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1

Greed and the Market

John Meadowcroft

In the 1987 Oliver Stone-directed movie *Wall Street*, Michael Douglas portrays Gordon Gekko, a 'corporate raider' who specialises in taking-over firms and then asset-stripping them. In one of the film's most memorable scenes, Gekko attempts to persuade a meeting of shareholders to sell out to him with the promise of large financial rewards. Gekko encourages the shareholders to think only of their own pecuniary gain, to act on the basis of personal greed:

The point is, ladies and gentleman, that greed – for lack of a better word – is good. Greed is right. Greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms – greed for life, for money, for love, knowledge – has marked the upward surge of mankind.

Although Gekko is a fictional grotesque, his 'greed is good' speech has entered popular culture as the embodiment of much that is wrong with a market economy. The market, it is argued, encourages and rewards greed; it is an institutional framework within which the greedy and selfish will prosper, whereas the altruistic and temperate will fail.¹

In the market, it is claimed, the individual or firm willing to ruthlessly extract an extra unit of profit, prepared to lay-off loyal workers in an economic downturn, or happy to take risks with the health and safety of others, will enjoy a competitive advantage. Accordingly, it is argued that in a market economy, 'the cost of moral scruples... is likely to be business extinction'.² An unfettered market economy is believed

to be a place where the Gordon Gekkos of the world trample over others in a selfish rush to gratify their greed for ever more material wealth.

This chapter challenges this view of a market economy. After this introduction, the next section shows that greed is an imprecise and under-defined term that has been used to mean a number of different things. However, when greed has been used as a critique of the market its usage demonstrates a failure to appreciate some basic facts about economic development and the nature of any advanced economy. After setting out this failure, this chapter will then present a positive case for the market as an institutional framework that requires and enables people to consider the needs, wants and preferences of others in order to attain their own ends; the market is a process that puts private desire to public benefit. It will then be shown that success in the marketplace also requires a reputation for probity and trustworthiness at odds with the caricature of Gordon Gekko; the market is a 'school for virtue' that incentivises pro-social behaviour and punishes those who cheat. A short final section concludes.

Greed and wealth: some preliminary considerations

Greed is a concept that is often invoked, but is rarely defined. For example, a recent study of the role of 'greed' in financial markets offered no definition of what 'greed' might be.³ This is problematic because there is no consensus as to what constitutes greed. It is not necessarily obvious at what point a healthy appetite or a natural passion gives way to greed and among those scholars who have attempted to define greed, divergent definitions have been offered.

Posner, for example, has defined greed as '[caring] almost exclusively about making money'.⁴ Cooley, on the other hand, has offered a 'working definition' of greed as 'the gratification of my desires, beyond my own needs, at the expense of meeting your needs or the needs of a common good that includes the good of all planetary life'.⁵ Coser's study of 'greedy institutions' defined a greedy institution as one that demands 'exclusive and undivided loyalty', suggesting that greed describes an exclusive focus on one particular end, though that end need not necessarily be pecuniary.⁶

Although the term 'greed' is frequently used, it means different things to different people and in different contexts. In the context

that this chapter is concerned with – the way that greed has been used as a critique of the market – greed has been used to describe three different though linked phenomenon. First, greed may describe a desire for material wealth or consumption beyond one's needs; greed may be said to be the desire to satisfy wants as well as needs or to gratuitously consume things that are not needed. Second, greed may describe consumption that denies others the opportunity to similarly consume.⁷ Third, greed may describe an all-encompassing and exclusive desire to accumulate material wealth.⁸

However, there are reasons to be extremely cautious before accepting that any of these three understandings of greed can be used to construct a valid critique of a market economy.

Consumption beyond one's needs

The ability to satisfy more than one's basic needs is an attribute and a benefit of civilisation. In primitive societies people engage in a daily struggle to meet their basic needs of food, clothing and shelter, whereas in developed economies these basic needs are met with resources to spare. These resources can then be devoted to the pursuit of wants: things that are not necessary to sustain life, but may make life more pleasurable.

Among these wants we might include, for example, the fugues of Bach, fine wine and higher education. Clearly, these are things that people do not need; they are things that people 'merely' want. No one would die if they did not hear a Bach fugue, drink fine wine or obtain a higher education. But this does not render these things worthless.

