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The Profit Motive

by Amartya Sen

In an important and influential paper called 'The Results of Human Action but not of Human Design,' Friedrich von Hayek has noted the limitations of those theories — economic, political, legal or whatever — that have 'no room for anything which is "the result of human action but not of human design".'[1] In this context, Hayek pays particular attention to the achievements of self-seeking and profit maximization — producing public good through private motivation — and argues against the alleged virtues of 'deliberate design and planning'. He complains, with justice, about the 'the uncomprehending ridicule' later poured on Adam Smith's 'expression of the "invisible hand" by which "man is led to promote an end which was no part of his intention" ', and the consequent undermining of what Hayek calls 'this profound insight into the object of all social theory'.

However, all's well that ends well, and Hayek notes that the basic idea — revived by Carl Menger — 'now . . . seems to have become widely accepted, at least within the field of social theory proper' (pp 99-100). Certainly Adam Smith's version of it is now part of the standard tradition of economics. The professional economist is, by and large, much taken by the notion of private motivation achieving public good through the intermediary of the market mechanism. The results of two recent surveys of views of professional economists in the UK and the USA, analysed respectively by Samuel Brittan,[2] and Kearl, Pope, Whiting and Wimmer,[3] bring out the point forcefully.

In the British survey, it is in fact also possible to compare the response of professional economists with those of members of Parliament. It is interesting to note

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[1] F A Hayek, *Studies in Philosophy, Politics, and Economics* (Chicago: University of Chicago Press, 1967), pp 96-105.

[2] Samuel Brittan, *Is There an Economic Consensus? An Attitude Survey* (London: Macmillan, 1973).

[3] J Kearl, C Pope, G Whiting and L Wimmer, 'A Confusion of Economists?', *American Economic Review Proceedings*, 69 (1979).

that a very much higher percentage of professional economists than members of Parliament accepted the claim that 'in a free-enterprise economy, the presumed harmony between individual and public interest' is brought about by 'competitive markets and pursuit of self-interest by individuals' and/or 'a strong desire for profit maximization'. It is perhaps more interesting to observe that while 79 per cent of professional economists accepted this claim, the proportion of even *Conservative* MPs, not to mention the others, agreeing with that view was 20 per cent less than that figure, with a sizeable minority emphasizing the role of 'careful planning and coordination' and 'the exercise of social responsibility by private businessmen'.

Also rather interestingly, among the economists, the business economists were relatively the most sceptical of the claim. While 62 per cent of the business economists gave answers pinpointing markets, self-interest and profits, the proportions for academic economists and government economists were 82 per cent and 87 per cent respectively. The economists furthest from business had, it appears, the greatest respect for its ability to turn the pursuit of self-interest into a harmonious pursuance of public interest. Indeed, the academic economists who had devised the questionnaire had ticked the answer that the presumed harmony is brought about by 'competitive markets and pursuit of self-interest by individuals' as the 'correct' answer. One has to look only at standard textbooks to see the extent to which belief in that 'presumed harmony' and in that view of the correct answer is part of the basic training of the modern economist.

In this lecture I would like to re-examine the role of markets and self-seeking behaviour in achieving economic success. I would argue that the standard approach takes a remarkably limited view of the nature of the economic problem and of the tasks that an economy has to perform.

I am aware that there is a danger that the examination of private motivation and public interest may look like an annual event associated with the name of Fred Hirsch. Professor Frank Hahn gave the third Fred Hirsch Memorial Lecture last year on the subject of 'Reflections on the Invisible Hand',[1] and he discussed with his characteristic clarity and elegance the economic theory of markets, and what self-seeking may or may not do in economic allocation. I am not daunted by the danger of asking much the same questions again, since the questions are important and also because I shall argue for a somewhat different reading of both the contents of the questions and, naturally, the answers that they call for. Also, I believe, it is not inappropriate to pay particular attention to the roles of self-interest and the invisible

[1] F Hahn, 'Reflections on the Invisible Hand,' *Lloyds Bank Review*, No 144 (April 1982).

hand in a Fred Hirsch Memorial Lecture, since Fred Hirsch himself has done such outstanding work in this area. His *Social Limits to Growth*[1] presents some of the most interesting and far-reaching arguments on this issue.

Intentions and Results

The Hayekian claim regarding the profundity of the insight provided by the perspective of 'the results of human action but not of human design' seems to me to be difficult to sustain. That actions often have results different from and quite the opposite of their intended effects can, of course, be a matter of some significance. This possibility has been investigated in many different ways in social theory, one example being the Marxian study of dialectics, including the well-known argument that the actions of capitalists have the effect of ultimately destroying the system. Hayek himself has given several good examples of *contrariness* between design and outcome. It is, however, important to distinguish between those results of an action that are just not part of the design and those that are *opposite* to what was designed.

It is, I fear, a rather *un*profound thought to recognise that any action has many results that were not part of the design of the agent. This cannot but be the case. I cross the street at the pedestrian crossing, and this action has many results. First, I am now on the other side of the street, as indeed I intended to be. Second, you saw me crossing the street. Normally I would not give a damn whether you did or not, and almost certainly I did not have that vision of yours as part of my design. Third, I delayed a passing car slightly, which was not a part of my design. Fourth, the driver gets home slightly later; that was not my design. Fifth, the driver's delayed arrival makes the actions at his home slightly different in timing and possibly even in content. These things did not figure in my choice. If this discourse is generating boredom, then I have succeeded in making my point. The recognition that many results of our actions are not reflections of our design can, in itself, scarcely be one of great profundity.

