

MACHIAVELLI'S MISTAKE:

WHY GOOD LAWS ARE NO SUBSTITUTE FOR GOOD CITIZENS*

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Political philosophers from Aristotle to Thomas Aquinas, Jean-Jacques Rousseau, and Edmund Burke recognized the cultivation of civic virtue not only as the test of good government, but also as its essential foundation. “Lawgivers make the citizen good by inculcating habits in them,” Aristotle had written in the *Ethics*. “It is in this that a good constitution differs from a bad one.”(Aristotle, (1962):103) Early in the sixteenth century, Nicolò Machiavelli gave rather different advice: “Anyone who would order the laws of a republic must assume that all men are wicked (*rei*) ... it is said that hunger and poverty make them industrious, laws make them good.” (Machiavelli, (1984):69-70). The task of government for Machiavelli was to not to make citizens moral but rather to induce citizens motivated by what he termed the “natural and ordinary humors” to act as if they were good. A century and a half later, Hobbes asked how the potentially destructive consequences of the autonomous pursuit of individual gain might be constrained by the authority of a sovereign ruler.

The response of the classical economists was that good laws are those that harness the “natural and ordinary humors” for public ends. This was the key insight of Bernard Mandeville's *Fable of the Bees*. The subtitle of the 1714 edition of the *Fable* ((Mandeville, (1924))) announced that the work contained “..several discourses to demonstrate that human frailties...may be turn'd to the advantage of civil society, and made to supply the place of moral virtues,” with the result, he explains in the text (p.24), that “the worst of all the multitude did something for the common good.” In contrast to the Aristotelian view that good laws make good citizens, Mandeville suggested that the right institutions might harness shabby motives to elevated ends. Adam Smith's “invisible hand” explained how this economic alchemy could be accomplished.

Novel foundations for law and public policy followed. Thus in his *Essays: Moral, Political and Literary* (1742), David Hume, (1964) :117-118 recommended the “maxim” that

in contriving any system of government ... every man ought to be supposed to be a *knave* and to have no other end, in all his actions, than private interest. By this interest we must govern him, and, by means of it, make him, notwithstanding his

insatiable avarice and ambition, cooperate to public good.

In similar spirit, Jeremy Bentham (Bowring, (1962):380) offered his “*Duty and Interest* junction principle: Make it each man’s *interest* to observe ... that conduct which it is his *duty* to observe.” His *Introduction to the Principles of Morals and Legislation* is arguably the first text in what we now call public economics. In it Bentham laid out the public policy implications of Hume’s maxim. The early 20th century welfare economics of Marshall and Pigou provided the economic foundations of this claim.

As a result, economists, political theorists and constitutional thinkers since the late 18th century have taken amoral and self-regarding *Homo economicus* as their fundamental assumption about behavior, and partly for this reason, have stressed competitive markets, well-defined property rights, as well as efficient, (and since the 20th century) democratically-accountable states as the critical ingredients of governance. Good institutions thus displaced good citizens as the *sine qua non* of good government. Prices would do the work of morals.

This remains the canonical model of policy-making in economics. Hume's maxim is beautifully illustrated by implementation theory and mechanism design (Laffont, (2000), Maskin, (1985), Hurwicz, (1975)). These approaches seek to determine the contracts, property rights and other social rules – in short, constitutions – that induce individuals with conventional self-regarding preferences to implement (as a Nash equilibrium of a non-cooperative game) an outcome which is not sought by any of the individual participants, but which is socially valued. Moreover, because many economists believe that our institutions do this job tolerably well, they would not take issue with the philosopher David Gauthier, (1986):96 when he writes that: “morality has no application to market interactions under the conditions of perfect competition.”

The classical constitutional challenge posed by Bentham, Hume, Smith and others constitutes the Holy Grail that still motivates policy design: to find laws and other public policies that would simultaneously facilitate peoples' the pursuit of their own ends, while inducing each to take adequate account of the effects of their actions on others. In posing the challenge this way they correctly identified the source of the market failures that to this day provide the primary rationale for government interventions. Economics in the intervening years has considerably sharpened our understanding of what it means to that people “take adequate account of the

effects of their actions on others” and why, when they do not, the resulting decentralized allocations will be inefficient. The result is a coherent guide for Machiavelli's prince clarifying what it might mean to induce citizens to act if they were good, namely to provide incentives and constraints such that a self regarding individual would act as if he valued the effect of his actions on others in the same manner that those effected would evaluate them.

