Moral Foundations of Capitalism: Study Guide 2

Studying for the Exam. The best method of studying for the class exams is to (i) review the class notes and readings, (ii) work through the study guide and (iii) review the problems in the lecture notes. Everything covered in the notes and in class may be included on the exams, although clearly the exam will focus most of its attention on the material covered in lecture.

The hardest questions on the study guide are more difficult than the hardest questions on the second midterm. So, if you can do everything on the study guide you should be in good shape for the exam. The actual problems on the exam will similar to, but somewhat different from the practice problems included below.

I. Identify and or Define

a. Aristotle	k. utilitarian
b. More	l. invisible hand
c. Grotius	m. virtue
d. Baxter	n. Nash equilibrium
e. Franklin	o. coordination game
f. Smith	p. median voter
g. Bentham	q. shirking dilemma
h. Mill	r. work ethic
i. Spencer	s. gains from trade
j. Pigou	t. externality

II.   Matching exercise: link the following philosophers with their ideas.

Aristotle	Protestant work ethic launched capitalism
More	utility principle
Grotius	impartial spectator
Baxter	the sea as common property
La Court	happiness as the ultimate end
Locke	religious tolerance
Franklin	profits as divine obligation
Smith	co-evolution of man, morality, and society
Kant	better to be a human unsatisfied than a pig satisfied

Bentham	harmony of economic and moral interests
Bastiat	utopia as a monastery
Mill	he that gets all he can honestly and saves all he can, will certainly become rich
Spencer	categorical imperative
Weber	taxation can undermine virtue

III. Philosophers and Ideas about Ethics and Markets

A. Aristotle argued that ethical conduct contributed to human happiness. Explain briefly his theory of human happiness and the manner in which ethical dispositions can be acquired.

B. Baxter is best known for his idea of a "calling."   Explain briefly what a "calling is" and what its implications for careers in commerce tend to be.

C. Locke argued that there are three foundations for ethical or normative conduct.   List the three categories and describe briefly the kinds of ethical rules that he would associate with each of the categories.

D. Smith argued that humans are predisposed to behave in accord with "moral sentiments."   Explain briefly the main elements of his theory of ethical behavior.

E. Bentham in a sense reinvented Aristotle's "ultimate aim," but he has a much simpler theory of human happiness.   Briefly explain both his ideas about human happiness and the manner in which happiness or utility can be used to determine ethical conduct and good public policies.

F. Spencer regarded himself to be a utilitarian, but had an evolutionary theory of both utility and ethics. Briefly summarize his theory and his critique of earlier utilitarian theories.

G. Utilitarians generally favored market activities and opposed regulating them. Explain (i) their arguments in favor of market activities, (ii) the reasons why they opposed transactions deemed fraudulent, and (iii) why government regulation of markets was unnecessary or counter productive.

H. Create a table of 10 philosophers in temporal order, listing the century in which they wrote and at least two of their ideas. Then discuss the extent to which a general increase in support for commerce is evident in their conclusions about the role of commerce in a good life and good society.

IV. Puzzles and other Discussion Questions

  A.   Develop a game that illustrates the Law Enforcement Dilemma, when all law enforcers are pragmatists.

  a.   Explain why law-enforcement is unlikely to be uniform or fair in this case.

  b.   Show how a "rule-enforcing" or "promise-keeping" norm can solve the problem when they are internalized by agents of the anti-corruption agency.   Explain your reasoning and the new payoffs in the game matrix.

  B.   Discuss why the median voter's moral beliefs are likely to influence the persons elected to high office and the types of policies that are adopted.

  a.   Be sure to include brief discussions of why the median voter is important and why his or her norms may affect how he or she votes.

  b.   Also be sure to explain why the ethics of elected representatives are likely to be important to most voters—even pragmatists.

  c.   Explain also why ethical ideas can provide important support for democratic processes—which is to say the use of elections to choose representatives and make collective decisions.

C. Ethics and Commerce issues

  a.   Several of the authors read in the first part of the course were skeptical about the effect of markets on virtue (as with More, Baxter, and Montesquieu). Summarize their arguments. Now suppose that one of the three is dominant in a given society (widely internalized), how would they affect the extent of markets? Explain.

  b.   Mill suggests that governments should promote the development of a subset of virtues because they tend to increase progress. Review his argument and use a game to illustrate why increasing such virtues tend to increase progress, social utility, and social output (GNP).

  c.   Spencer argues that utilitarians neglect the ambiguity of their aggregate happiness norm. List at least 3 reasons why a utilitarian may have a difficult time choosing virtuous actions in a setting where his/her choice affects dozens of strangers.

  d.   Laboratory experiments suggest that a good deal of human behavior is inconsistent with the predictions of game theory when it assumes that individuals have only narrow self interests. For example, experiments normally find a good deal of cooperation in PD games—far more than the "zero" predicted. On the other hand, there is significant defection. Explain how variation in internalized ethical dispositions can account for both the extent of cooperation and defection.

  e.   It can be argued that progress is immoral based on the "do no harm principle." Explain the reasoning behind this claim and discuss how other normative theories might support rather than impede innovation and economic progress.   Is there any evidence that the most innovative societies have supportive ethical dispositions? Discuss.

