the test of time.[2] The modern tools of psychology and neuroscience are providing new, often compelling insights into moral values. In the dawn of the twenty-first century, every field of inquiry seems to have a "neuro" attached to it, and neuroethics has recently blossomed. Although the classical philosophers provided logical answers to ethical dilemmas, the question of why something was moral seemed forever in dispute, depending on the exquisite (or excruciating) philosophical reasoning. By examining people's brains, an understanding of why we are moral (or not) is emerging.

Although an extensive survey of neuroethics is beyond the scope of this introduction, a brief overview will help contextualize many of the chapters in this book.[3] An important, consistent finding from neuroethics in the past ten years is that the Kantian notion of morality as being learned by rational deduction is generally incorrect. When viewing immoral acts, nearly all human beings have a visceral, emotional, and rapid neural response. In many cases, even children have similar reactions. In other words, one does not need to learn what is right and wrong, most of us know this, or perhaps better, sense this, immediately.

These moral emotions have been localized to evolutionarily old areas of the human brain. Yet, moral emotions were largely dismissed in the post-Cartesian world, where rationality was seen as mankind's crowning achievement and was thought to be in conflict with the emotions. Although distinct areas of the brain can process information differently, which can provoke neural conflict, most often the parts of the brain associated with cognition and those associated with emotion work in tandem to guide our choices. This was elegantly demonstrated by Antonio Damasio's lab when studying patients with focal brain lesions in areas that process emotional stimuli. Damasio and colleagues found that these patients consistently make poor choices and have trouble adapting their behaviors to changing conditions.[4]

Many moral decisions have both cognitive and emotional components, including market decisions. For example, if your paycheck this month had an extra $10,000, you would likely feel joy ("extra money!"), and then perhaps fear ("I know they'll find me!"), and then maybe a cost-benefit calculation ("if I cash the check and play dumb, I can always return the money if they find out"). This might be followed by an emotionally weighted decision ("I didn't work for this money so I'm getting this unfairly, and therefore I should return it"). Not all of us would go through all these stages, but this example is meant to show that emotions and higher cognition are integrated and evolved to help us solve complex problems, including moral dilemmas.

Research on Markets

I recently attended a conference at University of California, Los Angeles. While walking from the parking structure two counties away to the faculty club, I spoke to some undergraduates who had set up a table with a sign that read "Students for Marxism." They were apparently trying to recruit members. I asked them why Marxism was the best way to organize a society. They repeated the usual egalitarian rhetoric, but could not answer my questions about how to spur innovation, and why the Soviet Union and other communist states had spectacularly failed; their best answer was "U.S. world domination," but this itself suggests that a democratic market system is a superior organizational form.

Why market economies have produced astonishing increases in wealth while socialist dictatorships have had disastrous economic performances has been the topic of extensive research.[5] The short answer is simple—we are not bees. Bees toil for the good of the hive because of the high degree of genetic relatedness between members and the near equality of productive skills between members (there is a simple division of labor in beehives between queens, workers, and drones). Human beings, on the other hand, have substantial, often identifiable, genetic variation. Our biological inclination to protect and nurture those who share our genes means that we favor the success of our family members over those to whom we are more distantly related.

Human beings have a wide variety of skills that they can offer to various businesses or use to start their own enterprises. We counsel our youth to find their niche in life, and indeed that is key to economic success. A market system generates a large number of organizations that seek people to provide a variety of services to them. Organizational types range from traditional, profit-oriented businesses to nonprofits to government to public and private universities. This plethora of opportunities and (often) objective markers of individual and organizational success allow the diversity of individual skills to find a remunerative employment niche.

In market economies, this niche-seeking behavior occurs organically as individuals and firms engage in bilateral search. In socialist economies, the assignment of individuals to jobs was typically done using a top-down approach. I may be able to work as an accountant, but it is not my passion, and I will have little incentive to improve myself as an accountant other than earning a larger paycheck. In socialist countries, even the latter incentive was removed. Because of genetic heterogeneity, the claimed equal sharing of resources triggered a race-to-the-bottom in work effort—my genes are little, if at all, helped by extra effort, so why bother? The design of market economies, then, is congruent with our evolved genetic predispositions.