If the “others” were our kin, neighbors, or friends, our concern for their well-being or our desire to avoid social sanction might induce us to take account of the effects of our actions on them. Reflecting this fact, an important response to the constitutional challenge – one that long predates the classical economists and that now seems utopian – is that caring for the well-being of others need not be confined to intimates but ought to be extended to all of those with whom one interacts. However, with the increasing scope of markets over the last half millennium, individuals have come to interact not with a few dozen, but with hundreds and indirectly with millions of strangers. And so, with the maturation of capitalism and growing influence of economic reasoning, the burden of good governance shifted from the task of cultivating civic virtue to the challenge of designing institutions that work tolerably well in its absence. Prices, not ethics would ensure that actors took account of the effects of their actions on others.

This ingenious classical economists' response to the constitutional challenge was not motivated by the belief that economic actors and citizens are amoral. Quite the contrary: Hume, pioneered the study of the evolution of social norms, and in the sentence immediately following the passage quoted above, mused that it is “strange that a maxim should be true in politics which is false in fact.” Smith, (1976 [1759]):3 in his *Theory of Moral Sentiments*, famously held that : “How selfish soever man may be supposed, there are evidently some principles in his nature that interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.” Even Machiavelli's “wicked” citizens were introduced as a prudent assumption for prince, not as a fact about human nature, an assumption that Machiavelli repeatedly questioned (Benner, (2009)). None of these writers assumed a malign human nature.

Instead the classical economists reasoned that when large numbers of strangers interact, ethical behavior would be an insufficient basis for good government, which therefore would need

to adopt a systems of constraints and incentives to supplement the civic virtues. They did not ignore moral behavior, but instead assumed it would be unaffected by incentive-based policies designed to harness self-interest. Because it is so often implicit, it may help to identify what may be its first explicit statement, by John Stuart Mill, (1844): 97

[Political economy] does not treat of the whole of man's nature...,... it is concerned with him solely as a being who desires to possess wealth,... it predicts only such ...phenomena ...as take place in consequence of the pursuit of wealth. It makes entire abstraction of every other human passion or motive.

Along with civic virtue, explicit incentives and constraints could thus contribute additively to good government: the effects of incentives and morals were thus separable in a sense to be made clear presently. As a result of this implicit separability assumption they failed to take account of the conditions under which civic virtue would flourish and favorably affect societal outcomes and how harnessing self-interest to the public good might attenuate civic virtue. The economists who followed Mill took the reasoning a step further by demonstrating that through a combination of market prices and governmental taxes and subsidies, material incentives could implement socially desirable social outcomes irrespective of individual preferences. This remarkable result seemingly dispensed with virtue entirely as a foundation of good government and spared the policy maker or constitution writer the liberal embarrassment of favoring some values over others.

Taking liberties with the essential role of economic thinking since Machiavelli and with the Florentine's own writings, this is Machiavelli's mistake. It is a mistake, I will show in the pages that follow, for two reasons

First, other-regarding or ethical motives such as fairness, honesty, reciprocity and generosity play an essential part in the functioning of all modern political and economic systems and in their absence optimal incentives of the type devised by mechanism designers and other economists are severely limited. . Moreover, the importance of these ethical and other social motives is likely to increase as the wealth of nations shifts from tangible steel and land to intangible knowledge and affect, and as the challenges facing peoples increasingly arise from global and other large scale interactions that cannot adequately be governed by private contract and governmental fiat or incentives. The “constitutions for knaves” approach, I will show, is

severely limited in addressing these issues, once one takes account of the limited nature of incentives and punishments that may be applied in liberal society, the kinds of information typically available to those designing incentives. This is true even if one assumes, inconsistently, that those designing public policy embrace exactly those civic virtues which this approach would like to dispense with in the rest of the population.

