



UNIVERSITY OF LEEDS

Moral Economics

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“Rethinking Sustainability from an Islamic Perspective

Transforming Economy and Societies”

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Definitions: What is economics?

Finance

- Money for exchange
- Balance sheets
- Leverage for production

Economics

- Incentive structures that determine human behaviour
- Formal and informal institutions
- Values and ethics

Definitions: Types of value ethics

Consequentialism

- Utilitarian: consequences will maximize well-being

Deontological

- Acting in accordance with moral rules and laws

Virtue

- Moving towards a virtuous goal: justice, courage, piety, wisdom

Utilitarianism

Jeremy Bentham 1748-1832

'... it is the greatest happiness of the greatest number that is the measure of right and wrong'

(1776, A Fragment on Government)



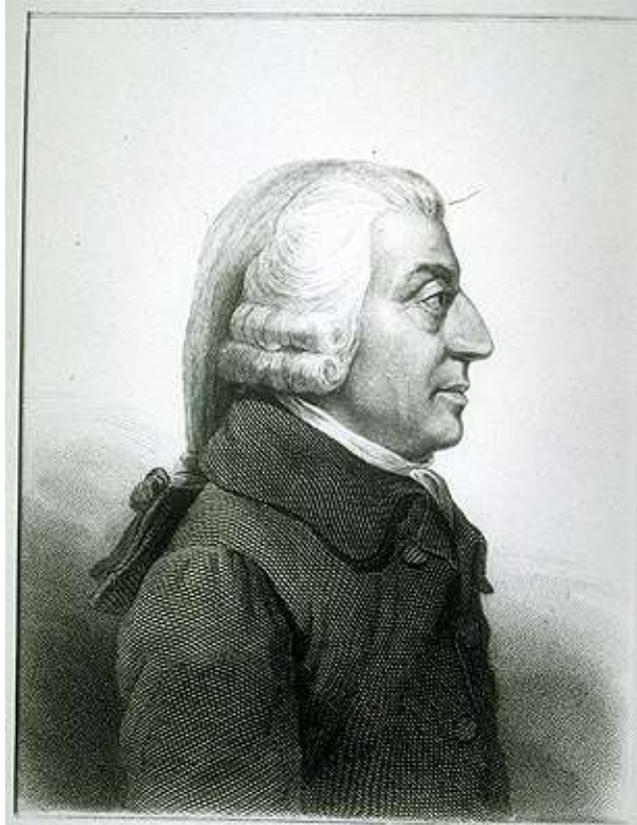
Self-interest -> Markets -> Societal well-being



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 self-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.