It would be, of course, quite a different matter if the interesting results happened to be the *opposite* of what we intended. But it is important to recognize that this is not the case with the invisible hand, by which — in Adam Smith's words — 'man is led to promote an end which was no part of his intention'. It is certainly the case, as Adam Smith made clear, that 'it is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own

[1] F Hirsch, *Social Limits to Growth* (London: Routledge and Kegan Paul, 1977).

interest'.[1] But the butcher, the brewer and the baker did not have a design that we should starve — a design that got frustrated by their pursuit of it. The butcher *et al* wanted to make money and so indeed they did. We intended to have dinner, as indeed we did. There is nothing startling or deeply illuminating in the recognition that not *all* the results were part of the design of *every* agent.

Congruence and Conflicts

The reason why this point is important is that the Smithian argument partly rests precisely on the ability of the market to *achieve* the results intended by individuals, ie, to fulfil the 'designs' of the participants — and *then* some more. I want bread and will happily give some money for it, and the baker wants money and will give me a loaf of bread in exchange. When we carry out the exchange, we do achieve what we set out to achieve, and in the process we have helped each other. In more complex cases too — with many agents and with production in addition to trade — the market works on the basis of congruence of interests of different participants. That is the essence of the Smithian perspective: different people have a common interest in exchange and the market gives them the opportunity to pursue their common interests — with success, *not* failure. Of course, they also have conflicting interests in many other matters, but the market is not concerned with resolving these conflicts.

It is precisely because the market equilibrium is partly what the agents designed to achieve that it has the various efficiency properties that fill up the text-books on market achievements. The market, on that analysis, turns out to be quite a good way of having results of human action that are *also* of human design. Given certain assumptions — especially the absence of interdependences working outside the market (the so-called 'externalities') — every competitive equilibrium is Pareto optimal, which means that no one can be made better off without making someone else worse off. Also, under certain — rather more stringent — assumptions (especially the absence of economies of large scale in addition to the absence of externalities), the converse is true. That is, every Pareto optimal state of affairs can be reached through some competitive market equilibrium corresponding to some initial distribution of 'endowments' or resources owned.

The latter result — the 'converse theorem' — has been thought to be a great result in favour of the market mechanism, and so in some ways it is. If Pareto optimality is taken to be a necessary even though not a sufficient condition for overall optimality, then the fact that every Pareto optimal outcome can be reached through the market mechanism does imply that — given the right initial conditions — the market mechanism can be used to reach even the very best social state.

However, three notes of caution should be introduced here. The first is the obvious one that the assumptions (such as no externality and no economy of large scale) are terribly demanding and will be often violated.

Second, while the 'converse theorem' is a tribute to the market mechanism, it is not a tribute to the invisible hand, ie, to the market unassisted by political intervention. The initial distribution of resources has to be got right, and this of course does involve a political process, indeed — quite possibly — a totally revolutionary one requiring a thorough redistribution of the ownership of means of production, depending on the particular Pareto optimal outcome that is identified as socially best. The contrast between capitalism and socialism is not the same as that between market and non-market allocation. Indeed, many of the main results in the theory of resource allocation involving the market mechanism were first investigated and established by economists looking for socialist allocation procedures — Oscar Lange and Abba Lerner being two of the greatest of this class.

Third, while the result in question is a tribute to the market mechanism, it suggests the need to go beyond the market mechanism to get the information that would be needed to decide how best to distribute the resources initially. Under the market mechanism, given the right initial distribution and right prices, people may have the incentive to take the right decisions about production, consumption, etc. But they don't have a similar incentive to reveal information about themselves that makes decisions regarding the initial distribution of resources possible. Disclosures about productive abilities, tastes, etc, can go against one's own interests in the determination of the initial distribution of resources, eg, confession of higher ability or lower needs may have the effect of one's getting a lower share of non-labour resources in the initial split up. There have been some suggestions about how to deal with this problem, but none really promises easy success.

Thus, the 'converse theorem' may, in fact, turn out to be of rather less practical interest than the first theorem, which simply asserts that under the specified conditions, no matter what initial distribution of resources we begin from, the outcome will be Pareto optimal. Of course, as already mentioned, even in getting this result there are formidable difficulties since the assumptions needed are by no means easily fulfilled.

[1] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776, Book I, Chapter II; Everyman's Library (London: Dent, 1910), vol 1, p 13.

In discussing this question — the relevance of the first theorem — it is also worth bearing in mind that while Pareto optimality is some achievement, it is not in itself a grand prize. All that Pareto optimality implies is that there is no other feasible alternative that is better for everyone without exception, or better for some and no worse for anyone. A state in which some people are starving and suffering from acute deprivation while others are tasting the good life can still be Pareto optimal if the poor cannot be made better off without cutting into the pleasures of the rich — no matter by how small an amount. Pareto optimality is faint praise indeed.

