Economic Behavior: An Inherent Problem With Utilitarianism

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Some fundamental issues of economic behavior

The title of this article indicates that there is some inherent problem with utilitarian thinking. To develop this thesis, it is necessary to explore the nature of human behavior and to examine the necessary implications of utility analysis when it is extended to utilitarianism. As it is understood here, economic behavior is a fundamental component of human nature. In particular, it is rooted in the observation that all human beings have a natural interest in behaving economically. That is, all human beings have a vested interest in capturing the greatest return on their scarce resources. Toward this end, any individual will have a natural tendency to avoid wasting his resources and will, instead, attempt to be frugal, thrifty, and prudent in managing them. This should be readily affirmed considering the prospect of what would happen if it were not true. As Clarence Carson has written, AIf this were not the case, it is easy to believe [the human race] would have long since perished from the face of the earth (Carson, 1991).@ Put bluntly, in a world characterized by the scarcity of resources, prodigality and the foolish disposition of one's efforts will surely lead to disaster.

The French economist, Frederic Bastiat echoed the centrality of this fundamental component of human nature in an essay he wrote entitled, AEffort and Result.@ In this essay he compared two views of how wealth is created and concluded that real wealth, Aincreases proportionately to the increase in the *ratio of the result to effort* (Bastiat, 1964).@ He argued:

> It is well to note that the *universal practice* of mankind is always guided by (this) principle. No one has ever seen, and no one ever will see, any person who works, whether he be a farmer,

> manufacturer, merchant, artisan, soldier, writer, or scholar, who does not devote all the powers of his mind to working better, more quickly, and more economicallyCin short, to doing more with less (Bastiat, 1964, p. 21).

This principle of human behavior is, of course, nothing new among economists. In fact, the primary tenet of modern economics is the notion that individuals are rationally self-interested. On this foundation, economists have made significant headway in explaining not only much of what takes place in trading relationships, but also in developing the model of supply and demand as an extremely useful tool for predicting the outcomes of various changes in important variables. Given that all this is so, most economists would probably wonder what could be wrong with utility analysis?

The fundamental problem of utility analysis and mathematical equilibrium models is that they are founded upon a naturalist vision of the cosmos and the philosophical foundations for this vision can be refuted. Economists all know that utility theory was originally promoted by Jeremy Bentham and John Stuart Mill in the nineteenth century. These men were very much influenced by the Enlightenment that was pressing forward the implications of the many scientific advancements being made in physics, astronomy, and the other hard sciences at the time. Indeed, the discoveries of natural laws or principles of action and reaction in the natural world had led to an increasingly mechanical understanding of the universe. As the mechanical view of nature progressed, thinkers and writers more and more assumed that all phenomena must belong to a vast mechanized system called Nature. As this conception developed, it was perhaps inevitable that thinkers would eventually attempt to explain the whole universe, including human life in the context of the well-oiled machine called Nature. When this occurred, a full blown naturalism became prominent and deterministic theories of human behavior were promoted. Bentham and Mill both stand in this line of reasoning. Richard Weaver has captured this progression well in his book, *Ideas Have Consequences*. In noting the progression of Enlightenment thought, he writes:

> [Then came] psychological behaviorism, which denied not only freedom of the WILL but even such elementary means of direction as instinct. Because the scandalous nature of this theory is quickly apparent, it failed to win converts in such numbers as the others[(materialism, evolution, etc.)]; yet it is only a logical extension of them and should in fairness be embraced by the upholders of material causation. Essentially, it is a reduction to absurdity of the line of reasoning which began when man bade a cheerful goodbye to the concept of transcendence (Weaver, 1948).

In his book titled, *Miracles,* C. S. Lewis accurately explains the inherent absurdity associated with naturalism that Weaver has so bluntly stated. The problem is that naturalism refutes itself on its own terms. In his book Lewis argues the case effectively:

> What the Naturalist believes is that the ultimate Fact, the thing you can't go behind, is a vast process in space and time which is *going on of its own accord.* Inside that total system every particular event...happens because some other event has happened; in the long run, because the Total Event is happening...[Therefore,] by Naturalism we mean the doctrine that only NatureCthe whole interlocked systemCexists. And if that were true, every thing and event would, if we knew enough, be explicable without remainder...as a necessary product of the system...[But] all possible knowledge...depends on the validity of reasoning. If the feeling of certainty which we express by words like *must be* and *therefore* and *since* is a real perception of how things outside our own minds really >must' be, well and good. But if this certainty is merely a feeling *in* our own minds and not a genuine insight into realities beyond themCif it merely represents the way our minds happen to workCthen we can have no knowledge. Unless human reasoning is valid no science can be true. It follows that no account of the universe can be true unless that account leaves it possible for our thinking to be real

> insight. A theory which explained everything else in the whole universe but which made it impossible to believe that our thinking was valid, would be utterly out of court. For that theory would itself have been reached by <u>thinking</u>, and if <u>thinking</u> is not valid that theory would, of course, be itself demolished. It would have destroyed its own credentials...Naturalism, as commonly held, is precisely a theory of this sort (Lewis, 1947).

