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## Economy and Morality



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# Economy and Morality

The Philosophy of the Welfare State

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## Preface

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This book, which will construct a relationship between the economy and morality, is intended to provide a systematic approach to economic ethics. It considers two fundamental questions: (1) whether the economy is justified by morality and (2) whether morality, in turn, is supported by the economy. Since under the rule of modernism in academe, economics and ethics are conceived as two virtual, unrelated worlds, these questions require careful consideration lest they threaten the foundations of the two disciplines. I explore this problem along two dimensions: *values* and *institutions*. This approach will permit an analysis of the nature of economic ethics, which differs from general ethics in that it also deals with the real processes of the economy.

Although there have been numerous attempts to address the relationship between the economy and morality, many (except for some excellent work in economic philosophy) are no more than emotional statements criticizing the unethical nature of the economy (and economics) or moralistic rationales for integrating altruism and self-interest. Since I believe that the economy cannot work without morality nor morality without the economy, it is necessary to grasp the close relationship between the economy and morality by returning to the foundations of economic and moral knowledge. Both economics and ethics are the superior disciplines that have pursued different subjects by different methods after a long history of moral science in which the two were united. It would be naïve if not irresponsible to suggest a sort of outright antithesis or synthesis between the economy and morality.

The approach used here is twofold. First, I seek a connection between the economy and morality on the dimension of *values* by reconstructing a coherent system of ethics that coordinates the 'right, good, and virtue.' In other words, I am trying to find those hidden philosophical roots that the grand trees of economics and ethics, so to speak, have developed under the ground. The result will be an economic philosophy constructed from an examination of the principles of contemporary ethical theory. I believe that this paradigm of economic philosophy will be acceptable to both economics and ethics. Second, based on this system of economic philosophy, I build a connection between the economy and morality on the dimension of *institutions* and present the philosophy of the *welfare state*. It is necessary to

introduce politics into this discussion, because on the institutional level the coordination of the economy and morality should not be left to the formation of practices through a spontaneous process alone but be mediated by the deliberate action of politics. Thus my conception of the welfare state is that of a tripartite public institution composed of capitalism, democracy, and social security.

The coordination of *values* and *institutions* with regard to the economy, politics, and society is both a theoretical and a practical challenge to contemporary social scientists. The reconstruction of the welfare state has been placed on the agenda of practical politics in developed countries, but this cannot be achieved by a makeshift social policy. Reform of the welfare state should be worked out as the reconstruction of capitalism, democracy, and social security as a whole by a good command of ethical theory and all functions of public institutions. The disciplines of social science in the appropriate combination should provide the basic direction for reform.

On the dimension of values, the book considers two key philosophical issues: *efficiency versus justice* and *liberty versus excellence*. Resolving the double antithesis of values will virtually constitute a connection between the economy and morality in terms of *values*; it will also provide the direction for reconstructing the economic, political, and social structure of the welfare state in terms of *institutions*.

In the discussion of liberty versus excellence, I present an argument that is apparently unfamiliar to contemporary economic thinking, because it emphasizes the importance of the ontological concept of being (or existence) in addition to the concepts of behavior (or act) and institution (or rule). Economists can understand that the 'good' regulates 'act' and the 'right' determines 'rule,' but there is no thought in economics that 'virtue' drives the 'existence' of human beings. It seems to me, however, that this idea was the starting point of economics. The Cambridge economist Alfred Marshall, who had high aspirations to contribute to the well-being of humankind, had once studied ethics. According to the memoir by John Maynard Keynes ([1924] 1972, pp. 200–201), Marshall, about the time he resolved to shift from ethics to economics, bought a small oil painting of a worn-out, grieving destitute person and called the man his patron saint. Looking at the portrait every day, he feared that his work in economics would degenerate into a theoretical exercise. He regarded the improvement of man's abilities as the ultimate goal of future society. Arthur Cecil Pigou, one of Marshall's disciples and the father of welfare economics, explained that economics began with 'the social enthusiasm which revolts from the sordidness of mean streets and the joylessness of withered lives' ([1920] 1932, p. 5). Both men regarded the starting point of economics as the perception of human 'misery' rather than sophisticated notions of 'efficiency'

and 'justice.' This idea was not confined to the British tradition of economics. At his inaugural lecture at the University of Freiburg, Max Weber, the disciple of the German Historical School, had reminded us of the ultimate concern of economics as the 'quality of the human beings' rather than economic efficiency and social justice (Weber [1895] 1994, p. 15). However, because economists long lacked the academic concepts of virtue, excellence, and being, the ideas of thoughtful scholars remained mere prose and were buried between the lines in economic works.