Another extraordinary and initially unexpected value of market economies is using the “wisdom of crowds.” A socialist planner needed to set the price of a loaf of bread, but the bread lines in the Soviet Union, East Germany, Cuba, North Korea, and so on, indicated that the price was often unable to satisfy the demand for bread. In market economies, thousands of individual bakeries and grocery stories set their own prices daily depending on market conditions. They have a powerful incentive to get prices right: too high and they will drive customers away, too low and they will lose money and their business will eventually fail. Individuals voting with their purses and wallets determine from whom they prefer to purchase bread, the kinds of bread they favor, and the preferred location and service. Even a large team of socialist planners could not match this minute-by-minute evolving wisdom when setting production goals and prices. Thus, seeking to safeguard our genes because of competition for profits leads to the broad satisfaction of others’ desires.

A fascinating example of market wisdom is reported in a recent paper by Michael T. Maloney and J. Harold Mulherin. They examined the impact of the tragic 1986 space shuttle *Challenger* explosion on the valuation of the four companies that were the major contractors for the National Aeronautics and Space Administration (NASA).[6] All four companies, Rockwell International, McDonnell Douglas, Morton Thiokol, and Martin Marietta, were publicly traded. All four refused to comment on the *Challenger* disaster the day it crashed eight minutes after take-off, killing seven crewmembers. After a nearly five-month investigation by a presidential commission, the culprit for the disaster was found to be an O-ring produced by Morton Thiokol. Astonishingly, this conclusion was already known *three hours* after the *Challenger* exploded. Morton Thiokol stock fell 12 percent, while the other companies’ stocks were off just 2.5 percent. Similar information revelation through individual choices in markets happens less dramatically every day. How this happens is not well understood, but investors have an incentive to use all available information and adapt to new circumstances as quickly as possible. This incentivized flexibility was, and is, completely absent in socialist economies.

In market economies, not only is exchange adaptation (varying prices and quantities bought and sold) important, but so is institutional flexibility (modifying the rules of exchange). Think of institutions as a bridge and exchange as cars driving over the bridge. Drivers adjust their speeds and lane choices to optimize the flow of cars over the bridge, and most drivers have an incentive to do so—time is limited, and, for most, driving is not a leisure activity. The bridge itself must also flex so that the pressure from the cars, wind, and other external forces do not cause it to rupture and collapse. Bridge design adheres to a "goldilocks principle": too much flexibility, as well as too little, can cause failure. In market economies, institutions that evolve have been shown to outperform those that do not. Flexible institutions are typically based on English common law: rules evolve case by case. Western inflexible institutions are based on the Napoleonic civil codes that fix violations and associated remedies.[7] A similar inflexibility cripples most Islamic economies.[8]

Finally, market exchange itself may lead to a society where individuals have stronger character values. The clearest evidence for this is the studies of fairness in small-scale societies conducted by Henrich and colleagues.[9] They showed that the likelihood of making fair offers to a stranger in one's society is more strongly predicted by the extent of trade in markets than any other factor they have found. Exchange is inherently other-regarding—both you and I must benefit if exchange is to occur. In this sense, exchange in markets is virtuous: one must consider not only one's own needs but also the needs of another.

Socialist economies, on the other hand, provide innumerable incentives to be non-virtuous. This lack of values is understandable when one seeks to survive, rather than thrive. Purges, gulags, and innumerable spies do not make a virtuous society. The feedback loops between social organization and behavior in markets is an issue that arises throughout this book.

The Reason for This Book

This volume is the culmination of more than two years of research by a transdisciplinary group of scholars, most of whom began the project with little knowledge of its subject. Although we believed that values might play an important role in supporting economic exchange, we did not know if this was supported by solid evidence or, in fact, what evidence to examine. We wondered if markets and market participants might be inherently immoral; we considered whether markets devalue human beings and degrade their dignity. Or, could the opposite be true?

This book calls into question the commonly held view that the economy is dominated by greed and selfishness. The cartoon of "greed is good" is nearly ubiquitous in Western countries, and often is even more strongly accepted in less developed nations. Yet, this pervasive belief is inconsistent with the scrutiny of scholars both ancient and modern. The desire to correct this misunderstanding of market exchange in a rigorous multidisciplinary way is the reason for this volume.

