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Smith versus Friedman: Markets and ethics

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Abstract

This paper addresses the issue of ethics in modern business thought from the perspective of the father of modern economics Adam Smith using both *An Inquiry Into the Nature and Causes of the Wealth of Nations* and *The Theory of Moral Sentiments*. The foundation of modern business thought is represented by the Chicago/Austrian School of economic thought using Milton Friedman as a basis and examples from the popular business press and from the work of accounting scholars to illustrate the pervasiveness of this idea of market solutions to ethical problems.

It is contended that modern business theory, as represented by this neoclassical economic paradigm, has established a moral code for business based on efficiency of outcome and the assumed link of efficiency to self-interested behavior. The result is markets as the arbitrators of ethical outcomes, and profit maximization as the ultimate moral code.

Keywords: Adam Smith; Milton Friedman; Markets; Accounting; Ethics; Accounting education; Economics; Profit maximization; Baumal, W.J.; Business ethics

1. Introduction

On October 21st, 2003, the incoming chairman of the AICPA gave a speech on integrity and stated that the basis for the other two core values (competence and objectivity) is integrity (Voynich, 2003). Without integrity, competence is dangerous and without integrity, objectivity will always be questioned. An objective expert system that becomes a legal

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shield to avoid the consequences of poor decisions displays both a lack of competence and a lack of integrity. On the other hand, competence without integrity is a successful fraud waiting to happen. Ultimately integrity is destroyed by a weak moral code or by uncertainty about standards of conduct. A lack of integrity may lead to unethical behavior but more importantly a lack of ethical understanding may lead to a lack of integrity. This completes the circle because there are levels of competence for ethics as well, and Voynich's approach to integrity, presented in his October 2003 speech, highlighted the competence aspect of integrity because the code of behavior appears as an integral part of the definition.

> "When I speak about our core values, I always put competence in the middle—integrity, competence, and objectivity. I do this because I believe integrity and objectivity are the strengths that hold up and give life to our competence. In other words, our value is not given to us because of our technical abilities. Our value is attributed to us by the way we practice our profession and live by the code of ethics in all aspects of our daily lives.
>
> Integrity, by definition, is key to our profession. Integrity: a rigid adherence to a code of behavior. We are expected to live by a code of ethics which serves as the North Star for all of our activities." (Voynich, 2003, p. 3)

In short, integrity does not stand alone, nor is it fully supported by competence and objectivity because integrity demands an underlying moral code.[1] Moral integrity demands competence in morality but few business students will find ethics in the school curriculum. Very few business students will take ethics classes outside of the business curriculum, and many will not take a separate business ethics course, but every business major will take a macro and microeconomics sequence.

In this sequence, the student will be presented with the rational utility maximizing view of human behavior. The ethical content of these economics classes is ignored because we present the economic ideas as positive social science and therefore value free. In the neoclassical economic view of the world a set of behaviors is assumed that is taught will result in the best outcome for society. The calculus of pleasure and pain is displayed with graphs and mathematical formulas with the assumptions underpinning the efficient solutions presented to imply that any deviation from these behaviors is antithetical to capitalism. The behaviors presented include utility maximization and profit maximization as necessary ingredients to the market solution. This is all presented as a science, as a world of positive ideas and ultimately serves as the basis for positive accounting theory.

The standard for behavior presented as the foundation for neoclassical economic models is often referred to as Social Darwinism, a standard not far removed from survival of the fittest, and any violation of these strict requirements is considered antithetical to the ultimate goal of markets: efficiency. In the economics of the Chicago School (of which Milton Friedman is a leading light) and the Austrian School, all human motivation is limited to rational utility maximization and all decisions are exchanges based on utility maximization. This has the effect of turning everything, into a commodity, including sex and the decision

[1] In the extreme the defense in the Nuremburg trials was integrity because in the end just following orders when the line of command is clear is just integrity when the code calls for unblinking obedience to a cause.