I argue that the goals of the welfare state are first to relieve men and women from misery and then to raise them to excellence. Efficiency and justice, both familiar value concepts to economists, might be regarded as an auxiliary means to human excellence and flourishing. The reason for this is as follows. The point of the controversy surrounding *efficiency versus justice* is well known in economics. But the claim of justice alone over efficiency does not indicate a desirable state of an economy. Although justice is a strong ethical position, it only prescribes the allocation of rights. It is the function of excellence as a moral standard to evaluate the quality of an economy and the living conditions of human beings and to indicate the ultimate direction of society to which efficiency and justice are to be applied. Various romantic claims of quality of life and human flourishing must be justified by a normative theory of excellence. Thus justice and excellence impose effective constraints on the principles of economic freedom and market efficiency. The metaphor of 'two banks of the river' in the following introduction is based on this idea.

To study social science, knowledge of four areas, philosophy, politics, economics, and sociology (PPES) is required. This book is an attempt at such interdisciplinary research, and I hope that it will stimulate discussion among these disciplines to construct a paradigm of PPES through an inquiry into contemporary issues of the welfare state.

It was my good fortune to have as my copyeditor Mrs Stevie G. Champion, who did an excellent job of editing the English translation of my book on Joseph Alois Schumpeter, *Schumpeter and the Idea of Social Science* (Cambridge University Press, 1997); I am grateful to her for patiently assisting me again.



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## Introduction: two banks of the river – a metaphor

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The economy is embedded in society, and *how* it is embedded determines its nature. The economic philosophy I advocate can be depicted metaphorically. Let us suppose that the economy is a river and the two main constraints of that economy are the two banks of the river. A river is controlled and conserved by two banks. In our image, one bank of the river constitutes institutional conditions representing the foundation of an economic system, and the opposite bank consists of a society's cultural achievements that extend beyond economic activity. The two riverbanks may be identified simply as 'institution' and 'culture' respectively, and the solid stratum underlying the two banks and the river may be represented by 'value.' It is the task of economic philosophy to investigate the three social categories (that is, institution, culture, and value) in which the economy is embedded, beyond an enquiry of the economic mechanism that is empirically concerned with the flow of the river, so to speak.

### WHAT UNDERLIES THE ECONOMY?

As illustrated by Mesopotamia between the Tigris and the Euphrates, Egypt along the Nile, and China along the Yellow River, the inhabitants of the birthplace of the ancient civilization benefited from the rivers in having fertile land, in forming settlements, and in widening transport and trade. Furthermore, the rivers supported the richness of animal and plant life. In such communities, irrigation and flood control were always the major tasks of rulers. Just as it is necessary to control, utilize, and conserve rivers by constructing banks, so is it essential to make arrangements for controlling an economy, which is liable to overflow and cause damage despite its potential benefits to humankind.

Generally speaking, economic activity means the allocation of resources to provide goods and services to satisfy human desires. A primitive life in ancient times did not differ from a technologically developed life in modern times with respect to the formal structure of such resource allocation. The first economic principle is always 'efficiency,' which means rationality in

the choice of behavior that will maximize consumer satisfaction within resource and technological constraints. Efficiency, a key word in economics, means prudence to use the terminology of moral philosophy. Both efficiency and prudence belong to an adaptive type of human behavior, one that can accommodate a society's various constraints. To realize an efficient economy, the society needs institutional arrangements that promote and maintain fair competition among economic agents.