Those involved in this research program spent six working meetings together over two and a half years investigating moral markets. During the first several meetings, a common language and frames of analysis were developed so that philosophers could be understood by lawyers, and primatologists and economists could converse. Most of us were not even sure what values were, if anything. Normally academics refrain from admitting their own ignorance, but it was the very realization of not knowing that led us, with open minds, on an exploratory journey into morals and markets.

We came into this endeavor humbled by the breadth of the topic and sought to learn from one another. We began our first meetings by asking participants *not* to write anything—hard for academics! In our fourth meeting, participants wrote five to ten pages, a chapter draft by meeting 5, with revisions following. This approach produced a high degree of cross-fertilization across both individual contributors and fields. Each chapter evolved through the process of presentation, critique, and rewriting, which the book reflects: chapters extensively cross-reference findings in other chapters, as well as in the broader literature.

Contributors to this volume identify their affiliations as anthropology, biology, business, cognitive science, economics, law, neuroscience, philosophy, political science, and primatology, but this does not even touch upon the truly spectacular set of skills each contributor brought to this endeavor. Frans de Waal, a primatologist, has identified the sources of human compassion by studying our closest living ancestors. Peter Richerson, an anthropologist, uses evolutionary theory to understand how cultures change and transmit information over generations. The economist Robert Frank has pioneered the study of moral emotions when making economic decisions . . . and the list goes on.

Our explorations of moral markets also relied on experts who did not write chapters themselves but came to our meetings to inform those who did. Their influence is evident in many of the chapters, though their names do not always appear in the references. Our organizing principle was to attract the best people to the project, encourage them to talk to and learn from one another, identify new avenues for research, and provide them with an impetus to go down these paths.

Implications of Moral Markets

Our research revealed that most economic exchange, whether with strangers or known individuals, relies on character values such as honesty, trust, reliability, and fairness. Reliance on these values, we argue, arise in the normal course of human interactions, without overt enforcement—lawyers, judges, or the police are present in a paucity of economic transactions. Indeed, we show that legal regulations may perversely lead to an increase in immoral behaviors by crowding out our innate sense of fair play. Nevertheless, cheating does occur, and the institutional rules of exchange and their enforcement are a critical reinforcement of values. Civil laws can be understood, a fortiori, as an institutionalized approach to punish immoral behaviors in markets. Why, for example, as a society, do we spend millions of dollars to prosecute minor economic violations and punish the convicted with incarceration? Economic efficiency would argue for a simple payment to the aggrieved party, but such fines do not assuage our desire to punish moral violators.

We discovered that the very freedom to exchange in markets celebrates individual dignity and choice but also allows for transgressions. The exceptional increases in wealth in many areas of the world during the last two hundred years would not have been possible without the specialization of tasks and economies of scale. Yet, along with specialization came the decline of the sole proprietor craftsman and self-directed economic life. Although loss of autonomy is associated with increased wages, it has created a conflict in our economic lives. The burgeoning number of entrepreneurs, who often take pay cuts and bear large risks to start their own businesses, is evidence that autonomy itself is valued. There may be a middle ground, however, as my late colleague, Peter Drucker, has argued. Granting autonomy to employees within a business organization not only recognizes and restores the human need for self-direction but can also raise productivity. Yet, permitting employee autonomy runs counter to the standard principal-agent model of business organization, where unmonitored employees are assumed to shirk. This book seeks to reconcile these views.

Markets are moral in two senses. Moral behavior is necessary for exchange in moderately regulated markets, for example, to reduce cheating without exorbitant transactions costs. Market exchange itself can also lead to an understanding of fair exchange and in this way build social capital in non-market settings. Research has shown that the values that create social capital are a potent stimulus for economic development.[10] As a result, understanding moral markets is especially important in less developed countries. Nations from Iraq and Afghanistan to Mozambique and Tanzania are presently concentrating on developing their economies. For them, getting beyond the cartoon of evil capitalism is critical. Tanzanian capitalism needs to reflect the values of Tanzanian society. Nevertheless, as this book illustrates, many values are universally shared and it is these values that lead to moral markets.

