A point of contention between two groups of social scientists has surprisingly significant ramifications for the moral quality of our economic life. The issue is how to preserve the integrity of the market, a matter of growing concern since the advent of the savings and loan (S&L) crisis, the recent round of defense contract scandals, discovery of shenanigans in the commodity exchanges and numerous other incidents of corporate criminal conduct—labs that make money by reporting test results without conducting them; adulteration of baby food; falsification of maintenance records by airlines, and so on, ad nauseam.

Neoclassical economists argue, following Adam Smith, the author of The Wealth of Nations, that markets are self-regulating. Because each person participates in exchanges to advance his own self-interest, there is no need for external regulation. Manufacturers who fail to honor their word to deliver goods will lose future orders. Customers who find that products do not work as promised will cease to buy them, and so on. Indeed, neoclassical economists expect that greedy people will not try dishonest business practices.
for fear of being put out of business by those who keep their word.

As a result of this belief in the ability of the invisible hand not only to facilitate economic exchanges but also to ensure their ethical quality, lists of the prerequisites of a free market, provided by neoclassical economists such as George Stigler and Gerard Debreu, do not include any reference to ethical sustaining mechanisms, or even externally generated rules of the game. The lists of prerequisites mention only that buyers and sellers must be small relative to the market; that firms act independently of one another; that complete information about offers to buy or sell be freely available; and that resources be transferable among users.

Those neoclassical economists who do concern themselves with the rules of the market assume that they are somehow naturally provided, and hence do not require any special effort or attention. Or they may assume that the ethics-sustaining measures will arise out of the give-and-take within free markets, as participants, recognizing the efficiency of having such rules, formulate them and abide by them out of sheer self-interest.

Socioeconomists (who draw heavily on social sciences other than economics in studying economic behavior) include in their analysis the “other” Adam Smith, the author of The Theory of Moral Sentiments. They maintain that all markets are encapsulated in societies, which provide the markets with the rules prescribing what is morally acceptable—what is and what is not tolerable. The encompassing society has specific mechanisms to ensure that the markets “behave.” These mechanisms include government regulations but do not necessarily rely chiefly upon them: Community values, peer pressure exerted through associations of businesspersons, and moral education are the most important of these regulators. According to this socioeconomic mode of analysis, those concerned with preservation of markets must concern themselves with the effective working of these non-market mechanisms.

REGULATION: SOLUTION OR PROBLEM?

Before examining the current status of these morality-sustaining mechanisms in our society and inquiring whether they need urgent repair, I will consider the neoclassical suggestion that the moral difficulties of the market arise from government regulation rather than from weakening of ethical mechanisms. The S&L crisis provides an important case in point. Although the $500 billion-plus mess has many causes, practically all agree that changes in banking regulations in the early 1980s were a major instigating factor. These changes raised the maximum insured deposit from $40,000 to $100,000 in 1980; relaxed capital requirements; and above all, beginning in 1982, allowed thrifts to invest in high-profit, high-risk markets such as commercial real estate and junk bonds.

Socioeconomists may argue that this was actually a measure of deregulation rather than of change in regulation, but neoclassical economists are bound to argue that if there had been no government insurance in the first place, the risky behavior of S&Ls would have corrected itself. Those S&Ls that took too much risk would have failed, taking with them only the investments of their stockholders and depositors but not taxpayers’ billions. Moreover, depositors soon would have
learned to avoid risky institutions, or would have demanded high premiums for their investments (as they do in the junk bond markets), or sought private insurance that is self-financing.

This line of argument, however, ignores the fact that the regulation of financial institutions was introduced precisely because the unscrupulous conduct of financiers, banks, and savings institutions (and insurers) in the preregulatory days had major detrimental effects not merely on depositors and investors but on the whole economy.

Modern economies require large concentrations of capital, but prior to the establishment of national banks and a uniform currency in 1863, bank failure, counterfeiting, and banks’ refusal to honor currency (state banks were free to issue their own notes) were so common that the public was reluctant to entrust financial institutions with their deposits. Additionally, the fragmented system could not provide the flows of credit necessary for economic development—for example, rich New England banks had no reliable way to channel funds to the credit-starved South and West. Eventually, this lead to the formation of the Federal Reserve system in 1913. Still, runs on banks and lack of public confidence were problems until the establishment of federally insured deposits in 1933.

In short, the financial markets were not adequately self-regulating, and thus corrections via public institutions were vitally needed. Indeed, this has become one of those market “failures” neoclassical economists acknowledge and allow, as a matter of public good, for some measure of external regulation.

While excessive and poorly drafted regulations are clearly a major cause of economic problems, removing the government completely is not an acceptable course for anyone.