In the long history of humankind, it has not been more than two and a half centuries since human beings freed themselves from economic constraints by introducing innovations in the form of new commodities, new technology and new institutions. This is the phenomenon of modern economic growth that surfaced after the Industrial Revolution, from which emerged the new principle of 'growth through innovation' in contrast to 'efficiency through adaptation.' Economic growth was made possible by the institutions of capitalism that work to encourage abstinence from current desires in favor of future desires and to transform the saved surplus into capital accumulation. Capitalism is an economic system that carries out a capitalistic mode of production motivated by secular abstinence and profit maximization under private ownership and market mechanisms.

Social security is another basic institution characteristic of the contemporary economy. It is the means by which the government allocates resources in order to correct various kinds of unfairness and injustice in a capitalist market economy; the government provides social services such as health care, pensions, and welfare based on a certain definition of basic human needs. The leading construct of social security is 'justice,' however defined, which is often regarded as the countervailing value of 'efficiency' and 'growth.' The behavior intended to implement the idea of justice is social solidarity based on citizens' participation in public decision-making, in contrast to behaviour based on private decision-making in market exchange. Thus we have the third organizing principle of a society: 'justice through solidarity.' If a capitalist system is involved with the intertemporal allocation of private desires, a social security system is concerned with the interpersonal allocation of private desires; it assumes the principles of communities such as families and local associations that historically preceded the market economy.

The question 'What underlies an economic system?' relates to the identification of institutions that lay the foundation for an economic system. Although the foremost values of an economic society have been developed historically in a sequence of 'efficiency through adaptation,' 'growth through innovation,' and 'justice through solidarity,' the basic philosophical task is to examine the internal consistency of these three principles that

emerged historically. Moreover, although the social security system in a contemporary welfare state was maintained primarily by virtue of rapid economic growth and a young population structure during the several decades after World War II, it is now subjected to the criticism that its management contradicts economic efficiency and hinders economic growth; it is also confronted with a financial crisis in meeting the increasing demand for social services during a period of stagnant economic growth and ageing of population.

## WHAT EXISTS BEYOND THE ECONOMY?

Problems, however, are not limited to the plausibility and sustainability of the welfare state. We must raise a further question, 'What do people want to achieve through economic activity?' In other words, what is the ultimate goal of an economy? Humankind in the past, although at a lower standard of living than we presently enjoy, sometimes developed remarkable spiritual and material cultures and contributed to the accumulation of a valuable human legacy. Having attained an unprecedented economic abundance, what should we do for the future?

Unfortunately, humankind has continued to repeat its history of insanity and devastation. In particular, the twentieth century was characterized by a series of wars on a worldwide scale employing high-technology destruction. Whereas the world of the economy and commerce presupposes peace and prudence as a model of man and society, political attempts to attain world hegemony evoke dangerous emotions that caused nations to deviate from their framework of peace and prudence in order to eliminate economic constraints at one fell swoop. In the last century these attempts repressed individual liberties and resulted in the dominance of a detested totalitarian ideology. The minimum significance of democracy is to be found in refuting the ideology of madness, destruction, and oppression by citizens' participation in the governance of their society.

The term 'welfare state,' coined in contrast with the 'warfare state' during World War II, refers to an institution of social security that mitigates the harshness of a market economy, on the one hand, and demands close cooperation with democracy as the civic foundation of welfare, on the other. The welfare state thus thrives for solidarity and security and peace and prudence by controlling market power and political power, both of which are liable to be out of control. Given this relationship, the contemporary economic, political, and social system consists of 'capitalism, democracy, and social security,' the totality of which I call the *welfare state*.

Then, our question about the goal of economic activity now reads: 'What values does the welfare state intend to realize using this apparatus?' Suppose that a rich and secure society whose inhabitants enjoy longevity is achieved through the welfare state. In what sense are we proud of it? The values of efficiency, growth, and justice will have no meaning unless they are combined with far-reaching ideals and virtuous lives. It is incumbent on us to pay attention to the concept of being and to examine the relationship between individual liberty and social institutions from the viewpoint of promoting a flourishing of population.