Overview of the Book

The five sections of this book provide units of related thought, flowing from the most fundamental organizing principles to current implications of moral markets. We begin with the philosophical basis for establishing what values are and how they affect our behavior. Next, we offer evidence for the presence of values among our ancestors, and describe how values and societies coevolved. We then examine how values influence and are influenced by laws. Finally, we conclude by examining insights presented throughout the volume to illuminate how values directly underpin economic exchange and business practices. Readers may choose, of course, to read the book in a different order. Indeed, each chapter draws on findings in other chapters so eclectic readers, after choosing their own starting point, are given a roadmap suggesting how one might proceed after reading a single chapter.

Part 1, "The Philosophical Foundations of Values," contains the first three chapters. Chapter 1, "The Stories Markets Tell" by William D. Casebeer, analyzes why market exchange has gotten a bad rap. Casebeer's conclusion is that it sells; simply put, it is more compelling to tell a tale of bad market behavior than the quotidian normalcy of purchase and delivery. Using the Aristotelian model of ethos, logos, and pathos, he shows why stories of abominable market behaviors persist, and then argues, using a virtue-theoretic lens, that participation in markets per se can promote moral development.

In chapter 2, "Free Enterprise, Sympathy, and Virtue," Robert C. Solomon identifies a person's virtues as essential to a good life, which follows from Aristotelian philosophy. Solomon argues that the inherent value of a virtuous life extends directly to ethical behavior in our business lives. The causal mechanism producing virtuous behavior, according to Adam Smith, is that we feel sympathy for our fellow human beings. This often leads us to behave in socially responsible ways.

Robert H. Frank contends in chapter 3, "The Status of Moral Emotions in Consequentialist Moral Reasoning," that our moral intuitions are valuable guides to behavior, even when they lead to suboptimal outcomes. These intuitions often draw upon the emotion felt when observing (or imagining) a particular behavior. Moral emotions, Frank proposes, are commitment devices that keep us from breaking our word. We are endowed with these moral emotions because we are social creatures, dependent on others for survival.

Part 2, "Non-human Origins of Values," which includes chapters 4 and 5, deepens the foundation of how values affect exchange by studying the behavior of nonhuman primates. In chapter 4, "How Selfish an Animal?" Frans B. M. de Waal presents evidence showing that various nonhuman species behave altruistically (incurring a cost to help another), even without the cognitive machinery to fully understand the consequences of their actions. De Waal uses this framework to discuss how his studies of monkeys and apes reveal their strategies to enforce fairness and punish free riders. Based on this evidence, he proposes that the motivation in humans to cooperate is ancient and therefore deeply embedded in human nature.

Sarah F. Brosnan's contribution, "Fairness and Other-Regarding Preferences in Non-Human Primates," chapter 5, examines several types of altruistic behaviors in our closest nonhuman relatives. She begins with an evolutionary analysis of behavior in which altruism was valuable in a number of environments. The circumstances of the social interaction, Brosnan argues, are essential to understanding altruistic behaviors. Nonhuman primates have a wide range of contingent behaviors that lead to nuanced responses to requests for, and violations of, cooperation. For example, the gender and rank of the animals matter. Brosnan concludes that these evolutionary roots provide the basis for the human psychology of cooperative exchange in markets.

Part 3, "The Evolution of Values and Society," which includes chapters 6 and 7, examines how values filter through, and change, societies. In chapter 6, "The Evolution of Free-Enterprise Values," Peter J. Richerson and Robert Boyd provide evidence that market exchange systems co-evolved with the values of reciprocation and honesty. They examine why it took biologically modern humans around forty thousand years to establish systems of market exchange. More succinctly, the authors examine the evolution of social institutions governing interpersonal trade. They contend that shared values, which they call the "moral hidden hand," are essential to understand the evolution of market institutions.

In chapter 7, "Building Trust by Wasting Time," Carl Bergstrom, Ben Kerr, and Michael Lachmann take a different approach from that of Richerson and Boyd and build a model showing that markets may create the values that allow them to function effectively. Their model shows that market exchange can generate other-regarding preferences from purely self-interested individuals by altering the institutions of exchange. Their model shows that "wasting time" is a commitment device in building a relationship with a trading partner by reducing the payoff from exploitation. Although Bergstrom and collaborators do not address proximate mechanisms, Robert Frank's discussion of moral emotions facilitating commitment in chapter 3 nicely complements this chapter's results.