In most economic problems the interests of the different people involved are partly congruent, partly conflicting. The market mechanism on its own confines its attention only to issues of congruence, leaving the interest conflicts unaddressed. It could, of course, turn out that the process of meeting the congruent interests itself might have the effect of reducing disparities and inequalities. For example, it has been argued that market-based economic growth of the type seen in the newly industrializing economies such as South Korea, Hong Kong, Taiwan and Singapore tends to be particularly beneficial to the poor — the potentially unwaged and unemployed. I shall presently have more to say on possible pitfalls in reading the experiences of these newly industrializing countries, but I don't doubt that there must be many examples all over the world in which market-based pursuit of congruent interests has also reduced disparities. But there are also many examples in which precisely the opposite has happened. To take just one set of cases, there is strong evidence that the poor have shared relatively little in the fast economic growth in Latin America, and the congruent interests have been pursued in a way that has made the conflicts more sharp and violent.

Embedded in most problems of congruence is a problem of conflict, since the congruent interests can be pursued in many different ways with very different divisions of joint benefits. Both you and I may benefit from having some deal rather than none, and each may prefer having either of the deals, A and B, to no deal at all, but A may be better than B for you and B better than A for me. In the choice of *either* deal over *none*, our interests are congruent. In the choice *between* deals, they conflict. The situation in game-theoretic terms is one that J F Nash, the mathematician, has called a 'bargaining problem'.[1]

The market mechanism with each person pursuing his self-interest is geared to making sure that the congruent interests are exploited, but it does not offer a mechanism for harmonious or fair resolution of the problem of conflict that is

[1] J F Nash, 'The Bargaining Problem,' *Econometrica*, 18 (1950).

inoperably embedded in the congruent exercise. The 'presumed harmony' referred to in the questionnaire discussed earlier, stands for, at best, a half-truth. The market division of benefits tends to reflect, roughly speaking, the economic 'power balance' of different individuals and groups — an idea that has been formalized in terms of the concept of the 'core'.[1]

Positional Goods and Public Interest

One of the remarkable achievements of Fred Hirsch's analysis of 'social limits to growth' is the weaving together of the different types of failures that the market mechanism produces and to get from it an understanding of the malaise and the preoccupations of modern Western society. I shall not try to summarise that analysis, but I will comment on two particular points of immediate relevance to my discussion. Hirsch's concept of 'positional goods' helps us to understand why the elements of conflict have tended to acquire a new importance in the modern world. Many sources of enjoyment depend on the relative position of a person vis-a-vis others, eg, a person holding an eminent position in a job hierarchy, or — to take a different type of example — having access to an uncrowded beach. It is not possible to increase the supply of these positional goods, and one's ability to enjoy these goods depends on being ahead of others.

The increasing importance of positional goods has two important — and rather distinct — aspects. First, in case of any given positional good, there is no congruence of interest, since the total supply is fixed. In 'positional competition,' as Hirsch explains, 'what winners win, losers lose' (*op cit* p 52). There is little scope for the market to enhance 'efficiency' through expanding the availability of positional goods.

However, this should not be taken to imply that the market cannot improve the well-being of all individuals in positional exchange, if exchange of different positional goods were possible. Indeed, the standard model of 'general equilibrium of exchange' also has the feature of having fixed total supply of goods. One positional good can be fruitfully exchanged for another *if* such exchanges were possible. This is where the second feature comes in. Most positional goods are not marketed and many of them are non-marketable. Thus the scope for mutually beneficial exchange of positional goods among the individuals happens to be severely limited. These two features together make the conflict elements dominate in the allocation of many of the

[1] See K J Arrow and F Hahn, *General Competitive Analysis* (San Francisco: Holden Day, 1971: reprinted by North-Holland).

positional goods, and make the congruent elements rather rare and difficult to exploit through the market mechanism.

Hirsch has pointed out that with material progress the pressure on positional goods has increased sharply. The fixity of total supply has made positional goods relatively scarce as the supplies of other goods have expanded. This has had the effect of making the market mechanism that much less adequate for the modern society.

Another force in the direction of making markets less adequate is the increasing importance of public goods — goods for which one person's consumption does not conflict with that of another. You and I may both benefit from a clean city centre, or a better television programme, without interfering with each other's consumption. Public goods involve strong congruence of interests, and as such it might be thought that the market mechanism should be able to deal with it very well. But in fact it cannot, since the market operates by insisting on a price to be paid for *possessing* a good, whereas in the case of public goods like enjoying a clean city centre or a good TV programme, such a pricing arrangement is not easy to devise. The market is good at taking care of issues of congruence of a special type only. It cannot handle well issues of conflict (including that involved in positional goods); nor issues of congruence in which the good in question is not individually possessed (as in the case of public goods).

The failure of the market mechanism based on the profit motive to deal with public goods is a specific example of its failure to deal with interdependences that work outside the price system. These problems have received a great deal of attention in the literature and the underlying analytical issues have been illustrated by games such as the Prisoner's Dilemma. There are various different ways of responding to this type of difficulty. One way is to use state intervention and the public sector. Indeed, the enormous growth of the public sector in the recent years has not a little to do with this issue. Hirsch analyses this trend, but goes on to discuss another route, to wit, changing the behaviour norms, including the eschewal of the profit motive (*op cit* p 146).

Motives and Outcomes

The rationale of Hirsch's suggestion regarding behavioural reorientation lies in the argument that self-interested behaviour may be collectively self-defeating. The

Prisoner's Dilemma illustrates the problem very clearly.[1] Given the actions of others, it is in the interest of everyone to pursue self-interest directly, and each has a dominant strategy. But, for everyone it would have been better if they all had pursued some other, not directly self-interest-oriented, strategy. I shall have more to say on this presently, but before that a more elementary type of failure is worth discussing.