There is no question that only when a free market system, which permits the pursuit of private desires, is supplemented by a secure system of justice and a democratic system of political equality, will individual autonomy be substantially guaranteed and an opportunity to develop individual capabilities afforded. In economic theory, individual liberty as the presupposition of market activity is merely a means to maximize satisfaction of given preferences. True individual liberty offers two more things. First, autonomous individuals are free critically to examine individual preferences, to cultivate skills, to achieve a standard of excellence, and to transform themselves positively and rationally in various fields of social practice. Second, they can participate directly or indirectly in the formation of public policy and its institutional framework, and contribute to public decision-making through the understanding and discussion of civic issues. While the former is concerned with the private sphere and the latter with the public sphere, both will change the status quo in the private and public spheres.

In short, under the tripartite institutional apparatus of guaranteeing market liberty, social justice, and political equality true individual liberty helps people to accomplish what is beyond these values if and only if they act to transform themselves and society. Thus liberty becomes a bridge between the two banks of an economy. For this purpose, the liberty of choice, of exchange, and of competition in the system of markets is not enough, nor is liberty based on justice and equality in the systems of social security and political democracy. What are required of individuals are the pursuit of voluntariness and pluralism, the cultivation of moral faculties, the promotion of public spirit, the effort to gain self-realization, the exertion of creativity, and the elevation of human dignity. From true individual liberty emerge outstanding achievements in science, the arts, thought, culture, lifestyles, and identity. Although these endeavors need economic resources, they are beyond economic valuation and are conceived as the ultimate human ends of economic activity. If these values can be called perfection or excellence, we have the fourth normative principle: 'excellence through liberty.' This ideal is interpreted as the 'cultural value' that holds true in all areas of social activity.



## COORDINATION OF VALUES BY THE WELFARE STATE

I argue that excellence is the goal of a society after it has achieved economic affluence and social justice. The ethics of excellence has been a distinctive position of moral philosophy since Aristotle; it emphasizes virtue over happiness and justice. Reconstruction of the welfare state does not result from economic and technical considerations alone. Its three components – capitalism, democracy, and social security – comprise the apparatus set up on this side of the river, and should be oriented to the opposite bank.

The relationship between the set of values and the set of institutions can be summarized as follows. First, the market mechanism of capitalism prepares the economic foundation for a free society on the basis of economic principles, that is, ‘efficiency through adaptation’ and ‘growth through innovation.’ Second, social security corrects and complements the market system and is based on the ethical principle of ‘justice through solidarity.’ Third, democracy as a political system aims to control the economy and society by means of the equal participation of citizens in order to achieve self-governance of the public sphere. Seen from a different angle, democracy is a political process that is indispensable to the construction of a just ethical system within the economy and society. The three components of the welfare state on this side of the river are expected to contribute to the ultimate goal on the other side of the river through the guidance of the ethical principle, ‘excellence through liberty.’

Socialist and communist regimes, although they once seized the minds of people using the ideology of justice, were unable to produce an economic system amenable to efficiency and growth, because they rejected market institutions, believing that the human nature of self-interest could be abandoned. No economic system is sustainable without efficiency and growth. Moreover, these regimes denied individual liberty and established a dictatorship involving horrendous political struggles; eventually they collapsed. Whatever the economic performance of a society may be, it is impossible for a society without liberty to consider the prospects for the ultimate human goal.

This is not an old story. Excessive economic and social regulation in capitalist countries involves the same danger as in socialist countries with regard to control of the private sector by the government. It is reasonable that the worldwide trend of deregulation and privatization should promote a shift from the government to the private sector. Just for this reason, however, the more persistent and pervasive this trend is, the more effective management of social security and democracy is needed as a bulwark

against markets, and the more crucial individual participation in public decision-making becomes. It follows that a shift 'from the private to the public sphere' is required along with a shift 'from the government to the private sphere.'