One may argue that if there were no public till, defense contractors could not bilk the public out of billions of dollars. However, not even extreme libertarians argue that we need no publicly provided defense. Competitive bidding is sometimes recommended as a way to introduce market discipline in this public realm, but it is far from a cure-all. Competitive bidding can be rigged by contractors’ bribes, and many of the items we buy—from aircraft carriers to B1 bombers—are so big there is only one, at most two, producers, and hence no basis for true competition. When the government complained to General Dynamics about shoddy products and grand-scale overbilling for nuclear submarines, the company in effect said that it would cease to produce them. The Defense Department, having no other source to turn to, was forced to yield.

Clearly some regulation of defense contractors is required. Similarly, without some government regulation, customers would not be able to tell if prescription and over-the-counter drugs had been tested for safety until it was too late.

In short, while excessive, stupid, and
poorly drafted regulations are clearly a major cause of economic problems—and in turn lead to ethical temptations that would not exist if government were not involved—removing the government completely (as distinct from cutting its role and powers) is not an acceptable course for anyone.

**ALTERNATIVE WAYS TO REGULATE THE MARKET**

The best way to minimize government regulation of the market is to rely heavily on three other factors: culture, associations of practitioners, and personal and profes-
sional moral education. Although these must be considered one at a time, they work best in conjunction with one another, each supporting and magnifying the others.

Moral Culture. Culture is a term often loosely applied to the sets of values that are shared by members of a certain group—for example, corporate cultures. Indeed, each business community has an unspoken set of dos and don’ts. For example, in the 1980s in the United States, hostile raids of corporations by outsiders were considered proper conduct, but in Britain, West Germany, and France they were heavily frowned upon. As a result, considering such raids in those countries was morally unthinkable, just as American CEOs would not think of walking down Main Street stark naked, carrying a billboard for their product, whether or not that would improve “exposure” for their products. Those who attempted to do so would be condemned by their business community, and they would find no cooperation in many other areas they required. (Hostile raids are not necessarily unethical or economically undesirable; the preceding discussion simply uses them as an example to illustrate the workings of business culture.)

The norms of business culture are constantly changing, affected by a variety of forces. Business culture was rather wild in the free-for-all days of the robber barons, and may have been tamed to some extent during the Progressive era, but what has happened in recent decades is much less clear. Because there are no reliable measurements of the ethicality of business culture and changes in it, it is almost impossible to ascertain whether the standards have changed. Did corporate America grow more tolerant of unrestrained greed? Was this the case in some industries (defense, finance) but not in others? Or have we become more sensitive to occurrences that abounded in previous decades, such as insider trading? There are no convincing, let alone conclusive, answers. It is clear, though, that in the late seventies and early eighties, criminal and unethical conduct was surprisingly common.

The Resolution Trust Corporation, established to manage the savings and loan bailout, reports that criminal fraud was discovered in 60 percent of the savings institutions seized by the government in 1989. The inspector general’s office in the Department of Defense reports that twenty of the one hundred largest defense contractors have been convicted in criminal cases since 1983. A study by the Department of Justice that looked at almost six hundred of the largest U.S. publicly owned manufacturing, wholesale, retail, and service corporations (with annual sales of $300 million or more), showed that during 1975 and 1976, “over 60 per-

The best way to minimize government regulation of the market is to rely heavily on three factors: culture, associations of practitioners, and personal and professional moral education.
cent had at least one enforcement action initiated against them (actions were all federal—administrative, civil, and criminal).” And that “more than 40 percent of the manufacturing corporations engaged in repeated violations.” My own study of the Fortune five hundred found that 62 percent were involved in one or more incidents of corrupt behavior—these included price-fixing, environmental and antitrust violations, bribery, and fraud—during the period between 1975 and 1984. A General Accounting Office report issued on April 26, 1990, found that about 52 percent of the gasoline sampled was labeled as having a higher octane level than it actually contained. The report estimates that such misbranding costs American motorists as much as $150 million per year.

The business community, whatever it privately felt about these incidents, did not express public condemnation of the conduct involved. On the contrary, business representatives have taken the position that corporations are law abiding: “Many, if not most, organizations are composed of morally and ethically honorable people who genuinely try to comply with the law” (testimony of John Borgwardt, Boise Cascade Corp. Feb. 14, 1990, before U.S. Sentencing Commission). They also claim that if transgressions do occur it is frequently because of some “rogue employee’s misstep” (Robert J. Giuffra, The American Enterprise, May/June 1990), or because “compliance with our laws is not always a simple and precise task” (James Carty, National Association of Manufacturers, May 24, 1990, testimony before House Subcommittee on Criminal Justice). Thus, it is claimed, unintentional violations may occur in even the most conscientious corporations. At most, business representatives were willing to acknowledge that there are a few corporations created solely for the purpose of criminal activity (Mafia-run drug processing plants, for example) that deserve punishment.