Therefore, any theory of human behavior that is based upon a closed naturalistic view of the world is itself self-referentially absurd when it is pressed to its logical conclusion. Since utility analysis is necessarily attached to such a view, it is doomed because it is essentially dehumanizing and abandons logical and rational thought. As such, this view cannot provide us with the necessary anchor upon which to base our study. For this reason, much of human behavior cannot be explained within the context of the theory. This follows because the very essence of what it means to be human mitigates against such a naturalistic perspective of the universe. This is the case because economic modeling begins by assuming that individuals are utility maximizers. As a result, mathematical analysis requires that individual utility functions be held fixed. The upshot of this assumption is the implicit notion that behavior is determined within the confines of a mathematical model. If that were true, all human action is purely mechanical rather than the result of thought and reflection. While most economists recognize this limitation, as a practical matter, it is very easy to ignore it in the pursuit of one's research. As a result, it is necessary for economists to take great care in extending our discussions of human behavior to account for the evolution of individual values. In examining this issue, Jennifer Roback Morse notes that human preferences are not fixed and are readily changed. In a lecture she gave on the subject, she argued her case in the following fashion:

> [A] deterministic view of the human person cannot reckon with the reality of human freedom, the possibility of genuine choice, nor the reality of the personal will. The claim that we

> can change an economic outcome by altering the constraints depends on the preferences of the person being static. With given preferences, we economists can predict how changes in constraints will change outcomes. In effect, we treat the person as a stimulus-response machine. When ordinary people think of Achoice@ they usually mean more than responding to incentives. They usually mean that a person has made some decision about what to value, about what to consider a cost or benefit, about what really gives them satisfaction. And choice of this kind, is exactly what is absent from the economists' model using static preferences (Morse, 1997).

She goes on to point out that by trying to subsume *all* human behavior into the context of utility analysis, economists are actually undermining the very concept of human freedom and choice and are leaving the study worse for wear. She notes that nothing need be sacrificed of price theory as long as the clear limitations of its usefulness in describing human action are recognized. Rather, such an acknowledgment would open the door for the consideration of the whole process by which individual preferences are initially formed and how they are reshaped over time, if human beings are free to choose in a legitimate sense of the phrase, then it is clear that individuals really do use their powers of reason and observation to devise and enact plans which aim at reaping the benefits of perceived economic opportunities. It is also clear that this behavior is more than a deterministic response to some outside stimulus. This kind of behavior is missing from utility theory.

Not all economists approach the issue of human behavior in terms of strict utility analysis. Among those who have sought another direction in describing human behavior are the Austrians. For this reason, they have developed some excellent insights into the nature of human action. For example, Israel Kirzner has done a good job of expanding economic understanding by focusing on an understanding of human beings who actually do think and perceive. In his work he used an alternative understanding of human action to describe the market process. His position is that, AWhat happens in markets is not haphazard, but the consequence of inescapable economic regularities, expressing themselves in obviously relevant tendencies (Morse).@ Therefore, he sees underlying forces which systematically move the economy along. Yet, these forces do not eliminate human choice. In fact, human choice is so important that the market itself cannot be tightly understood apart from human action. He sees people who bring their individual thoughts and understandings of the nature of things to the market place in an effort to take advantage of trading opportunities that they individually perceive. The whole process results in the expansion of knowledge itself. Nonetheless, the direction of change will always be somewhat unpredictable. As Kirzner himself puts the matter:

> For Austrians...mutual knowledge is...full of gaps at any given time, yet the market process is understood to provide a systematic set of forces, set in motion by entrepreneurial alertness, which tend to reduce the extent of mutual ignorance. Knowledge is not perfect; but neither is ignorance necessarily invincible. Equilibrium is indeed never attained, yet the market does exhibit powerful tendencies towards it. Market co-ordination is not to be smuggled into economics by assumption; but neither is it to be peremptorily ruled out simply by referring to the uncertainty of the future (Morse).

