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The altruism in economics

The City of Yonkers, New York, wound up in a distressing predicament early this year. The municipal budget was running a deficit and the economic crisis was sorely aggravating the problem. Layoffs were needed and among the casualties were six firefighters, including, most regrettably, a young man who'd recently rescued several children from a burning apartment building. The job cuts were due to go into effect the first week of January.

But then something remarkable happened. The men and women of the **Yonkers Fire Department** offered to work days free for six months so the city could save money and their colleagues could save their jobs. The deal was approved by 75 percent of firefighters and the layoffs were avoided. "Everyone is aware of what is going on with the economy," explains Patrick Brady, president of the local firefighter's union. "We banded together and voted to save our brethren."

Amid the job losses, the home foreclosures and the bankruptcies of this crushing recession, these sorts of stories provide a rare glimmer of hope. Across the country and around the world, people are sharing jobs or accepting reduced wages in order to help their colleagues and prevent wider unemployment. (See **How to avoid layoffs** for more stories of recessionary selflessness.) President Barack Obama even lauded these efforts in his inauguration speech, saying it's "the selflessness of workers who would rather cut their hours than see a friend lose their job which sees us through our darkest hours."

Indeed, this selflessness is heartening. But such altruism is also evidence that the standard economic theory our financial system has been built upon is hopelessly flawed. For the past 50 years, economic policy has been poisoned by the cynical premise that people are innately selfish and materialistic. This is what has been taught in economics classes; this is what has informed government decisions such as bank deregulation; and this is what has spawned the Wall Street culture of "greed is good."

Now the basic tenets of economics are being reconsidered. A growing body of experimental work by behavioral economists proves altruism not only exists but is one of our primary motivations, even in financial affairs. And if some progressive economists have their way, we may be on the cusp of a more humane era in which altruism, not avarice, becomes the trait our economic system nourishes. "It is increasingly obvious that people are motivated by morality; people are motivated by ethics," says Herbert Gintis, an emeritus professor at the **University of Massachusetts** and one of the leading economists studying altruism. "We may be seeing a possible renaissance of economic theory."

Economics has long been known as the "dismal science" for its ruthless view that people are motivated solely by their financial or material interests. The roots of this theory can be traced to Adam Smith, who proposed that individuals acting selfishly form an "invisible hand" that creates the best society possible. "By pursuing his own interest," wrote the 18th-century Scottish philosopher in The Wealth of Nations, "he frequently promotes that of the society more effectually than when he really intends to promote it." A century later, political economist John Stuart Mill inspired the term "Homo economicus" by invoking man as "a being who inevitably does that by which he may obtain the greatest amount of necessaries, conveniences and luxuries, with the smallest quantity of labor and physical self-denial."

These propositions became the pillars of traditional economics and were embraced by George Stigler, Milton Friedman, Alan Greenspan and the other titans who shaped the economy in the second half of the 20th century. Trickle-down theory, laissez-faire capitalism and supply-side economics are all edifices constructed on the foundation that people are rational, self-interested financial actors. Nobody captured the doctrine more succinctly than Stigler, the late Nobel laureate who ignited the crusade against government regulation: "[Smith's] construct of the self-interest-seeking individual in a competitive environment is Newtonian in its universality," he wrote.

Alas, all this was a distortion. Smith was actually something of a humanist who, in *The Theory of Moral Sentiments*, celebrated the altruistic instinct. "How selfish soever man may be supposed," wrote Smith, "there are evidently some principles in his nature, which interest him in the fortune of others and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it." The problem for Smith, and the generations of economists who followed, was that "moral sentiments" were difficult to quantify. So they were ultimately excluded from economic theory.

It was evolutionary biologists, with their penchant for field observation, who started to explore the question in an empirical manner. It began with Charles Darwin, who was amazed by the cooperation among bees; moved to William Hamilton, who studied altruism among rabbits; and went on to include Robert Trivers' work on sharing among vampire bats. Once altruism was established in the natural world, the same analytical eye inevitably turned toward the human sphere.