Adam Smith, *The Wealth of Nations*, 1776

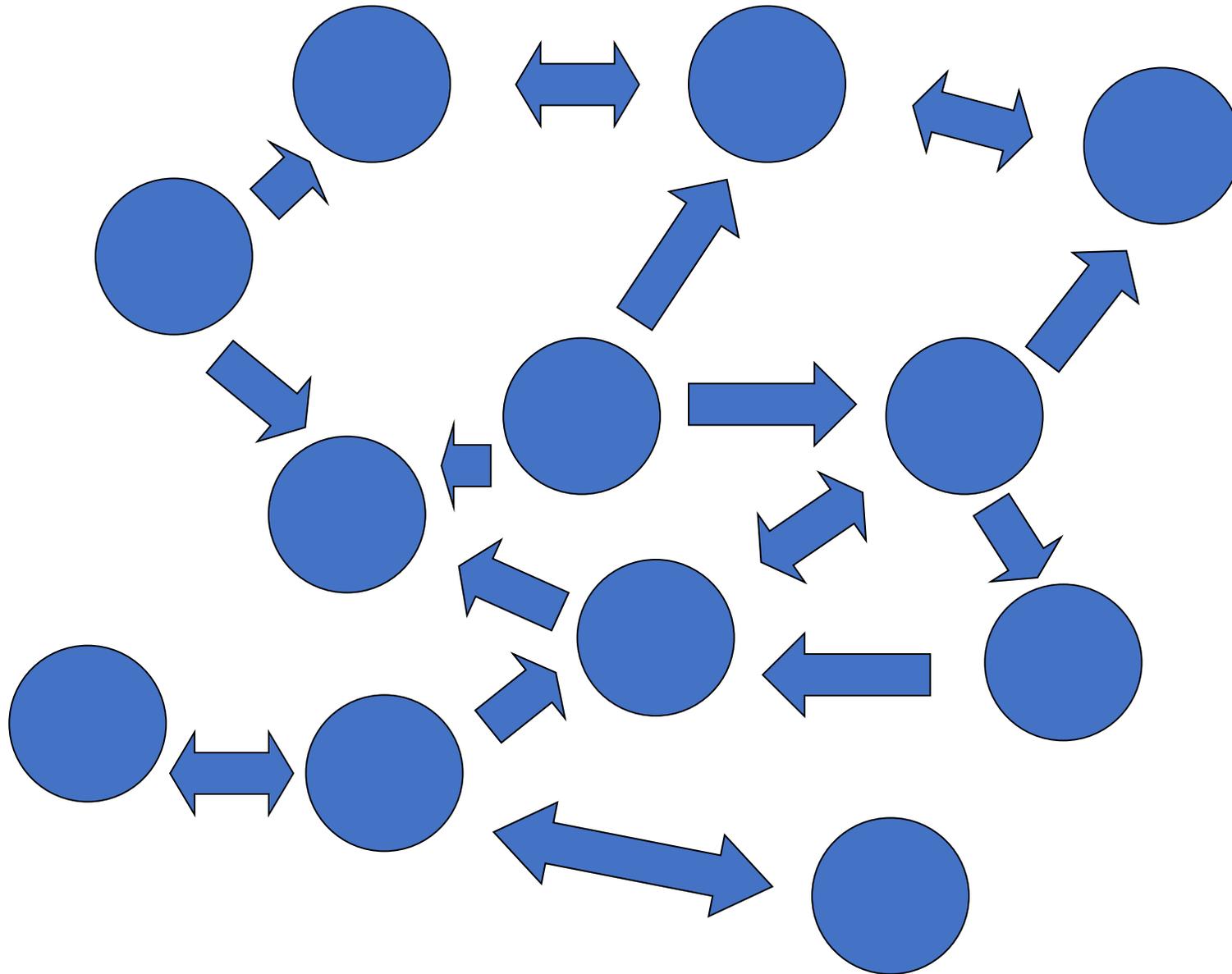
Utilitarian hidden hand of the market

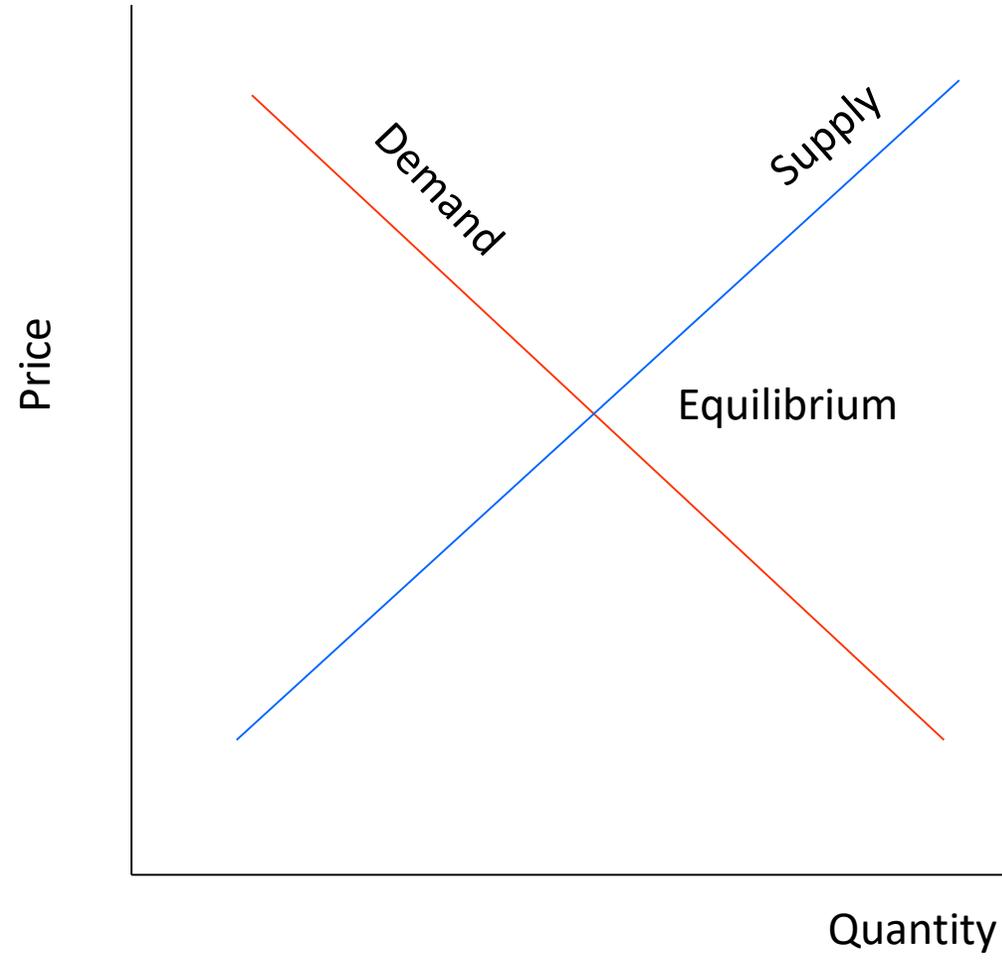


“[An individual is] led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was not part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.”

Adam Smith, *The Wealth of Nations*, 1776

Individuals interacting in markets increase overall social utility





Private Market Problems

Private markets are only efficient if:

- Buyers and sellers have 'perfect information'
- There are no public goods
- No externalities
- No monopoly buyers or sellers
- No increasing returns to scale
- No transaction costs
- No taxes
- No common property
- No other distortions between costs paid by buyers and benefits received by sellers

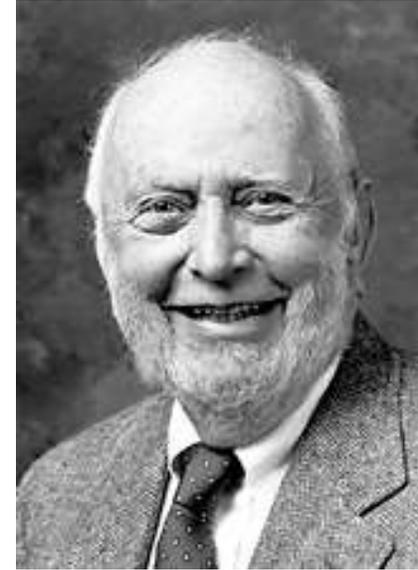
Monopoly

‘During the days of Muhammad, a small group of merchants met agricultural producers outside the city and bought the entire crop, thereby gaining a monopoly over the market. The produce was later sold at a higher price within the city. Muhammad condemned this practice since it caused injury both to the producers (who in the absence of numerous customers were forced to sell goods at a lower price) and the inhabitants of Medina.’

Investment Laws in Muslim Countries Handbook Volume 1

Douglass C. North

- Born 1920
- Nobel Prize in Economics 1993
- *“convinced that the tools of neo-classical economic theory were not up to the task of explaining the kind of fundamental societal change that had characterized European economies from medieval times onward”*



Institutions

“Institutions are the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, and self imposed codes of conduct), and their enforcement characteristics.” North, 1993 Nobel Lecture

- Incentive structure of a society
- Political and economic institutions - > determinant of economic performance

Institutions and Pirates

'The organizations that come into existence will reflect the opportunities provided by the institutional matrix. That is, if the institutional framework rewards piracy then piratical organizations will come into existence; and if the institutional framework rewards productive activities then organizations - firms - will come into existence to engage in productive activities.'