Rather, it is the satisfaction of wants as well as needs that distinguishes civilisation from primitive societies. To deny that wants (as oppose to needs) have no moral worth is to deny the very value of civilisation itself. As Hayek put it: 'To say that a desire is not important because it is not innate is to say that the whole cultural achievement of man is not important'.⁹

There is nothing inherently virtuous about an economy that only satisfies people's needs. On the contrary, it is an economy that satisfies wants as well as needs that offers the greatest possibilities for human flourishing because it provides far greater scope for cultural development and enables cultural products to be made available to the widest possible range of people.

Consumption that denies others the opportunity to similarly consume

The view that it is greedy to engage in consumption that denies others the opportunity to similarly consume would appear to be informed by a concern with economic inequality, both between countries and within countries. There is a genuine concern that to consume luxuries while other struggle to survive is immoral and that the poverty of people in the poorest parts of the world may in some way result from the large amount of resources consumed by people in relatively wealthy nations.

Where resources are scarce – as is the case in every human society – the allocation of resources to one particular use means that those resources cannot be put to other uses. In one sense, then, all consumption denies other consumption opportunities. But it does not follow that the wealth of one person, group or society is in some way the cause of the poverty of another.

This point can be illustrated with the example of the economic performance of South Korea and Nigeria during the second half of the twentieth century. In 1950 the GDP per head of South Korea and Nigeria were almost identical at about a third of the world average. Between 1950 and 2000, Nigerian GDP per head rose by about 50 per cent and South Korean GDP per head increased by more than 2,000 per cent. By 2000, Nigerian GDP per head was one-fifth of the world average, whereas South Korean GDP per head had risen to more than twice the world average. But South Korea's economic development did not cause or create Nigeria's poverty. Rather, South Korea went through a process of economic development while Nigeria was left behind.¹⁰

Prosperity is not a zero-sum game in which different individuals, groups or societies compete for a share of a fixed pot of wealth. Rather, economic development involves *the creation of new wealth*: the resource pot can be made bigger. It is only this process of wealth creation that enables many millions of people to be lifted out of poverty in a short period of time, as happened in Europe and North America in the eighteenth and nineteenth centuries and in East Asia in the twentieth century.

Ceasing or limiting economic activity in one part of the world will not make other parts of the world richer. Rather, the challenge

is to spread economic development more widely. Economic history shows that the only way to achieve this is to extend and develop markets in the poorer parts of the world that are currently excluded from the global economy.

Hence, if South Korea were to give large portions of its wealth to Nigeria, it might make a small number of fortunate Nigerians better-off in the short term, but it would not lead to the long-term eradication of poverty in Nigeria; this can only occur via the development of an advanced market economy in that country. Indeed, given the compelling evidence that international aid can blight development by propping-up corrupt regimes and incentivising rent-seeking as oppose to productive activity, there is good reason to believe that unless an appropriate institutional structure is in place a transfer of resources from a wealthy country to a poor country will hinder rather than help development.¹¹

It is also the case that economic development cannot take place uniformly and universally so that the whole of a society advances in one great Maoist leap forward. Rather, economic development must take place in echelon fashion, so that some people advance before others and therefore enjoy a superior standard of living to many of their contemporaries. This means that at any one point in time there will be people who do not have access to 'the best' that a particular society can offer. Some people will be able to enjoy exotic foreign holidays or access to consumer goods that others cannot, for example. This is unavoidable unless particular choices (whether exotic foreign holidays or particular consumer goods) are prohibited until and unless they can be made available universally. But continued economic development will mean that those people who do not have access to 'the best' will still enjoy a lifestyle that a generation earlier would have been the preserve of the most privileged and their children will, in turn, one day enjoy a lifestyle that was beyond their means.

The pursuit of luxury and convenience by the wealthy also serves to raise living standards throughout society because the rich pay for new products and research that ultimately benefit all. In the eighteenth century Adam Smith noted that in order to enjoy the luxury of fast transportation, the rich paid for new roads to be laid, invested in the development of new carriages and in the breeding of faster horses, all of which benefited the whole of society.¹²

Similarly, to give two contemporary examples, individuals who first purchased personal computers and mobile phones when those products were beyond the means of most people paid for the technological research and development that has led to these goods now being produced at a price affordable to all members of the same societies.

Although the wealthy intend only to enjoy luxuries that they alone can afford, their actions in fact serve an important social function, funding research and experimentation, testing new products and new ways of living, which, if popular, will in time become accessible to all. Indeed, without wealthy individuals to perform this function, an egalitarian society would have to set aside a particular category of people to test new products and lifestyles to see if they should be made available to the whole population.¹³

In every society beyond the poorest and most primitive, then, there will be some individuals who consume goods and services that are beyond the means of most of their contemporaries. The consumption of such luxuries should not be condemned, but is a necessary part of the process of economic development that ultimately benefits all.