In 1973, a landmark experiment was conducted at blood banks in Kansas City and Denver. It was inspired by the "crowding out" theory of British social researcher Richard Titmuss, the idea that people perform certain tasks, such as donating blood, for the common good, but that their motivation would be "crowded out" if they were offered a financial reward. The two blood banks were ideal testing grounds because both had "willing" files bearing the names of previous donors. For the experiment, a control group was sent the typical letter announcing a blood drive; a test group was sent the same correspondence offering $10 for a donation. The results were decisive: Within the control group, 93 percent responded to the call to donate; for those offered a cash reward, only 65 percent contributed. "I felt we'd made a real breakthrough," recalls Bill Upton, who ran the experiment as a psychology student at **Cornell University** in Ithaca, New York, in the 1970s. "It was significant evidence that money wasn't necessarily an incentive."

In fact, the result was remarkable for two reasons. First, it contradicted standard economic theory and proved the existence of human altruism. Second, this major advancement in understanding financial motivation had been made by a psychology student using a sociologist's theory. Where were the economists?

The reality is that for most of history, economists have preferred theory to experimentation. This changed when the field of behavioral economics began to take shape in the 1970s. The movement adopted insights from psychology along with the empirical methods used in other social sciences to bring a fuller picture of human motivation and decision-making to economics. Behavioral economics has now blossomed into one of the field's most influential disciplines, with its practitioners populating the bestseller lists and advising the White House and its experiments resonating throughout academia.

Once the experimenting began, the hallowed economic pillars began to crumble. What was perhaps the most important development occurred in 1982 when German economists at the **University of Cologne** created the Ultimatum Game. In this experiment, Player A is given $10 and Player B is given nothing. Player A must make an offer to Player B; both parties keep the money only if that offer is accepted. According to standard economic theory, the minimum offer of $1 should be made and accepted because it represents a clear financial gain for Player B. But in the thousands of times the experiment has been run, the average accepted offer is $4 and offers of less than $3 are routinely rejected. People, it turned out, were more concerned about equality than financial gain. "Fairness is fairly universal," says Werner Güth, one of the economists who ran the experiment.

Such a statement may seem so obvious as to be banal. After all, the idea that people have an innate morality has been tossed about for millennia, from Plato's Meno to the French philosopher Auguste Comte's invention of the word "altruism" in the 19th century. But for economists weaned on the brutal model of Homo economicus, proof of something as simple as fairness was revolutionary.

The evidence wasn't just coming from controlled experiments. In the 1990s, Swiss government officials wanted to build a nuclear waste facility outside the village of Wolfenschiessen. After a robust public awareness campaign, a bare majority of villagers—51 percent—supported the project. In hopes of bringing more people on board, payments of up to $8,700 per person was offered; instead, support plummeted to 25 percent. Villagers said they considered the money a bribe and felt belittled that their moral quandary had become a financial transaction. “The message was clear: People are much more altruistic than standard economics claims,” says Bruno Frey, an economist at the **University of Zurich** who studied the Wolfenschiessen case. “The challenge is for economists to nurture this intrinsic motivation instead of crowding it out.”

Behavioral economists Uri Gneezy and Aldo Rustichini conducted another revealing study. Several daycare centers in Israel had problems with parents picking up their children late, so the economists devised a system f nominal fines—about $3 for each late pickup—to see if this would prompt punctuality. On the contrary, ırdiness soared, the rate sometimes tripling. The conclusion? Fines rendered lateness acceptable because it ecame a financial transaction, while social norms—respect for the daycare workers, for example—were a etter motivator for punctuality.

Intrigued, Gneezy and Rustichini went on to show that volunteers collected more money for charities than those who were paid to canvas. “The traditional assumption in economics was that people would do anything for a material payoff,” says Gneezy. “This assumption took economics a long way, and it is still a good assumption in situations, such as two traders on the floor at the stock exchange. But there are situations where other relationships, communal relationships, are preferable.”