Part 4, "Values, Law, and Public Policy," which includes chapters 8 to 11, examines the design of moral markets in modern societies. The authors of these chapters show that formal institutions governing exchange in the United States were intended to be value-free, even though the previous chapters have shown that the institutions of exchange depend critically on values. Lynn A. Stout's contribution in chapter 8, "Why We Overlook Conscience," analyzes why the legal academy (following economics) has taught students that people are narrowly self-interested maximizers. She argues that this is partly owing to the ordinariness of other-regarding behaviors, similar to

Casebeer's analysis in chapter 1. Stout provides six reasons why we overlook conscience as a source of moral guidance. She concludes that many laws seek to promote unselfish behaviors, and the law's ignorance of the role of conscience makes it less effective than it could be. Specifically, laws that permit the exercise of moral emotions such as shame may be more effective than explicitly amoral laws.

Erin O'Hara's contribution in chapter 9, "Trustworthiness and Contract," examines the role of good behavior in contract law. Her primary finding is that the threat of paying direct damages to a breach of contract reduces violations and therefore motivates trustworthiness, though imperfectly. Further, O'Hara suggests that penalty damages do not lead to sufficient trustworthiness because of the low likelihood of their imposition. She concludes that the flexibility of American contract law leads to near-optimal levels of contract fulfillment.

In chapter 10, David Schwab and Elinor Ostrom examine the role of values in the design and implementation of public policy. Their chapter, "The Vital Role of Norms and Rules in Maintaining Open Public and Private Economies," examines the role of institutions in providing information about one's reputation for trustworthiness. Institutions can do this effectively by marshaling economies of scale, making reputational information available at a low cost. An example is credit-reporting agencies. Schwab and Ostrom then analyze how institutions can be made immune to manipulation by political actors.

Chapter 11, "Values, Mechanism Design, and Fairness" by Oliver Goodenough, examines whether a value for fairness can be embedded in economic transactions. He concludes that it can, and often is, through the laws governing exchange. Laws provide a method to resolve welfare losses that may occur without fairness, something lacking, for example, in prisoner's dilemma games. He provides additional evidence that fairness reduces conflict and transactions costs and thus promotes social welfare and enhanced living standards. I offer a similar conclusion on economic regulation in chapter 12.

Part 5, "Values and the Economy," which includes the final chapters 12 to 15, directly analyzes the impact of values on personal and impersonal exchange, as well as on business organization. In chapter 12, "Value and Values: Moral Economics," I ask why corporate scandals such as Enron occur if values are essential in proscribing behaviors. I argue that the particular corporate culture and likely physiologic state of employees conspired to overcome their innate sense of moral values, and then use this example to analyze the neurophysiology of moral sentiments. I then distinguish environments likely to promote or inhibit the activation of the neural mechanisms supporting moral decisions. This chapter focuses on the role of the neuroactive peptide oxytocin in guiding moral decisions in markets by inducing a sense of empathy for others—a proximate mechanism supporting Adam Smith's intuition. As discussed in chapters 9 and 10, institutions play an important role in creating environments where values can flourish.

Chapter 13, "Building a Market: From Personal to Impersonal Exchange" by Erik Kimbrough, Vernon L Smith, and Bart J. Wilson, presents the results of a fascinating experiment on endogenous market formation. Kimbrough and colleagues set up a laboratory environment where one can earn money by selling what one produces and purchasing what others make. But, at what price, do market participants exchange? And what are the rules of exchange? Their report of the conversations about rules between participants insightful and often funny. For example, two trading partners exchange this message through a computer-mediated chat room when seeking to consummate another trade: "when i [*sic*] eat everyone eat." The authors find that subjects quickly work out the rules of exchange and find a trading partner. In large groups, however, nearly all exchange is bilateral, that is, it is personal. The move to impersonal exchange appears to require the imposition of formal institutions.