It is possible for the active pursuit of self-interest to be not only collectively self-defeating but also individually self-defeating. Even without any interpersonal interdependence of the kind referred to earlier, aiming directly at self-interest may be bad for achieving it.

Henry Sidgwick — that great utilitarian philosopher and economist — has pointed out that trying actively to maximise personal happiness may have the effect of producing a disposition that makes happiness difficult to achieve. Hayek's 'results of human action but not of human design' takes, incidentally, a rather serious form here. The question of choosing between dispositions has figured importantly in the writings of such philosophers as Richard Hare, Robert Adams, and Jon Elster. Having a roving eye for the quick 'utile' might well be disastrous for achieving happiness.

The cultivation of achievement-oriented motivation in the modern society can indeed produce psychological and social barriers to personal happiness. Motivational uptightness can be a serious impediment to enjoying life. The activist who, to vary a famous Presidential description, can chew gum *only when* he is crossing the street, certainly has some problems. So has the person who relentlessly pursues positional success.

The agony of the maximizer may be less known to the economist than to the novelist, but it is no less important for that reason. Indeed, the neglect of serious psychological issues in traditional economics is truly remarkable, and it is only recently that this lacuna has begun to get some response in the writings of — in addition to

[1] See my 'Behaviour and the Concept of Preference,' *Economica*, 40 (1973), reprinted in my *Choice, Welfare and Measurement* (Oxford: Basil Blackwell, 1982), and Derek Parfit, 'Prudence Morality, and the Prisoner's Dilemma,' *Proceedings of the British Academy for 1979* (London: Oxford University Press, 1981).

Fred Hirsch — Albert Hirschman, Janos Kornai, Tibor Scitovsky, Harvey Leibenstein, Thomas Schelling, George Akerlof and William Dickens, and others.[1]

Procedural Assessment

I have so far been proceeding on the implicit understanding that the market mechanism has to be assessed in terms of its results. That implicit assumption has been shared by economists of very different schools of thought — from Milton Friedman to John Kenneth Galbraith. The differences between the schools on this issue have centred on the question as to what results the profit motive and the market mechanism, do *in fact*, have. There is, however, a well-developed philosophical approach in social theory arguing against end-state judgments. For example, Robert Nozick in his influential and important book, *Anarchy, State and Utopia*,[2] has argued in favour of downgrading consequence-based evaluation into a minor secondary position compared with the imperative of the right procedural rules. Nozick has seen a collection of rights, including that of ownership, and transfer, as central. Individuals have these rights and 'there are things no person or group may do to them'. Since the rights of ownership and transfer include exchange, markets are, in this view, justified by antecedent rights rather than by consequent outcomes. Nozick points to (what he calls) 'invisible-hand explanations' of the emergence of social institutions (such as markets), citing Adam Smith (*op cit* p 18), but there is no assessment of such institutions in terms of the goodness of interest-fulfilling outcomes. If this view is accepted, then the focus of traditional discussion of the merits and demerits of the market is quite misplaced, since the right to exchange exists no matter what the consequences of such market operations happen to be. The focus is on 'entitlements', not on results.

This approach involves a major philosophical departure and *inter alia* it rejects seeing markets in the way economists have typically done, ie, in terms of what

[1] A O Hirschman, *Exit, Voice, and Loyalty* (Cambridge, Mass: Harvard University Press, 1970), and *Shifting Involvements: Private and Public Action* (Princeton: Princeton University Press, 1982); J Kornai, *Anti-Equilibrium* (Amsterdam: North-Holland, 1971); T Scitovsky, *The Joyless Economy* (Oxford: Oxford University Press, 1976); Harvey Leibenstein, *Beyond Economic Man: A New Foundation for Microeconomics* (Cambridge, Mass: Harvard University Press, 1976); Thomas Schelling, *Micromotives and Macrobehaviour* (New York: Norton, 1978); George Akerlof and William T Dickens, 'The Economic Consequences of Cognitive Dissonance,' *American Economic Review*, 72 (1982); Howard Margolis, *Selfishness, Altruism and Rationality* (Cambridge: Cambridge University Press, 1982). See also the important critique of Robert Solow in his AEA Presidential Address, 'On Theories of Unemployment,' *American Economic Review*, 70 (1980). For some sceptical notes by one of the founders, see John Hicks, 'The Measurement of Real Income,' *Oxford Economic Papers*, 10 (1958), reprinted in his *Wealth and Welfare* (Oxford: Blackwell, 1981), pp 148-150.

[2] R Nozick, *Anarchy, State and Utopia* (New York: Basic Books, 1974).

markets do to people's interests (rather than how people's rights require markets). I believe these procedural issues deserve a great deal more attention than economists have been inclined to give them, and Nozick's analysis represents just one example of non-consequentialist moral reasoning which is potentially of much relevance to welfare economics.[1] While I shall not pursue this complex philosophical question here, which I have tried to do elsewhere,[2] I should make two quick remarks on this approach specifically related to the main enquiry.