Thus, Kirzner focuses the reader's attention on the process. As the market process continues, he notes that ignorance gives way to expanding, but incomplete, knowledge as long as participants in the economy remain free. That is, as long as property is protected from theft and fraud and people are free to engage in voluntary trade, the actions of each person will give rise to an expansion in the knowledge base and to a greater coordination of individual plans. Yet, because of the very nature of this kind of interaction, whereby individuals reflect upon how they might better their own circumstances from implementing some new approach, the exact direction of market change cannot be perfectly predicted beforehand since it would be impossible to formulate a mathematical model within which individual thoughts and efforts would proceed. In other words, it is impossible to know what pockets of mutual ignorance will be taken advantage of before such ignorance is driven out of existence by human action. The most that can be said is that human thought and effort will give rise to an expanding economy as long as the fundamental property rights of people in the economy are protected.

This is not to say that no prediction can be made of human behavior whatsoever. Only that the predictions that can be made, must be made within certain limitations. To argue that no prediction can be made would be to give up the study altogether and to accept the position of the Aradical subjectivist@ who sees all human choice as a matter of whim. In this view, human beings are either so creative and imaginative, or so capable of arbitrary choice, that no prediction of human action is possible. Kirzner rejects this line of thought and opts for a middle ground position rather than embracing either radical skepticism, which is becoming so fashionable in our Apostmodern@ age; or positivism, which cannot be sustained on logical grounds. Since, naturalism fails the test of rationality, and Aradical subjectivism@ rules out the value of any study whatsoever, it might be wise for economists to consider more deliberately the work of the Austrians, as well as that of any others who provide some reasonable foundation for our efforts.

Reviving the study of theology as a new direction in economic analysis

In developing a better understanding of actual human choice, much was lost when the study of theology was abandoned. The study of theology has a long history. In the course of time, theologians have examined not only the nature of human behavior, but also issues of the market place as well (Rothbard). Over the years, one of the issues that has been particularly important to theologians is that of free will. As has already been discussed, the issue of human free agency is also of economic interest. As discussed above, naturalism fails logically to provide a sufficient basis for a positive study of human behavior. Hence, in any social science the abandonment of theology was premature. For this reason, the work of theologians will help economists clarify some finer points of human action so that issues of morality and virtue can be dealt with without undermining the nature of our own study.

A good example of how this might progress can be found by looking at the work of the nineteenth-century Princeton theologian, Charles Hodge. Hodge dealt with the subject of free agency in his *Systematic Theology* (Hodge, 1993). In much the same way that Kirzner argues for a rational understanding of human behavior between positions of the neoclassicist and the radical subjectivist, Hodge developed a theory of human behavior that rested between the positions of what he called necessity and contingency. The interesting feature of this is that Hodge's work is so complete on the subject that it subsumes that of Kirzncr. In dealing with the topic of free agency, Hodge describes three theories of human behavior. He called the theories necessity, contingency, and certainty. Hodge's goal was to argue in favor of the theory of certainty as the only one that was thinkable among the three.

Hodge began his examination by considering the theory of necessity. Under this theoretical category he included all theories that assert that human action is the necessary response to a given situation. He pointed out that if human behavior follows necessarily from a given set of conditions, then the individual loses his identity as a thinking, planning, and acting creature. The result is a view of the world, and of individual human action, that is fatalistic. In this case, decisions are made in a mechanical fashion. As such, we are left with a view of human life in which decisions are made without reference to human reason. In fact, nothing is left of reason or love or morality. They are assumed to be just certain effects following naturally from some specific causes that necessarily preceded them. The result of such an understanding of human behavior is that the individual cannot be held responsible for the consequences of his actions because they were merely the necessary response to the situation. In the context of this terminology, utility theory would be classified as a theory of necessity and is, therefore, fatalistic. But this understanding of life goes against the fundamental consciousness that each person possesses of himself. For this reason, any theory of human behavior under this category is just not persuasive. Therefore, if real free agency is to be salvaged, it must be understood on the basis of an alternative approach.