If the integrity of markets is to be preserved or, when necessary, enhanced, this orientation will have to change. Business leaders must take a major role in designating what is beyond the bounds of acceptable conduct, involving business managers in discussing and accepting these values, and redefining the business culture. They may not feel that insider trading is definable or clearly unethical even if it is illegal, and they may wish to embrace hostile raids as proper, but they can hardly refrain from condemning the sale of bogus parts to airlines, which endanger the lives of passengers; manufacture of faulty weapons that blow up in the hands of unsuspecting victims; or failure to report fatalities caused by drugs. This may be a timely corrective to what some see as ramifications left over from Reagan policies, welcomed by significant parts of the business community—which to some seem to have endorsed unrestrained wheeling and dealing, unbound greed.

Associations. When I was appointed staff director of a commission investigating nursing homes in New York State, the demand was for more government regulation of the industry. The commission was appointed after months of reports of gross abuses in largely proprietary (profit-making) nursing homes. Owners were said to have diverted funds allocated to buy their patients’ food and medicines to purchase rare paintings and luxuries for themselves. The homes were understaffed, and the elderly were drugged to make them more manageable.

As the commission prepared for public hearings, I invited the heads of ten ma-
major corporations for a private discussion. I told their representatives that the commission wished to learn what the business community could do to curb abuses. After all, I pointed out, other professions, such as law and medicine, have their own codes of ethics and enforcement mechanisms. Though it was, and is, true that these are far from sufficient to ensure a high standard of moral conduct, at least attorneys and physicians have systematically considered what is proper conduct. They take violators aside, encourage them to straighten out, and can and sometimes do expel the most abusive from their circles. "Could the managers of business use their professional associations to help weed out the kind of people who were leading abusers in the nursing homes?" I inquired.

It was like giving a party to which nobody came. Leaders in the business community, at least those members with whom I spoke at the time and since, were not interested. Their responses were in part technical and in a sense valid. Business management was different from law and medicine: it was not really a profession; anyone could become a manager. There was nothing from which to disbar errant managers; they needed no license to practice or access to a controlled place like a hospital or court. Hence, there was no way to exclude unethical practitioners.

However, the business representatives were unwilling to acknowledge the important role of moral communities. If a group of managers of major corporations—say from IBM, Xerox, Delta, CBS, Quaker Oats, and a few other upstanding ones—were to develop a moral code of behaviors expected from managers and corporations, and privately (or if need be publicly) censor those who grossly violated the code, this would have significant salutary effects on the moral level of the business community.

Existing associations such as the Business Roundtable (an organization that embraces the major American corporations, those that often, for better or worse, act as role models for others), the Chamber of Commerce, the National Association of Manufacturers, and the Business Conference provide major avenues that could be used to conduct dialogues to develop such a moral code. Each of these associations has leaders who often speak up on other issues ranging from the need to reduce the deficit to fixing American schools. This leadership, with very rare exceptions, has yet to be applied to the issues at hand.

It is surely more difficult to appeal to one's own community to shore up ethical standards (or even help figure out what those standards are) than to preach to others. Yet this is what is necessary if we are to help bring about a more ethical

My own study of the Fortune five hundred found that 62 percent were involved in one or more incidents of corrupt behavior.
business community, shore up the integrity of the markets, prevent the decline of the legitimacy of business, and slow the calls for re-regulation. Indeed, precisely because the business community played next to no role in the S&L cleanup, new regulations have already been introduced

the teachers of morality, as difficult and controversial as this job is.

Business schools must pick up the slack as well. Since many who enroll often have insufficient moral education or believe that businesspeople must leave their values behind, a number of busi-

If and when the corporate culture clearly defines acceptable and unacceptable behaviors, business morality will be enhanced.

in this industry, and many more are likely to follow.

Moral Education. Last but not least, individual members of the business community must be reached. Ideally, moral education starts at home and is reinforced by one's peers, neighbors, and churches. However, the fact is, given the sorry state of American families, many are not sufficiently intact to provide effective education, least of all moral education. Single parents or married couples, who come home after an exhausting day at work to do household chores, often have little time or energy to deal with psychologically taxing matters such as questioning their children's conduct or helping them choose proper peers. Pop psychology provides the parents with further assurances that they need not intervene. As a result, schools are increasingly becoming

ness schools have always had courses in ethics. In recent years, their numbers have increased. Still, most students graduate from business schools having received very little moral education. This is an area in which major improvements need to be made.

To reiterate: All these factors work best when they pull together. If and when the corporate culture clearly defines acceptable and unacceptable behaviors; business associations cajole, censor, or expel those who violate their perceptions of right and wrong; and families, and all schools—from elementary through professional—participate in moral education, business morality will be enhanced. This will significantly reduce the need for government regulation and will ensure the integrity of the market.■