First, the justification of markets in terms of rights of ownership and transfer is independent of the exact nature of human motivation in a way that a consequence-based assessment of markets cannot be. What guides people in undertaking exchange in the market matters not at all in justifying the markets, since it is their privilege to be guided by whatever they like irrespective of consequences. Thus, while the Nozickian approach is pro-market, it need not be pro-profit-motive in any sense. People are free to pursue profits if they so choose, but they need not, and Nozick gives some good reasons as to why they may choose not to.[3]

Second, any consequence-independent justification suffers from the possibility that the consequences may be so disastrous that the entire approach may look altogether unplausible. Nozick does not deal with this issue at all adequately, and states that 'the question of whether these side constraints reflecting rights are absolute, or whether they may be violated in order to avoid catastrophic moral horror, and if the latter, what the resulting structure might look like, is one I hope largely to avoid' (p 30). But this is a serious issue to leave open, since permitting violation of allegedly consequence-independent rights is the thin end of the wedge. Once consequence-based arguments are accepted as relevant, then it is not clear what obvious stopping place there is for a theory that was set up on a purely procedural approach.

Consequences, Disasters and Achievements

Terrible consequences emerging from the exercise of rights in market situations are not only imaginable in theory, they are also observable in the real world. In my book *Poverty and Famines: An Essay on Entitlement and Deprivation*,[4] I have presented evidence to indicate that many famines — even very big ones — have taken place in

[1] See A Sen and B Williams, eds, *Utilitarianism and beyond* (Cambridge: Cambridge University Press, 1982).

[2] Especially in 'Rights and Agency,' *Philosophy and Public Affairs*, 11 (1982), and 'Liberty and Social Choice,' *Journal of Philosophy*, 80 (1983).

[3] Nozick, Chapter 8.

[4] Oxford: Clarendon Press, and New York: OUP, 1981.

the recent past with no over-all decline of food availability, and millions have died because of being deprived of food in terms of market command, reflecting sharp failures of entitlement. There is something deeply unplausible about asserting that justification of rules of ownership, exchange and market operations can be really consequence-independent, and in this case unaffected by matters of life and death.

It is, of course, true that such terrible consequences have not occurred in the richer market-based economies of the West. People do not go begging for food in the countries that are now called, merciless to geography, the North. But this is not the result of any guarantee that the market or profit maximization has provided, but rather due to the social security that the state has offered. With the magnitude of unemployment being what it is today in Western Europe or North America, the 'entitlements' of many millions of people in the moral system based on ownership have amounted to being next to nothing. The reason why these countries have not been visited by disaster is precisely the existence of systematic transfers through the state of the kind that the mortal entitlement theory does so much to reject.

I should not, however, concentrate my attention only on the failures of the market system and must look also at the achievements. Indeed, the last few decades have also been seen as years of great cheer for the market mechanism. Until fairly recently the richer market economies have grown very fast in economic terms. While over the last two decades the growth rate of gross national product per capita in the 'industrial market economies' (3.6 per cent over 1960-80), has been a little lower than that of 'nonmarket industrial economies', ie, the richer communist countries (4.2 per cent),[1] the world record of fast growth among all the richer countries — market and nonmarket — is held by Japan (7.1 per cent). Also, the high growth of several 'non market economies' has been combined with remarkable shortages in specific goods, including food.

As far as the poorer economies are concerned, if we concentrate attention on countries outside Europe and North America, the highest growth performers have been Singapore (7.5 per cent), South Korea (7.0 per cent), and Hong Kong (6.8 per cent), according to the *World Development Report* over 1960-80. These are, of course, all economies with private ownership and markets. The fact that these countries have combined fast economic growth with no noticeable worsening of the relative distribution of income has received, with justice, much admiration and many eulogies. The literature on the theory of economic development is beginning to reflect appreciation of these performances. One of the most distinguished examples of this

[1] *World Development Report* (Washington, DC: World Bank, 1982), Table 1.

type of analysis can be found in Ian Little's new book, *Economic Development*.[1] The 'old guards' at that side of the fence, such as Peter Bauer who wrote such a lonely — but excellent — book called *Dissent on Development*,[2] can rejoice at this trend, and Bauer can with justified pride write a new book reflecting the changing professional opinion, and call it, perhaps, *Assent At Long Last on Development*.

There is, however, some difficulty in reading the experiences of the East Asian newly industrializing countries — countries that Ian Little calls by the delightful name 'baby tigers' (*op cit* p 262). Hong Kong and Singapore are essentially city economies, and if we look at growth rates of cities, there are others that compare with the performance of these baby tigers, which benefit from being babies at least in size. There are no great rural masses to drag them down. But South Korea is a fairly large country, and is no city state. The difficulty, however, in reading great significance into the performance of South Korea as a success story for the 'invisible hand' is the fact that the hands that reared South Korean growth were very visible indeed. The government played a major part in fostering economic growth in South Korea, and as has been argued, 'no state outside the socialist bloc ever came anywhere near this measure of control over the economy's investible resources.'[3] Indeed, adding government savings to deposits in nationalized banks, the South Korean government had control over two-thirds of the investment resources in the country in the period of its rapid acceleration of growth. This governmental power was firmly used to guide investment in chosen directions through differential interest rates and credit availabilities. I have discussed this question in some detail elsewhere.[4] Even Korean export expansion was founded on building an industrial base through severe import controls before export promotion was promoted, and even now the import of many items is restricted or prohibited. The economic expansion was directly orchestrated by an activist central government.