Having rejected the necessity of human behavior. Hodge then considered the opposite alternative. He refers to this theory of human behavior as the contingency theory. He argues that if human behavior is contingent, then the individual must be thought of as not only possessing the power of self-determination of his actions, but also of possessing the power of the self-determination of his will. If this were an accurate description *of* human beings, then human decisions could not be predicted at all. That is, if in deciding upon any particular course of action the person might decide upon any act regardless of the antecedents that make him the person that he is, then there could be no confidence that he might behave in a certain way. This is exactly the position taken by the Aradical subjectivist@ that we considered earlier. But this position begs the question of whether or not a person can decide upon a course of action against his own will? The contingency theory assumes that the will is not determined by the internal and external antecedents and is, therefore, self-determined. Thus, it is assumed that the individual can potentially choose against his own will. The problem with this conception of choice is that everything is uncertain and no prediction whatsoever can be made of human behavior. Rather, all human choice is capacious and arbitrary. But while it is certainly conceivable that someone might have chosen differently in a given situation had certain principles and affections been more heavily weighed at the moment of choice, it seems utterly absurd to assume that liberty of choice requires that people be capable of choosing something other than their own choice. In the final analysis, this is the assumption being made in his theory of human behavior. For this reason, it is not at all persuasive either.

Against these two extremes, Hodge offers a middle ground. He calls the middle ground the theory of the certainty of behavior. In the context of this theory, the individual's volitions and actions are assumed to be determined by the person's own reason, feelings, affections, and character. In this case, the choice the individual makes in a particular situation is based upon the antecedent state of mind of that individual. While there may well be conflicting desires at the moment of the decision to act, it is understood that the action actually taken is not capricious or arbitrary. Rather, the individual's choice is rooted in who he is. In addition, the more that an individual's character is developed according to the principles of virtuous behavior, the greater the confidence that others can have that he will behave in certain ways in given situations. For example, a man who embraces the principle of honesty will actually tell others the truth on a regular basis. As he continues to do so, people who know him will observe that he is honest and they will come to expect *him* to continue this kind of behavior. Alternatively, someone who lies when it is convenient to lie will destroy the confidence that people have in him. They will come to expect him to lie in such situations and will not trust him even if he is telling the truth. In this case the failure to embrace the principle of honesty will result in ambiguity. Therefore, the greater the extent to which the principle of honesty becomes part of a person's makeup, the more people will develop trust in that person. Within this view, the individual is neither a machine nor is his behavior so arbitrary and capricious that those who deal with him cannot be somewhat certain of what his next choice might be. What matters in human action is the heart *of* the individual. But no other human being will ever fully know all that is in the heart of someone else (i.e., all the principles, affections, feelings, and reasons that give rise to the individual's will). Therefore, his behavior can never be fully predicted. In addition, as the individual learns new things by authority and experience, his character is molded and changed in new directions. For these two reasons, there will always be a degree to which the predictability of human behavior will remain beyond our capacity of mathematical precision. Yet much prediction can still be made. In addition, within this kind of understanding of human behavior, economists can readily discuss the morality and virtue of certain courses of action which, in the final analysis, are important to people as they weigh between certain alternatives.

Government policy and the practical difference of including morality into the discussion of economics

Does it make any difference in practice that the main theory underlying modern economics eliminates real choice? Furthermore, does the inclusion of moral issues really matter on a practical level? In the main, most economists have gone about their business as if it did not. Instead, most have been content to conduct the bulk of their work within the context of deterministic equilibrium models that assume static, utilitarian human preferences. In doing so, economists have had to embrace positivism, at least, implicitly and this point of view eliminates normative values from the discussion. But, if moral principles are important to the understanding of human behavior, then such a limitation in perspective *is* more than a little unfortunate.

In the course of developing her work on human action, Jennifer Roback Morse wrote an excellent article about the issues of state policy and moral behavior titled, AThe Modern State as an Occasion of Sin: A Public Choice Analysis of the Welfare State (Morse).@ In this article, Morse presents the case that state-run welfare programs tempt people to behave immorally and that this temptation arises even if one assumes that the program is offered in the very best of circumstances. In her paper she assumes the very highest motives on the part of the administrators of the program. Yet, in spite of this assumption, she is still led to conclude that moral behavior will decline because of some well-known economic problems, including rent seeking, moral hazard, and the prisoner's dilemma.

Using these economic principles, Morse develops her argument by considering the necessary structure of state welfare programs. She points out that these programs must be set up to operate along the lines of some rather specific rules that limit the discretion of administrators of the program. The purpose of such rules stems from the need to protect Athe public from abuse by either unscrupulous or politicized bureaucrats (Morse).@ Thus, the guidelines serve as a means of holding *the* government agency accountable. Therefore, once a welfare program is enacted by the state, money or in-kind transfers are arranged by the agency as long as the potential recipient qualifies for the assistance under the terms *of* the legislation. It is for this reason that issues of moral hazard and the prisoner's dilemma come into play. First, some people who do not qualify for the programs will be tempted to work less or undertake some other imprudent behavior in order to sink to the level whereby they might qualify for the benefits of the program. While the person is not engaging in outright fraud, he is nevertheless engaging in behavior that is both deceitful and slothful in order to secure a portion of the program's benefits.