North, 1993 Nobel Lecture

Transaction Costs

- Only institutions that minimise transaction costs will survive

Transaction costs include:

- Cost of searching for a partner (or group) with whom to exchange
- Screening potential partners to ascertain trustworthiness
- Bargaining with potential partners (and officials) to reach an agreement
- Transferring the products
- Monitoring the agreement to ensure conditions are fulfilled
- Enforcing the exchange agreement

Transaction Costs

Increased by:

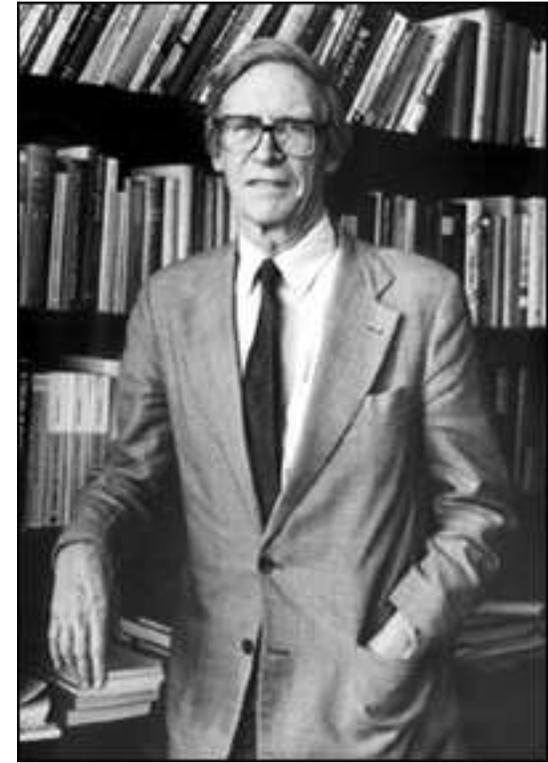
- Complexity of regulation
- Lack of trust
- Uncooperative behaviour

Institutions need to:

- Simplify regulation
- Promote trust
- Promote co-operation

John Rawls 1921-2002

A Theory of Justice *"Each person possesses an inviolability founded on justice that even the welfare of society as a whole cannot override. Therefore, in a just society the rights secured by justice are not subject to political bargaining or to the calculus of social interests."*



Principles of Justice

Two initial principles of justice

1. Equality in the assignment of basic rights and duties
2. Social and economic inequalities are just only if they result in compensating benefits for everyone, and in particular for the least advantaged members of society

(Rawls, 1999 p. 13)

Brundtland Sustainability: Time and Justice

"..development that meets the needs of the present without compromising the ability of future generations to meet their own needs"

(World Commission on the Environment and Development "Brundtland Commission" 1987)



“Well! I've often seen a cat without a grin,” thought Alice; “but a grin without a cat! It's the most curious thing I ever saw in all my life!”



Time and Justice

"There is no way for later generations to help the situation of the least fortunate earlier generation."

(Rawls, 1999, p. 254)

- All generations are equal
- Fairness in the present generation will ensure fairness in future generations
- There is no time preference for justice

Time and money

Quran (3: 130)

O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful.

Time and discount rates



- Nuclear, hydro, solar
- How do the costs discounted to net present value compare?
- Green economics: zero discount rate
- Future is worth the same as the present

Moral economics

Free markets

- There is nothing wrong with free markets
- BUT - assumptions must hold

Institutions

- Laws and social norms
- BUT - justice considerations paramount

Time preferences

- Generations are equal through time
- Future is worth the same as the present