In fact it is remarkable that if we look at the sizeable developing countries, the fast growing and otherwise high-performing countries have all had governments that have been directly and actively involved in the planning of economic and social performance. I don't mean that they have powerful governments — that is certainly the case but that is true of almost all developing countries anyway. I mean that the

[1] I M D Little, *Economic Development: Theory, Policy, and International Relations* (New York: Basic Books, 1982).
[2] P T Bauer, *Dissent on Development* (London: Weidenfeld, 1971).
[3] M K Datta-Chaudhuri, 'Industrialization and Foreign Trade: An Analysis Based on the Development Experience of the Republic of Korea and the Philippines,' ILO Working Paper WP II-4, Asian Employment Programme, ARTEP, ILO, Bangkok, 1979.
[4] 'Public Action and the Quality of Life in Developing Countries,' *Oxford Bulletin of Economics and Statistics*, 43 (1981).

governments have been involved with economic planning and with deliberate and ambitious public action. The types of planning used have varied, say between China, Sri Lanka, South Korea and Yugoslavia, but their respective successes are directly linked to deliberation and design, rather than being just the results of uncoordinated profit seeking or atomistic pursuit of self-interest. I have discussed these issues elsewhere,[1] and will not pursue them further here.

Motives and Behaviour

The issue of public action is, however, rather different from that of the best orientation of individual behaviour. In this respect, the ambitious Chinese attempt at replacing the profit motive and self-seeking by non-incentive systems seems to have been acknowledged as a failure. Certainly, the extent of cultural reorientation that was called for required such a drastic revision of human motivation that it would have been totally remarkable if it had been an easy success.

But it would be a mistake to think that the alternatives to the profit motive must, of necessity, take such a drastic form. In our day to day actions there is much scope for departing from self-seeking in a less grand way. There is, in fact, very little doubt that neither the family as a social unit nor the firm as an economic unit can really operate entirely on the basis of individual self-seeking. Norms of behaviour depart from that not only vis-a-vis other members of the family but in terms of loyalty to colleagues and to the firm.

To some extent this has been observed in all types of economies, but the scope for such non-profit behaviour also varies greatly between countries. It has been argued with much force and plausibility that the success of the Japanese economy owes not a little to what Michio Morishima has recently called 'the Japanese ethos',[2] which clearly has deep historical roots. The extent of loyalty, cooperation, sense of duty, and public spirit that is observed in Japanese factories is evidently in sharp contrast with what can be found in, say, Britain.

There is little doubt that the Japanese attitude to private gain and public duty differs greatly from that in other rich, industrial countries. Much has been written on that contrast. The differences in social psychology play a major part not only in

[1] 'Development: Which Way Now?' Presidential Address, Development Studies Association, given in Dublin, September 1982; to be published.
[2] Michio Morishima, *Why Has Japan 'Succeeded'? Western Technology and Japanese Ethos* Cambridge: Cambridge University Press, 1982.

economic performance but also in such other communal matters as the lower crime rate, much less frequent litigation (indeed, far fewer lawyers per unit of population), and so on. If the invisible hand does a great deal of visible good in Japan, the hand does not seem to work through the relentless pursuit of self-interest.

In fact, when one considers how production takes place in a modern industrial establishment, it is quite incredible to think that being actively self-interested can be such a virtue. Success in production depends greatly on team work, and while that interdependent picture provides incentive for a group, it is not an incentive that can be effectively translated into rewards and punishments related to individual work and performance.

Milton Friedman has argued in his *Essays in Positive Economics* that 'the process of "natural selection" . . . helps to validate the hypothesis' of profit maximization.[1] The profit maximizing firms survive and do better. This process may indeed work *if* deliberate attempts at profit maximization are likely to produce more actual profits and more expansion. However, when it comes to individual workers, the argument does not translate at all. Indeed, insofar as workers with better team spirit do better than self-interest maximizing workers, one might expect the argument to favour the development of team spirit rather than of maximization of individual interests or profits. Morishima's historical account of the emergence of the Japanese ethos may be supplemented by an argument for sustenance through better survival.

Fred Hirsch's analysis of the need to reorient behaviour norms is very relevant here. His argument is this:

> where individual preferences can be satisfied in sum only or most efficiently through collective action, privately directed behaviour may lose its inherent advantages over collectively oriented behaviour *even as a means to satisfying individual preferences themselves*, however self-interested. It follows that the best result may be attained by steering or guiding certain motives of individual behaviour into social rather than individual orientation, though still on the basis of privately directed preferences. This requires not a change in human nature, 'merely' a change in human convention or instinct or attitude of the same order as the shifts in social conventions or moral standards that have gone along with major changes in economic conditions in the past (p 146).

In understanding this proposed solution, it is important to see that Hirsch is not arguing for a change of what people actually would like to achieve. It is not an argument for changing one's goals, which of course will be a defeatist solution to the problem at hand (no matter how desirable for other reasons). The argument is a strategic one for better achieving the given self-interested objectives. Self-interest-based objectives are achieved better for the group as a whole by the individuals

[1] Milton Friedman, *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953), p 22.

behaving differently, *as if* they are maximising some other objectives.[1] The so-called 'Japanese ethos' can be just the ethos of behaviour and not necessarily of having different ultimate objectives.

Roles, Information and Self-interest

At this stage of the discussion, a different type of difficulty altogether may be considered. Surely the Adam Smithian argument about the merits of self-interested behaviour in the context of exchange builds on the twin fact that (1) such behaviour gives everyone the *role* of protecting and pursuing his or her own interests, and (2) the interests of each person are best *known* by the person himself or herself. While such behaviour does not resolve conflicts, nor take care of pursuing congruent interests in the presence of interdependences of the kind specified, it does help in the fulfilment of many congruent interests. Are we not in danger of losing even the limited virtues of self-interest maximization (related to role division and informational efficiency) if the motivational parameters change?