The contemporary welfare state faces the challenge of constructing an institutional framework that embodies the values of liberty, efficiency, and growth, while keeping the value of justice in view of the tragic experience of humankind. The welfare state encounters not only a financial crisis but also a moral crisis of individual liberty given the easygoing and irresponsible supply and demand systems of social services. Moreover, democracy as public decision-making machinery has sometimes become a dead letter; politics has also become a field for pursuing self-interests, which constitutes the so-called iron triangle of Bureaucracy, Industry, and Politics. This is the crisis of political democracy. The most fundamental task of the social sciences today is to develop a comprehensive perspective in order to coordinate the foremost values mentioned above through an investigation of the practical operation of the welfare state consisting of capitalism, democracy, and social security. To put it another way, the task is to coordinate the *values* and *institutions* of contemporary human society.

The objective of this book is to elucidate the norms and systems of the welfare state within the scope of the two great disciplines, economics and ethics. The world of economics is dominated by the values of 'efficiency through adaptation' and 'growth through innovation,' while the world of ethics is dominated by the values of 'justice through solidarity' and 'excellence through liberty.' Economic ethics consists of these normative ideas that should govern an economy to enhance the well-being of the citizenry based on true individual liberty. These values do not remain mere ideas, but are embodied sometimes in positive laws and sometimes in the individual consciousness and social conventions. Thus values and institutions are not independent of each other; it is reasonable to recognize their close relationship from the start. Thus we define 'law, morality, and custom' as the *institutions as social norms*, on the one hand, and define 'capitalism, democracy, and social security' as the *institutions as social systems*, on the other. This book attempts to develop a philosophy of the welfare state in the context of the interrelationship between values and institutions. In view of the two meanings of 'institution,' this attempt represents an enquiry into two aspects of institution (social norm and social system), the welfare state being the institution addressed.

One qualification is needed here. The traditional concept of philosophy consists of three major areas: epistemology (methodology), ontology (metaphysics), and axiology (ethics). The philosophy of the welfare state, the subject matter of this book, concerns the ethics of the welfare state.

## THE PLAN OF THE BOOK

This book is divided into two parts. Part I, on values, has three chapters. Chapter 1 defines the economy and morality and explains the conceptual framework of this book. While economics and ethics have been recognized as separate disciplines, little effort has been made to unify the worlds of the economy and morality since the independence of economics from moral philosophy. I argue that the economic world and the ethical world are two schemes of social integration with remarkable universalizing capacities and that the concept of the 'good' constitutes an interface of the two worlds. In both economics and ethics, the concept of the good is widely used – explicitly or implicitly; it is an inclusive notion implying utility, welfare, well-being, happiness, and the like, based on interests, wants, desires, and preferences. In ethics, the good is defined in diverse ways; how the good is defined signifies the different positions of ethical theories. In economics, by contrast, the concept of goods (in the sense of commodities) in the plural form is defined as a means to bring about the good (in the sense of goodness) as an end, however differently the latter is defined. Economics is not concerned with the content of the good at all. Even the word 'good' does not appear in economics; the word 'utility' is enough to indicate the goal of economic activity. Starting from the concept of the good as the interface of the economy and morality, I will develop the systematic framework that is used throughout this book to explore the relationship between the two worlds.

Chapters 2 and 3 characterize the basic values that apply to both the economic and ethical worlds, such as efficiency, justice, liberty, and excellence. While Chapter 2 concerns the familiar antithesis between 'efficiency and justice,' Chapter 3 proposes a new antithesis between 'liberty and excellence.' Discussions of these values are based on the recent development of normative ethics after John Rawls, including utilitarianism, contractarianism, libertarianism, and communitarianism. These discussions, which describe various controversies, are concerned with the basic structure of society from a normative point of view; contemporary economic, political, and social issues cannot be dealt with apart from these discussions on a theoretical level. As a result of academic specialization, however, serious philosophical thinking has scarcely been undertaken in economics, even with regard to the ethical basis of the welfare state.

Part II, on institutions, investigates the ethical principles that are embodied in contemporary institutions with a focus on interrelated institutional structures. I define the contemporary welfare state as a compilation of 'capitalism, democracy, and social security,' in contrast to current usage, which narrowly identified the term 'welfare state' with social security.