The all-encompassing and exclusive desire to accumulate material wealth

The third way in which greed may be used as a critique of the market is if it is understood to describe an all-encompassing and exclusive desire to accumulate material wealth. Certainly it may be considered undesirable or imperfect that in market economies some people do appear to become obsessed with the pursuit of material wealth. But similarly it may be deemed undesirable or imperfect that some people appear to become obsessed with sex, or with food, or choose to devote a large proportion of their leisure time to watching television.

What activities people choose to engage in, even obsessively, must be a matter of individual choice. It only becomes a matter of public concern if their actions harm others.¹⁴ What is important, then, is the social consequences of the pursuit (obsessive or not) of material wealth via the market. To evaluate these social consequences it is necessary to consider the pre-requisites of the accumulation of income and wealth in a market economy.

Reconciling the greedy and the needy

In a canonical passage of his masterpiece *The Wealth of Nations*, Adam Smith described self-love as the principal motivation of market participants:

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 interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.¹⁵

Smith recognised that a market economy was not founded upon people altruistically providing goods and services for one another, but was built upon people motivated by their own self-interest to provide for others: we can expect to receive short shrift if we ask a shopkeeper altruistically to provide our dinner for free. This may lead to the assumption that a market economy is morally compromised because it is founded upon individuals working to maximise their own gain.

However, such a view would be a partial understanding of the morality of market transactions. While market participants may be motivated by self-interest or self-love, the result of their ostensibly self-serving actions is that other people's desires are also satisfied. Hence, in his other great work, *The Theory of Moral Sentiments*, Smith described how a 'poor man's son' who wished to attain wealth in a market economy had to put himself at the service of other people – even those he despised – in order to achieve the material success he desired. While Smith was sceptical as to the moral worth of material wealth, he nevertheless understood that its pursuit within the institutional context of a market economy produced socially beneficial consequences because it led self-interested people to serve the needs of others.¹⁶ This was one of the ways in which Smith envisaged that the 'invisible hand' of the market worked to promote the public good even when this was no one's intention.¹⁷

To give a contemporary example, then, although Bill Gates's principal motivation may have been to make himself richer, the development of new software programs by Microsoft has benefited large numbers of consumers who now have access to an unprecedented range and quality of computer software applications.

To be successful in a market economy, then, people must learn about and respond to the needs, wants and preferences of others. Hence, the butcher, the brewer and the baker may be greedy individuals seeking only to further their own interests, but their desire to do this leads them to consider and provide for other people. In this way, a market economy puts private desires to work for public benefit.

The market not only obliges self-serving individuals to learn about and respond to the needs of others, it also provides the most effective means of meeting those needs, irrespective of our underlying motivation. It may be possible to altruistically help a limited number of individuals of whom one has direct personal knowledge without recourse to the market – for example, when help or care is given to family members, or to a known, identifiable group, or even to a person in the street in need of assistance. But at a general, societal level it is only possible to help people of whom we have no direct personal knowledge by responding to the information about people's needs, wants and preferences communicated by market prices.

This is because in a market economy, prices perform an irreplaceable epistemological function. Prices communicate information about the needs and wants of consumers and the resources available to provide for them. Prices tell us, for example, that people attach greater value to a kilogram of asparagus than to a kilogram of potatoes, that building toilets out of gold is an inefficient use of resources, and that it is more cost-effective for the Scots to import wine from France than to grow grapes in greenhouses in the Highlands. Without market prices it would be practically impossible to make relative judgements about the value of different goods and services and to thereby ensure the efficient use of the resources at our disposal.¹⁸

However, prices are not simply a very efficient means of discovering and communicating information that could be found and communicated by some other means. Prices communicate information that may be dispersed throughout the economy, may reflect each individual's subjective perceptions and may be tacit and therefore impossible to articulate verbally. In the absence of market prices, some of the information that prices communicate would not exist, some of it could not be discovered and some of it could not be communicated.

The ability of market prices to simultaneously and instantaneously communicate a vast array of information among countless people often acting in complete ignorance of one another's existence is the principal reason why capitalist market economies outperformed their socialist counterparts in the twentieth century. Without some mechanism for accurately evaluating seemingly incommensurable ends it would be impossible to ensure that the benefits of economic activity exceed the costs and that the most highly desired and urgent options are chosen over the less desired and less urgent alternatives.