More other-regarding behaviour, unless it is specially symmetrical, can certainly lead to very unequal coverage of different people's interests. An assumption of 'symmetric goodwill' will be quite exacting.[2] It can, however, be pointed out that the market mechanism, even with self-interested behaviour, does not deal with issues of equity at all satisfactorily, and indeed, as already discussed, does not properly address the question of interest conflicts at all. Non-symmetric goodwill might introduce another element of asymmetry in the pursuit of different people's interests, but it would not necessarily make the over-all situation less just or more inequitable. Indeed, we can say very little in general about how the equity side of the picture will change with a motivational shift from self-interested behaviour, since so little can be said generally about equity under self-interest behaviour.

The change on the informational issue is, however, more easy to see and assess. Even if I pursue your interests with the same vigour that you would, and you pursue my interests in the same breathless way that I would, we may do worse jobs of these functions than if we were to look after our interests ourselves, respectively. This

[1] See my *On Economic Inequality* (Oxford: Clarendon Press, 1973) and 'Choice, Orderings and Morality,' in S Körner, ed, *Practical Reason* (Oxford: Basil Blackwell, 1974); reprinted in my *Choice, Welfare and Measurement*. See also George Akerlof, 'Loyalty Filters,' mimeographed, Institute of Business and Economic Research, University of California, Berkeley, 1982.
[2] Cf my 'Labour Allocation in a Cooperative Enterprise,' *Review of Economic Studies*, 33 (1966); David Collard, *Altruism and Economy* (Oxford: Martin Robertson, 1978).

recognition does nothing to wash away the problems of interdependence identified by Fred Hirsch and others and the failure of self-interest-based behaviour to deal with those problems. But superimposed on those problems are also some problems of informed pursuit of different people's respective interests, and replacing self-interested behaviour by other-regarding behaviour may punch a new hole as it plugs an old one.

It is interesting that there has been so little discussion of the impact of motivational change on the result of market equilibrium. There are, of course, some interesting and analytically important results about how special types of altruism might preserve some of the links between Pareto optimality and competitive equilibria.[1] But these results have been derived in quite a limited format, using strong assumptions, and they are in particular based on ignoring the force of the informational problem.

Some have seen relatively little difficulty in the market system being able to accommodate a great variety of motivational assumptions without losing its virtues. For example, in his lucid and illuminating report on the survey of the views of British economists (discussed earlier), Samuel Brittan refuses to be impressed by the assumption of the pursuit of self-interest in guaranteeing the achievements of the market. He remarks: 'the success of a competitive free enterprise economy, working under the right environmental policies, depends on people pursuing *self-chosen* interests, which can be altruistic, aesthetic or anything else.'[2] This is indeed so up to a point, in the sense that it may be possible to replace the achievement of, say, Pareto optimality by achieving a corresponding condition of non-improvability in terms of the different people's goals — whatever they are — rather than their self-interest or utilities.

On the other hand, other-regarding goals raise problems of consistency and coherence in a way that independent self-interests of different people do not. We can both try to do good to each other and end up failing to serve either person's interests. One has only to recollect O Henry's story 'The Gift of the Magi' to see how the pursuit of altruism can lead to frustration.

In his paper called 'Morality, Competition and Efficiency,[3] Robin Matthews has

[1] See S G Winter, Jr, 'A Simple Remark on the Second Optimality Theorem of Welfare Economics,' *Journal of Economic Theory*, 1 (1969); G C Archibald and D Donaldson, 'Non-Paternalism and Basic Theorems of Welfare Economics,' *Canadian Journal of Economics*, 9 (1976); Collard, *Altruism and Economy*.
[2] Brittan, p 53. See also R Sugden, 'On the Economics of Philanthropy,' *Economic Journal*, 92 (1982); A J Oswald, 'An Approach to the Economics of Unselfishness,' mimeographed, St John's College, Oxford, 1982.
[3] R C O Matthews, 'Morality, Competition and Efficiency,' *Manchester School*, (1981).

discussed lucidly how the information-revealing role of the pursuit of self-interest may be lost if people do behave according to some moral norms, eg, those given by act utilitarianism. The person who knows an individual best is the individual himself or herself, and this signalling function may well be quite lost if rather than acting on the basis of personal self-interest one pursues other goals. Doing good is not an easy matter with informational deficiency. (I remember the embarrassment of a friend who, staying as a guest of a family in Bombay, decided to be useful and expended the afternoon polishing up a small dirty-looking metal statue she found in the living room to discover later that she had made a thirteenth century icon look sparklingly modern.)

There are, in fact, the horns of a dilemma here. If individuals pursue goals other than the pursuit of self-interest, they can mess up the market mechanism informationally and also produce problems of consistency and coherence. On the other hand, if they do act selfishly, then they prevent the market from achieving efficiency in the presence of interdependences, not to mention other goals such as addressing problems of conflict.

What has to be recognized clearly is the unreality — and over-ambitiousness — of the neat, harmonious picture of social good coming from coherent and independent choices of individuals — a picture that has so deeply influenced economics. That account misses the real world by many miles. It is not easy — perhaps impossible — to replace that old model of success based on self-interested individuals, by another one with the same degree of ambition, and to get with equal ease a similarly neat picture of social good coming from the individual pursuit of some other simple motivation.