*Table 0.1 The interrelationship between values and institutions*

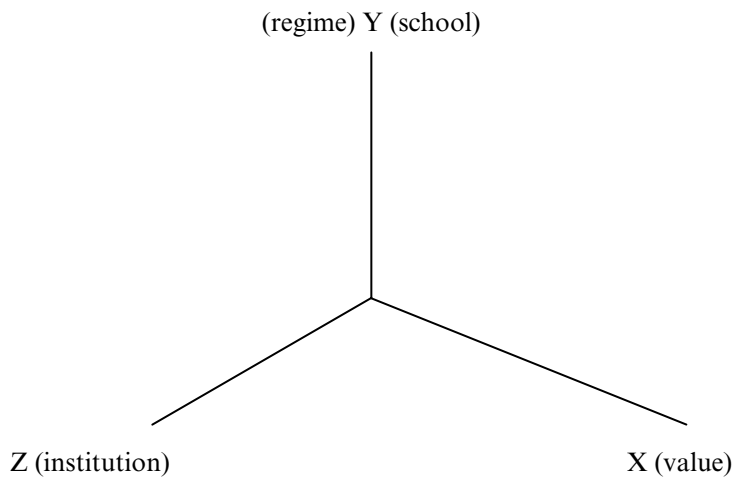
Institution \ Value	Value	Efficiency	Justice	Excellence
Capitalism				
Democracy				
Social security				

Chapters 4, 5, and 6 respectively consider the three components of the welfare state thus defined.

The relationship between Part I and Part II is depicted in Table 0.1. The horizontal axis of the image gives three representations of value (that is, efficiency, justice, and excellence); the vertical axis shows the three institutions comprising the contemporary welfare state (that is, capitalism, democracy, and social security). This image will be completed to ascertain the relationship between values and institutions. Not only is each institution linked to values, but also the interrelationship between institutions is examined in terms of the overall coordination of values and institutions.

There are two practical complications, however. First, since there are different schools of thought in moral and political philosophy (such as utilitarianism, contractarianism, libertarianism, and communitarianism), entries added to the image will differ accordingly. Ordinarily, a school of thought will construct a system that emphasizes specific concepts of value and advocates particular programs as a way of coordinating institutions. Therefore, different schools will add different entries to the image. Second, as international comparative studies of the welfare state indicate, different countries show different patterns of the welfare regime as a result of different ideologies and different institutional arrangements. Although countries do not necessarily hold consistent values and change them as a political office changes, it is possible to identify some correlations between values and institutions on the basis of empirical studies (for example, liberal welfare regime, social-democratic welfare regime, and conservative welfare regime à la Esping-Andersen, 1990). This is the typology of welfare state regimes.

To sum up, the framework for understanding the interrelationship between values and institutions is shown in Figure 0.1. A plane, consisting of an X axis (value) and a Z axis (institution), is the same as given in Table 0.1. Now, another axis Y is introduced to represent the problems of schools of thought and regimes; there are two alternative interpretations of the Y axis. On the plane composed of axes Y and X, we can see how different schools of thought or different welfare regimes accommodate



*Figure 0.1 The three-dimensional interrelationship between values and institutions*

values (that is, efficiency, justice, and excellence). On the plane with axes Y and Z, we can see how they coordinate institutional elements (that is, capitalism, democracy, and social security).

Finally, Chapter 7 provides insights on welfare reform. With regard to the specific areas of social security, including health care, pensions, welfare, and so forth, the need for their reconstruction in developed countries is imminent. But in view of the conflicting vested interests within a society, it is doubtful that political discussions starting from actual institutional conditions will be reasonable. Insofar as social institutions in general and the social security system in particular embody ethical values, the desirable reform of social security must be based on a comprehensive examination of the leading ethical values and the dominant institutional framework.

The Conclusions following Chapter 7 form a counterpart to the Introduction and give a summary of the book. The Introduction raises questions about how an economy should be constructed using the metaphorical two banks of a river. The Conclusions call for the pursuit of a just and excellent society.



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PART I

Values





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