Second, material incentives often crowd out moral sentiments dampening and even reversing the intended effects. In the next chapter I will provide extensive evidence that the classical separability assumption – the incentives and morals are additive in implementing desirable outcomes – is frequently violated. Explicit incentives backfire outside the behavioral experimentalist's lab as well.. Representative samples of Jewish West Bank settlers in 2005, Palestinian refugees in 2005, and Palestinian students in 2006 were asked how angry and disgusted they would feel or how supportive to violence they might be if their political leaders were to compromise on contested issues between the groups. Those who regarded their group's claims (on Jerusalem, for example) as reflecting “sacred values” (about half in each of the three groups) expressed far greater anger, disgust and support for violence if the compromise were accompanied by a monetary compensation for their own group than if no compensation were offered (Ginges, et al., (2007)) Similar results were found in a survey of the willingness of Swiss citizens to accept environmental hazards: the offer of compensation increased resistance to the local siting of a waste facility (Frey and Jegen, (2001).) In an unusual natural experiment, the imposition of fines designed to reduce hospital stays in Norway had the opposite effect (Holmas, et al., (2009)) while in England hospital stays were greatly reduced by a policy designed to evoke shame and pride in hospital management rather than the calculus of profit and loss.

Thus policies designed for a citizen seen “solely as a being who desires to possess wealth” are likely to be insufficient even when the separability assumption holds, and even to be counter productive when incentives crowd out morals.

If the explicit incentives that form the foundation of markets and public economics crowd out the virtues necessary for the functioning of a modern economy and polity, it would seem that the resulting society – liberal democratic capitalism – must be dynamically unstable, in the sense that it does not sustain the individual values and motives necessary for its functioning.

This concern, which I call the parasitic liberalism thesis, holds that markets and other institutions endorsed by liberals depend on family-based, religious and other traditional social norms that are endangered by these very institutions. Liberal society thus fails Rawls' test of "stability:" it does not "generate its own supportive moral attitudes." Experimental evidence presented mentioned above provides support for the idea. In chapter 3, I represent the thesis in a model of the dynamics of institutional and cultural change, indicating the conditions under which the cultural dynamic of liberal society leads to economic dysfunction, instability and eventually collapse. I then provide surprising cross-cultural evidence that is inconsistent with the implications of the model. Liberal societies are distinctive in their civic cultures, exhibiting levels of generosity, fairmindedness, and civic involvement that distinguish them from non-liberal societies. The parasitic liberalism thesis fails not because it misunderstands the cultural consequences of markets, but rather because it overrates the benign contribution of tradition to the moral underpinnings of liberal institutions, and underrates the contribution of the liberal state and other non-market aspects of the liberal social order to the flourishing of these civic virtues.

While allaying the fear that liberal society may be unstable due to the cultural consequences of markets, the task of designing public policies that account for the fact that moral motives are a fragile resource likely to be attenuated by explicit incentives remains. I address this challenge in Chapter 4.

Two empirical puzzles show that some incentives work almost exactly as conventional economic theory predicts while others backfire. Unraveling these puzzles will provide some guidelines for policy, but it requires an understanding of the causal mechanisms by which material incentives crowd out moral motives. Experimental and other evidence suggests that explicit incentives and social motivations may be at loggerheads due to individual desires for autonomy, self esteem and fairness, which may be compromised by incentives. The incentives and other policy interventions favored by economists – perfecting both property rights and the competitive process among economic actors – can also compromise the cultural environments in which individuals learn and retain moral motives.

How should a sophisticated hypothetical social engineer – that is, one who is aware of the motivational and institutional crowding out problem – design policies and institutions? Three

results are demonstrated. First the optimal use of incentives may be either greater or less in the presence of motivational crowding out compared to a case where it is absent. Second, cultural market failures are pervasive, and result in overuse of markets even under ideal conditions for (Coasean) bargaining in the design of property rights and other institutions. Finally, a new second best theorem is proposed: the better definition of property rights and other policies considered by economists to improve incentives may degrade economic performance when they crowd out ethical motivations and alternative governance institutions.

A closing coda (Chapter V) reflects on the value of a more intimate engagement between the political theory and philosophy of good governance on the one hand and the sciences of human cognition and behavior on the other.

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