This epistemological function of market prices is equally relevant to a society of perfect altruists and to one composed entirely of greedy egotists. In the absence of the information provided by market prices the assumption that people can act altruistically at a societal level becomes heroic. In the epistemological darkness of a priceless economy 'altruists' have little option but to pursue the ends that they consider the most important. Without knowledge of the relative costs and benefits of alternative courses of action they may engage in activities that waste resources and therefore are socially pernicious even though their intentions are altruistic.¹⁹

Self-interested motivation is not a pre-requisite for an individual to be able to use the price signals generated by the market. Although Adam Smith described 'self-love' as the motivating force of market participants, in reality what matters is not that individuals are self-interested, but that individuals *are motivated* to respond to the price signals generated by the market.

Economic coordination demands that people are entrepreneurially alert, which can only be the case if individuals pursue ends that they themselves believe to be important, irrespective of whether those ends are altruistic or self-interested. Smith's description of the importance of self-love to the operation of the market should be properly understood as highlighting the polycentric, decentralised basis of economic coordination and hence the importance of individual motivation to observe and respond to the demands of others that are communicated by the price mechanism.²⁰

Individuals may enter the marketplace greedily seeking to maximise their own material wealth. But in order to succeed in the marketplace they must reconcile their ends with the ends of others. Hence, the market requires that self-serving individuals put themselves at the service of others and re-evaluate and reformulate their

plans in the light of the knowledge of other people's preferences communicated by prices: in order to make ends meet, an aspiring racing driver becomes a car dealer, a would-be footballer trains as a fitness instructor and a resting actor works as a waiter. In this way, the market process spontaneously dovetails a myriad of different and frequently competing ends and values into a complex web of coordinated activity.²¹

The market as a school for virtue²²

The previous section set out how in order to succeed in a market economy a greedy and selfish individual will be required to learn about the needs, wants and preferences of others and will very often be required to revise and reframe their plans in the light of this knowledge. In this section it is argued that the market also incentivises virtuous behaviour. In a real world market economy the kind of ruthless and callous behaviour exhibited by the character of Gordon Gekko in *Wall Street* would be unlikely to lead to success in business.

The view that the social impact of the market is benign can be traced back to the *doux commerce* (or gentle commerce) thesis that was widely accepted by the key thinkers of the Enlightenment. As Hirschman has described, during the Enlightenment it was 'the conventional wisdom... that commerce was a civilizing agent of considerable power and range'.²³ Montesquieu, for example, in his eighteenth century classic *Spirit of the Laws*, wrote that 'it is almost a general rule that wherever manners are gentle there is commerce; and wherever there is commerce, manners are gentle'.²⁴ Similarly, in *Rights of Man*, Thomas Paine – often claimed as a forebear of socialism – described himself as 'an advocate for commerce, because I am a friend to its effects. It is a pacific system, operating to cordialize mankind'.²⁵

Perhaps the most famous advocate of the *doux commerce* thesis was Adam Smith. According to Smith: 'Wherever commerce is introduced into any country, probity and punctuality always accompany it', so that, 'When the greater part of the people are merchants they always bring probity and punctuality into fashion, and these therefore are the principal virtues of a commercial nation'.²⁶

Smith believed that in a market economy it was in each individual's self-interest to establish a reputation for trustworthiness

and probity because others were unlikely to enter into contracts with people who had a reputation for underhand dealing. As a consequence, even individuals who desired only their own personal advancement were led to behave in what was at least a morally tolerable fashion. The freedom to exit from relationships with those who proved undeserving of trust and to enter into new relationships with those who appeared more virtuous acted to drive up the general standard of human conduct in the same way that the forces of competition improved the standard of goods and services.²⁷

However, Smith's portrayal of eighteenth century commerce was nevertheless based upon repeated transactions among trades-people who had at least some direct personal knowledge of one another. Smith was less convinced that market exchanges could spontaneously produce trust when exchanges were more anonymous or not repeated. He famously cautioned:

Where people seldom deal with one another, we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they can lose by the injury which it does to their character.²⁸

This view questions the ability of markets to self-regulate when exchanges are not repeated and is reflected in the analysis of information asymmetries by contemporary economists who have argued that lack of trust among market participants in non-repeated exchanges may be an example of 'market failure'.²⁹ According to this perspective, when consumers lack the information to evaluate the quality of the product being supplied, or the reputation of the supplier, then competition may lead to a decline in the quality of the goods on sale. This is because every individual will act as if others are untrustworthy, believing that every good may be faulty or of low quality. It is claimed that consumers will therefore be unwilling to pay anything but a low price for goods they suspect to be second-rate. This is said to drive out quality from the marketplace, creating a race to the bottom rather than to the top.

