

Moral Foundations of Capitalism: Study Guide 1

Studying for the Midterm Exam. The best method of studying for the class exams is to (i) review your notes from the lectures and the webnotes provided, (ii) to take the quizzes seriously, and (iii) to work through the study guide. 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 exam will “overweight” the social dilemma material, which will make up between 40 and 50% of the points on the exam.

The hardest questions on the study guide are more difficult than the hardest questions on the midterm. And, the easiest question is easier than the average questions on the 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 be similar to, but often somewhat different from the practice problems included below.

I. Routine Questions, Basic Knowledge of Authors and Ideas

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

Aristotle	Protestant work ethic launched capitalism
Erasmus	The Dutch experience shows that ethics and markets are compatible
More	the utility principle
Grotius	impartial spectator
La Court	the sea as common property
Baxter	happiness as the ultimate end
Barclay	Merchants carry on the most sordid business and by the most corrupt methods.
Locke	religious tolerance
Montesquieu	GNP is a good approximation for aggregate utility
Franklin	profits can be a divine obligation
Smith	co-evolution of man, morality, and society
Kant	better to be a human unsatisfied than a pig satisfied
Bastiat	harmony of economic and moral interests

Bentham	utopia as a monastery
Mill	he that gets all he can honestly and saves all he can, will certainly become rich
Spencer	categorical imperative
Pigou	The ethics supported by markets make democracy more sustainable
Weber	Some forms of taxation undermine virtue

1. Identify and or Define (Answer with just a few sentences.)

- | | |
|-----------------|----------------------------|
| 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. assurance game |
| g. Bentham | q. prisoner's dilemma game |
| h. Mill | r. work ethic |
| i. Spencer | s. gains from trade |
| j. civil ethics | t. externality |

II. Short Answer Questions (Answer with a few sentences.)

- 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.
- 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.
- Locke argued that there are three foundations for ethical or normative conduct. List the three categories and describe briefly the kinds of ethical rules ideas that he would associate with each of the categories.
- Smith argued that humans are predisposed to behave in accord with "moral sentiments." Explain briefly the main elements of his theory of ethical behavior.
- Bentham in a sense reinvented Aristotle's "ultimate aim," but he has a much simpler theory of human happiness. Briefly explain both his ideas

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about human happiness and the manner in which happiness or utility can be used to determine ethical conduct.

7. 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.
8. 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.
9. 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.

III. Game Theoretic Analyses of Social Dilemmas (There are generally more parts to the questions listed below than will be on the exam.)

10. **On the Problem of Excess Conflict: the Hobbesian Dilemma.** Use a 3 by 3 game matrix to characterize the "Hobbesian Jungle."
 - a. Is there a Nash equilibrium?
 - b. Is the Nash equilibrium Pareto Optimal?
 - c. Now assume that both players have internalized a "wrong to attack" norm. Show how the payoffs may change enough to escape from the Hobbesian dilemma.
 - d. In a larger society would it be necessary for everyone to internalize this norm for peace to emerge?
 - e. Discuss how government can substitute or augment internalized norms that oppose attacking others.
 - f. Illustrate how a law enforcing government's effort to protect one's person and property can avoid the Hobbesian dilemma.
11. **On the Overuse of Common Resources.** Carefully construct a 3x3 game in which two persons make use of a common property such as a pond, pasture, or woodlot. Assume that the total output is maximized in the middle cell and falls as the total usage exceeds that one.
 - a. Characterize the Nash equilibrium of this game

- b. Is there a social dilemma at that Nash Equilibrium?
 - c. Think of two or three norms that can solve the problem and how the guilt or virtue payoffs would differ in those cases. (for example, privatization solution vs sharing rules)
12. **Free-Rider problems.** Construct a 2x2 game in which two persons can jointly produce or pay for a pure public good (such a clearing a sidewalk or road of snow).
 - a. Explain why your game (its strategies and payoffs) illustrate the free rider problem that affects the supply of public goods.
 - b. Show how an internalized ethic can solve the problem.
 - c. Show how subsidies for contributions can solve the problem.
 - d. Explain why subsidies may be useful even in cases in which ethical dispositions tend to reduce free riding in many situations.
13. **The Emergence of Conventions.** Construct a 2x2 coordination game and illustrate the gains from a convention in such cases.
 - a. List 5 types of behavior that could be used to label the two strategies—which is to say instances in which a coordination problem is likely to exist.
 - b. Discuss why internalized norms favoring one of these solutions may make a community more attractive than it would otherwise be.
 - c. List cases in which convention to exist in your community that do not seem to address a coordination problem, and explain why you believe this to be the case.
14. **Externality problems.** Construct a 3x3 game in which two persons can undertake different levels of an externality generating activity. Your game matrix should illustrate the dilemma associated with externalities. .
 - a. Characterize the Nash equilibrium of this game
 - b. Are their mutual gains from adopting a norm with respect to externalities?
 - c. Are their mutual gains from paying an enforcer (government) to enforce the regulation of externalities?
 - d. Show how either of the above can increase aggregate utility. (Hint: show how internal and external sanctions can change the payoffs and equilibrium.)
 - e. Show that either of the above solutions can be a Pareto Superior move.

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15. **On the advantages of Promise Keeping.** Construct a 3x3 game in which two persons can keep their promises all of the time, half of the time, or none of the time. Assume that for this community, mutually keeping promises always yields the greatest aggregate utility, but that individually each benefits privately when he/she breaches their promise and the other keeps it.
- Characterize the Nash equilibrium of this game
 - Are their mutual gains from adopting a norm of promise keeping?
 - How strong does an internalized promise keeping norms have to be to solve the promise keeping problem in your illustration?

Other Discussion Questions and Puzzles

16. More on Ethics and Commerce
- Several of the authors read in the first part of the course were skeptical about the effect of markets on virtue (as with More, Erasmus, and Montesquieu). Summarize their arguments. If those views were dominant, how would this affect the size of markets, if a significant number of persons (say 30%) take virtue into account when they choose their careers?
 - 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 one of those virtues tends to increase social utility or social output (GNP).
 - 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 persons.
17. 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, which is far more than the "zero" predicted. On the other hand, there is significant defection.

- What do these experiments tell you about the limits of game theory as a model of human decision making?
 - What do these experiments imply about the norms participants bring to the game?
18. More Philosophical Issues
- 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?
 - Spencer argues that people have moral instincts that are analogous to their geometric sense. Explain why he believes that utilitarians must rely upon 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?
 - 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 these appear to represent differences between private and civil ethics?
 - 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 analyzes. Under what circumstance, could they be regarded as the same theory of ethics?
 - Who said: "Virtue is the best guard against the many unavoidable evils incident to us; nothing better alleviates the weight of the afflictions, or gives a truer relish of the blessings, of human life."
20. **More Game Theory Practice.** 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

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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

21. 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.

22. As an 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.