In addition to this problem, after these programs are established and operated for some time, the problem of the prisoner's dilemma arises. As some people maneuver their circumstances so that they qualify for the largess that can be had from the public treasury, others are caught in a dilemma. If they remain marginally disqualified for the program, they begin to believe that they are being taken advantage of. Alternatively, to qualify for the program will require them to engage in the same kind of behavior as others. In this case, there will be a tendency to rationalize away the immoral nature of the behavior necessary to qualify and an Aentitlement mentality@ will emerge. The end result of such programs is the erosion of virtuous behavior of the populous over time.

This same problem exists when rent-seeking behavior on the part of businesses is undertaken. The theory of rent-seeking has been well developed by Gordon Tullock, James Buchanan, and other writers (Buchanan, Tullock & Tollison, 1980). Tullock defines rent-seeking as the use of resources to attain benefits for a minority while reducing the total product of the economy (Buchanan, Tullock & Tollison). Buchanan uses the term Ato describe behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus (Buchanan, Tullock & Tollison).@ As applied, the term is generally used to describe the process by which private citizens vie for government privilege in order to erect, displace, or maintain some competitive advantage.

The social loss from rent-seeking behavior arises from two sources. First, it comes from the source expenditures made by citizens in an effort to gain economic rents since these create no capital assets. Secondly, it comes from the subsequent reduction in output that would follow from successfully capturing monopoly privilege by way of government restraint. As Tullock concludes, ACompetition is not always a good thing. In a well-organized market, the individuals aiming solely at benefitting themselves end up benefitting other people. In a sufficiently badly organized market...they simply generate waste (Buchanan, Tullock & Tollison).@

One idea that emerges from this literature is the notion that economic behavior in the market place is essentially the same as that exhibited in rent-seeking. Throughout the literature this result arises from the assumption that all human behavior is characterized solely within the context of utility maximization. In this analytic format, the same behavior is shown to lead to either positive or negative outcomes depending upon the underlying institutional arrangements that exist.

But is this really the case? As mentioned earlier, Bastiat compared two views of how wealth is created, while only one was discussed initially. The other view holds that wealth increases to the extent that the *ratio of effort to result* is increased. This is precisely the reverse of the way that people naturally live their own lives. Yet, this must be the assumed position of all those who seek to gain special privileges by way of public policy because these privileges can only be had by extending the amount of effort required to gain a particular result. This is the very case being made in all the rent-seeking literature. Bastiat refers to the proponents of this view as Sisyphists. He named them after the Greek mythological figure, Sisyphus, who was condemned to spend eternity rolling a rock to the top of a mountain only to have it roll back down again. The point he was making is that such efforts are futile and actually work against general economic well-being. Despite this reality, there have always been examples of human beings seeking such privileges. The reason why this is true is because it is always possible to enrich one's self immediately by imposing greater burdens on others. But this kind of behavior is just plain immoral and is the outgrowth of the base human passions of greed, envy, jealousy, and covetousness. The extent to which government can be kept from being used in this fashion depends upon the vigilance of the general populace and their willingness to act towards one another with personal integrity and character. That is, the extent to which they are self-governed. In this case, the institutional arrangements discussed by Buchanan and Tullock would merely deter potential tyrants and thieves instead of serving as a conduit for their activity. But without this kind of integrity, people will more and more engage in their own rent-seeking activities to the detriment of the civilization within which they live.

From this perspective, the detrimental effects of rent-seeking are understood as arising from the immoral use of government to effectively take property from one group of people so as to benefit some other group. In essence, the process is really nothing more than a form of public theft. This approach is superior in that there is an essential, identifiable difference between two kinds of behavior. Specifically, there is a distinct difference between stealing someone's property and respecting it and, therefore, there is a real difference between the competition among thieves and the competition among entrepreneurs.

The inclusion of a discussion of morality, therefore, serves the positive purpose of describing the necessary consequences that follow from certain actions in certain situations. While it does carry with it a value judgment, such judgments are a fundamental part of the human experience. Thievery, whether it is carried out solely by individuals or through the political manipulation of government, invariably results in the same outcomeCnamely, the destruction of property and a reduction in output. Alternatively, respect for property and its use in voluntary trade consistently promotes productive activity, capital accumulation, economy of resource use, and growing economic output. The latter form of behavior is properly called moral, while the former, in all its forms, is immoral.

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