D. More Philosophical Issues:

  a.   One very difficult problem for utilitarians is that utility cannot be directly observed. How then can we tell when a policy increases aggregate utility? Are we implicitly making use of Smith's conception of moral sentiments?

  b.   Spencer argues that people have moral instincts that are analogous to their geometric sense.   Explain why he believes that utilitarians must ultimately rest on that instinct, but that utilitarian ethics should not stop with that instinct. Why does Spencer believe that rational analysis can improve ethics, if everyone already has moral intuitions?

  c.   Compare Mill's list of virtues that increase progress with Aristotle's list of virtues that increase lifetime happiness. Are there any important differences in the items on the list? If so, do the differences tend to support or impede economic development?

  d.   Consider (i) Smith's idea of moral sentiments and the impartial spectator, (ii) Spencer's idea of moral instincts, and (iii) Grotius' idea of natural law. Discuss differences and similarities in their theories of the grounding principles of ethics. Are there circumstances in which they lead to the same conclusions? Illustrate and explain your reasoning.

V. Game Theoretic Exercises and Review (See also Study Guide 1)

A. Review. Use a two-person two strategy matrix of payoffs to characterize the following social settings:

  i.   The Prisoner's Dilemma

  ii.   The Hobbesian Dilemma

   iii.   The Free Riding Dilemma

   iv. The gains from a mutually beneficial exchange

   v.   The Shirking Dilemma of Team Production

   vi. The Problem of Fraud

B. On the advantages of Team Production. Construct a 3x3 game in which two persons contribute to each others productivity. The team's total output increases with each person's (team member's) work. However, suppose that the private rewards of free riding are always greater than those of working hard.

   a.   Characterize the Nash equilibrium of this game

   b.   Are their mutual gains from internalizing a norm of working hard?

   c.   Are their mutual gains from paying an enforcer (firm owner or coop manager) to punish shirking?

   d.   Show how either of the above can increase aggregate output and utility. (Hint: show how the internal and external norms change the payoffs, etc.)

   e.   How do these results relate to Max Weber's theory of the emergence of capitalism?

   f.   How do these results relate to Mill's theory that prosperity (and aggregate utility) tend to increase as persons become "better" at cooperation.

C.   Use a game matrix to represent the "paper, rock, scissors" game.

   a.   Show that there is no Nash equilibrium in pure strategies.

   b.   Find a Nash equilibrium mixed (random) strategy for your game.

   c.   In what sense is your solution an equilibrium?

  C. Find the Nash Equilibria to the following games and determine whether there is a "dilemma" or not. If there is one, explain the nature of the dilemma. If not, explain why there is not.

Game Matrix 1

Al \ Bob	Work (A, B)	Shirk (A, B)
Ea = 8	10, 10	6, 12
Ea = 4	12, 6	8, 8

Game Matrix 2

Al \ Bob	Accept Offer (A, B)	Reject Offer (A,B)
Make Offer	10, 8	-3,-1
Don't Make Offer	-1, -3	5, 5

Game Matrix 3

Al \ Bob	Eb= 8 (A, B)	Eb=6 (A,B)	Eb=4 (A, B)	Eb=2 (A, B)
Ea = 8	10, 10	8,11	6, 12	5, 13
Ea = 6	11, 8	9, 9	7, 7	6, 11
Ea = 4	12, 6	10, 7	8, 8	6, 9
Ea = 2	13, 5	11, 6	9, 6	7, 7

Game Matrix 4

Al \ Bob	Eb= 8 (A, B)	Eb=6 (A,B)	Eb=4 (A, B)	Eb=2 (A, B)
Ea = 8	10, 10	8,11	6, 12	5, 13
Ea = 6	11, 8	8, 8	7, 7	5, 6
Ea = 4	12, 6	7, 7	6, 6	5, 5
Ea = 2	13, 5	6, 5	5, 5	4, 4

B. As an exercise, construct a 3x3 game with an Pareto optimal equilibrium (i) in the middle cell (ii) in the upper lefthand cell, (iii) in the upper righthand and lower lefthand cells.

C. As and exercise, construct a 3x3 game with a dilemma equilibrium (i) in the middle cell (ii) in the upper lefthand cell, (iii) in the upper righthand and lower lefthand cells. Explain the nature of the dilemma in each case.