What such accounts of market failure fail to anticipate, however, is that entrepreneurs have innovated to fill the 'trust gap' and to remove these impediments to successful trade. Entrepreneurs who specialise in checking the trustworthiness of others and who create

trust by developing a reputation for supplying assurance have entered the marketplace. In doing so, entrepreneurial innovation, such as the development of brand names and 'money-back' guarantees, has transformed potentially non-repeated exchange scenarios into what are effectively repeated or iterated transactions.

Brand named goods and franchised stores, in particular, provide an assurance function by reducing information costs and providing a bridge between otherwise anonymous buyers and sellers. A producer of pharmaceutical goods, for example, may have no contact with the final purchasers of her product, but may have repeat dealings and a relationship of trust with a branded pharmacy outlet, which in turn may have repeat dealings and a reputation for excellence with the final consumers of the good concerned.³⁰ Indeed, empirical analysis of markets hypothesised to fail due to asymmetric information, such as used car markets, offers no support for the theoretical claim that competition leads to declining product standards.³¹

Trust is a highly valuable asset for which there is a 'demand' and for this reason it is 'supplied' rather than undermined by the market. While the vast majority of participants within an advanced market economy do not engage in face-to-face exchanges, a host of institutions have developed to provide the trust necessary to sustain commercial exchange on a vast scale.

Thus, empirical analyses of 'generalised social trust' find no evidence that the proportion of people who exhibit trust in others declines with exposure to market forces. On the contrary, in a cross-country study of over fifty nation-states Berggren and Jordahl found a strongly positive correlation between the degree of economic freedom in a society (especially the security of property rights) and levels of trust in other people.³²

In a market economy, an individual motivated only by the self-interested desire to satisfy their own greed by accumulating as much material wealth as possible cannot simply behave in a ruthless manner without regard to the interests and values of others. On the contrary, the success of individuals and firms in the marketplace remains highly dependent on their ability to establish a reputation for honesty and trustworthiness. This is not meant to imply that markets lead to universally trustworthy conduct. There will always be those who engage in scams and crooked deals. What matters is that markets may provide mechanisms which reduce the excesses

that flow from human imperfections. Hence, as an institution, the market incentivises good conduct and trustworthy behaviour.

In the marketplace, people not only learn about the values and desires of others and how to meet them, but also about the reputational pre-requisites of commercial success. Moral behaviour is not a public good that imposes private costs on the individual who undertakes such action. Rather, the benefits of pro-social behaviour accrue to both society and the individual. It will, for example, be in the self-interest of a business to keep on employees during an economic downturn, as it is likely to receive the benefits of a loyal workforce already possessing the specialised knowledge it requires when the economic climate improves. Likewise, a firm that invests in the training of employees with disabilities can similarly expect to gain a loyal and dedicated workforce. As Maitland has noted: ‘the virtues are not (just) public goods – that is, unrequited gifts to society – but are a source of private advantage in the marketplace’.³³

Conclusion

In examining greed, this chapter has argued that the market is a social institution that incentivises socially beneficial behaviour. Success in the marketplace requires that people learn about the needs, wants and preferences of other people and then attempt to dovetail these ends with their own. Market prices communicate information about other people’s desires more effectively than any other mechanism, making it possible to respond to the demands of countless people dispersed across vast geographical distances. Without market prices we can only hope to help people of whom we have direct personal knowledge; with market prices we can extend our realm of concern to people not directly known to us.

Furthermore, the market encourages and rewards probity and trustworthiness, making virtue a public good as well as a private benefit. Hence, the market is not an institution where ruthless and greedy individuals like Gordon Gekko are able to selfishly pursue their own ends with complete disregard for other people.

Those of us fortunate to live in the developed world at the start of the twenty-first century are the wealthiest people to have ever lived on the planet. The standard of living that we enjoy would be beyond the imagination of most people who ever lived and many people

presently alive. The fact that we enjoy such wealth should not lead to derision, soul-searching or hand-wringing. Rather, the prosperity that we enjoy should be celebrated as one of the greatest achievements of human civilisation. The challenge is to make this standard of living available to all.

Notes

- 1 I define a market economy as an economic system in which the means of production are privately owned and individuals buy and sell goods and services at prices spontaneously generated by the actions of producers and consumers. This economic activity takes place within an institutional framework of the rule of law and the protection of property rights that may be provided by government.
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