Chapter 14, "Corporate Honesty and Business Education," by Herbert Gintis and Rakesh Khurana, asks, as does Lynn Stout in chapter 8, whether moral violations in markets are exacerbated by the way business schools teach. The authors document the pervasive use in business education of "agency theory" and its underlying assumption that market participants are greedy and narrowly self-interested. Yet, this runs counter to most findings by psychologists and behavioral economists, as well as by casual observation. Gintis and Khurana propose a modification of the standard economic model to include character virtues. They also advocate teaching students this more accurate model as well as building a virtuous business community to re-professionalize business education.

The book concludes with a provocative essay by Charles Handy, "What's a Business For?" Like Gintis and Khurana in the preceding chapter, Handy criticizes an overemphasis on share price as the metric for corporate success. He proposes that the purpose of a business "is not to make a profit, full stop" but rather to produce a profit so that people who work for the business can do what pleases them, support their families, and sustain relationships with others. Handy argues that companies should be managed as communities of employees organized to serve communities of customers. By doing so, and using moral values, the system will retain internal and external integrity.

Just as most human beings have an intact and active moral compass, so, too, does economic exchange, the child of human minds, have a vigorous moral dimension. Markets may, in fact, promote and deepen our moral sense of honesty, trust, fairness, and reciprocity. The American patriot, and president, Thomas Jefferson, in 1814, eloquently captured the essence of the argument that we are social creatures and most consider the rights and feelings of others:

> These good acts give pleasure, but how happens it that they give us pleasure? Because nature hath implanted in our breasts a love of others, a sense of duty to them, a moral instinct, in short, which prompts us irresistibly to feel and to succor their distresses.

The standard model of *Homo economicus*, although a useful approximation, is ill designed to understand the subtleties of market exchange. The contributors to this volume, like Jefferson himself, seek to engage in "hostility against every form of tyranny over the mind of man." Our collective view is that the characterization of market actors as greedy and selfish is farcical and egregiously needs to be remedied by the verity of moral markets. By weaving a vibrant analytical tapestry designed around moral values and markets, we hope to demonstrate both the source and powerful impact of moral markets.

Notes

1. Good general audience books include, for example, Marc Hauser, *Moral Minds: How Nature Designed Our Universal Sense of Right and Wrong* (New York: Ecco/HarperCollins, 2006); Matt Ridley *The Origins of Virtue* (London: Viking, 1996); and Michael Shermer *The Science of Good and Evil: Why People Cheat, Gossip, Care, Share, and Follow the Golden Rule* (New York: Holt, 2004).

2. See, for example, Jonathan Haidt, *The Happiness Hypothesis: Finding Ancient Truth in Modern Wisdom* (New York: Basic Books, 2006).

3. For a broad survey of the findings in neuroethics, see the books cited in notes 1 and 2 above, as well as Joshua Greene and Jonathan Haidt, "How (and Where) Does Moral Judgment Work?" *Trends in Cognitive Science* 6 (2002): 517–523; and William D. Casebeer, "Moral Cognition and Its Neural Constituents," *Nature Reviews Neuroscience* 4 (2003): 840–847.

4. Antonio R. Damasio, *Descartes' Error: Emotion, Reason, and the Human Brain* (New York: Grosset/Putnam, 1994).

5. See, for example, David S. Landes, *The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor* (New York: Norton, 1998).

6. Michael T. Maloney and J. Harold Mulherin, "The Complexity of Price Discovery in an Efficient Market: The Stock Market Reaction to the Challenger Crash," *Journal of Corporate Finance* 9, no. 4 (2003): 453–479.

7. See Paul G. Mahoney "The Common Law and Economic Growth: Hayek Might be Right," *Journal of Legal Studies* 30, no. 2 (2001): 503–525.

8. See Timur Kuran, *Islam and Mammon: The Economic Predicaments of Islamism*, Princeton, N.J.: Princeton University Press, 2004).

9. J. Henrich et al., *Foundations of Human Sociality; Economic Experiments and Ethnographic Evidence from Fifteen Small-Scale Societies* (Oxford: Oxford University Press, 2004).

10. See Paul J. Zak and Stephen Knack, "Trust and Growth," *The Economic Journal* 111 (2001): 295–321.