Some General Conclusions

First, the central economic problem can be seen as that of fulfilling congruent interests of different people, along with dealing with conflicts of interest fairly. The 'invisible hand' in the form of the market mechanism is geared to the congruence exercise, leaving the conflict problem unaddressed and essentially left to the equilibrium of relative powers and muscles (formalized in the notion of the 'core'). Despite claims to the contrary, the market and the profit motive cannot guarantee bringing about a 'harmony' of interests.

Second, the profit motive is, of course, a very powerful force and it can certainly do wonders. Its success is partly due to the fact that quite often the interdependences

underlying congruent interests can be captured within the market mechanism. The market mechanism succeeds, under these circumstances, because of the *fulfilment* of non-conflicting individual designs, and it is quite misleading to see this achievement as 'a result of human action but not of human design'.

Third, the conflict problem is, obviously, not amenable to solution in this way, and this failure can take a serious, even disastrous, form. Even the congruence problem may be insoluble through the market and the profit motive, if the congruence in the market mechanism with a price tag attached to each benefit and cost. The market is best at dealing with only one kind of congruence of interests.

Fourth, purely procedural justifications of the market independently of consequences — while interesting and challenging — ultimately lack plausibility. They do not, incidentally, do anything to support the profit motive.

Fifth, the profit motive and self-interest-based action can be self-defeating. Specialist maximizers can produce very general failures. There is the problem of being collectively self-defeating because of interdependences that elude the market, and these are of increasing importance, as Fred Hirsch has argued. There is, in addition, the problem of being individually self-defeating because of psychological conflicts between motivation and realization.

Sixth, while the problem of being individually self-defeating raises deep psychological issues, that of being collectively self-defeating raises questions of state action and cooperative efforts. It also points towards the case for behavioural modification. It is in that context important, as Hirsch has emphasized, to examine the possibility of behaviour norms that break away from the pursuit of self-interest by individuals to better achieve the fulfilment of those very interests. There is a clear link between this type of theory and the observed success of some economies, most importantly Japan.

Seventh, departures from self-interest maximization help in some respects but also hinder in other ways. Self-interest maximization serves to channel information into the market procedures; each pursuing the interests of others can, in many contexts, be informationally defective. Indeed, it is not easy to see that some rule of behaviour of the same type of generality as the pursuit of self-interest can, in fact, avoid both the Scylla of interdependence failures and the Charybdis of informational deficiency.

What goes wrong with the traditional model of the invisible hand is not just the limitation of relying exclusively on self-interest, but the stunning ambitiousness of trying to guarantee social efficiency — not to mention social optimality — on the basis of *independent* pursuit by individuals of some general objective (such as profits). This negative recognition, however, does nothing to undermine the importance of studying alternative behaviour norms and examining their consequences. Behaviour norms have to be assessed in the light of comparative achievements rather than just in terms of the attainment or not of efficiency or optimality. The effectiveness of non-profit behaviour is important in that less ambitious but more practical context.

Finally, I should point out that I have not had the opportunity to go into a fundamental question which Adam Smith had touched on and thought to be important. Should motivation be determined entirely by usefulness, or are there other important values to consider? Should the profit motive be recommended to all if it had proved impeccably useful? Should the 'Japanese ethos' be cultivated by all if it is really as useful as it seems to be? Adam Smith would have disputed that usefulness is all that is involved. Indeed, he did think that to praise a person for his useful qualities is to confuse him or her with something like a piece of furniture or a building:

> . . . it seems impossible that the approbation of virtue should be a sentiment of the same kind with that by which we approve of a convenient or well-contrived building, or that we should have no other reason for praising a man than that for which we commend a chest of drawers.[1]

While I have concentrated on assessing motivations in terms of their usefulness, I would not deny that Adam Smith is right and this cannot provide a full view of that important question. Even as economists we cannot altogether escape this deeper valuational issue. The subject is dismal enough as it is.

[1] *The Theory of Moral Sentiments*, IV 2 4, p 188. The immediate provocation for Smith's remark is Hume's analysis of virtue in terms of 'utility' (in the sense of usefulness).

Is Government Borrowing now too low?

by Dermot Glynn

In October 1976, Lloyds Bank Review published an article in which I discussed the question: 'Is government borrowing too high?' I argued that at that time it was; and also that the main requirement to give confidence in the soundness of the government's broad fiscal stance was to reduce the proportion of national income taken by government expenditure. 'The increase in the last three years — by 20 per cent in volume while output has risen by less than 2 per cent — is at the root of the current dilemma of high government borrowing and taxation'[1].

With hindsight, those conclusions seem to stand up well. In the intervening years, a great deal of attention has been given to the desirability of reducing the public sector borrowing requirement (psbr), and of improving control over public expenditure. This latter, however, remains an intractable problem.

However, it might be argued that attempts to reduce borrowing have gone too far; and that a psbr which is lower as a percentage of gdp than in any year since 1972, and which is declining even in nominal terms, is inappropriate in a recession which is deeper than any since the 1930s.

Some form of fiscal and/or monetary relaxation would clearly encourage economic recovery. On the other hand, the last thing one would want to see are changes that led to a resurgence of inflation, and so set at naught the progress so painfully won on that front. Whether or not the balance between these objectives is right is the main yardstick by which the overall fiscal stance will be judged, but other considerations are also often brought into the reckoning.

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[1] *Lloyds Bank Review*, October 1976, p 32.