Perhaps not surprisingly, traditional economists revolted. As Kristin Monroe, an expert in altruism and political theory at the **University of California, Irvine**, famously wrote, they tried to “squeeze a fat lady into a corset” by awkwardly forcing these new findings into the cynical confines of standard economic theory. The “warm glow theory,” for example, argues that behaving generously provides pleasure, which is a benefit, thus making altruism “impure.” Other experiments proved people are more likely to behave selflessly in public settings, rendering altruism a cost incurred to enhance one’s reputation. However, prying into a gift horse’s mouth in search of cavities doesn’t make the gift horse vanish. The essential had been accomplished: Economists were admitting, however reluctantly, that altruism existed.

If it feels as though economists are getting an unfair shake, consider the following. In the 1990s, another Cornell University economist, Robert Frank, tested the hypothesis that “exposure to the self-interest model commonly used in economics alters the extent to which people behave in self-interested ways.” Among the findings: Economics majors made less generous offers when playing the Ultimatum Game; economics professors gave less to charity than their university colleagues; and when asked to imagine they’d found somebody else’s $100 bill, economics students were three times more likely to say they’d keep the money than students from the astronomy department. “Economics training doesn’t make you more honest,” Frank says. “It’s wildly implausible. It would be like water running uphill.”

This cynicism comes with disturbing consequences: Negativity begets negativity. The Swiss economists Armin Falk and Michael Kosfeld conducted a seminal study in 2004 on distrust in the business environment.

They found that people treated with suspicion are less motivated. A company might, for example, enact a policy forbidding private Internet use at the office and there would be no impact on morale. However, if the company installs spy software on employees' computers, morale plunges.

This is another economic phenomenon redolent of evolutionary biology, the "tit-for-tat" survival strategy. Under this model, on meeting a stranger, the initial gesture should be conciliatory (a smile or a handshake are human demonstrations of goodwill). But from that point on, one should act as the stranger acts: hostile if hostile, cooperative if cooperative. In short, do unto others as they do unto you. By this logic, if an economic system treats people as mercenaries, mercenaries they will be. But the reverse is also true: Treat people as moral and altruistic, and most will be.

With this wealth of new findings, the challenge is to build new economic models that will eventually translate into viable policies. Among the vanguard on this quest is the University of Massachusetts' Gintis, who, as the lead author of ***Moral Sentiments and Material Interests***, has literally written the book on altruism and economics. The fact that Gintis champions a more nuanced economic theory can be partly attributed to his eclectic background. He was a Marxist in his youth and an adviser to Martin Luther King, Jr. in the 1960s, but he also studied advanced mathematics and received his Ph.D. in economics from **Harvard University**. Forty years of research has led him to a blunt conclusion: "Altruism isn't irrational," he says, "because if it were, the only rational people would be sociopaths." Of course, there will always be unscrupulous individuals who are devoid of altruism, but they're the exceptions rather than the rule.

Gintis proposes a theory called "strong reciprocity," arguing that bonds of trust and cooperation within a community often serve as greater motivation than material reward. The theory is based on the premise that humans evolved in small groups with strong social contracts and plenty of contact with strangers. Cooperation within the tribe was advantageous so long as free riders were punished. It was also the best gambit on encountering strangers. Cooperation, particularly in times of famine, was the only means of survival, so altruism became a favored evolutionary trait.

What this means, Gintis says, is that while financial incentives are important motives—perhaps even the most important—they can be trumped by a person's selfless instinct. This instinct is responsible for some of humanity's greatest achievements. "Movements for civil rights, civil liberties and political democracy in authoritarian states are responsible for creating modern liberal democracies," writes Gintis, "yet participation in such movements cannot usually be explained in terms of self-interest."

No shortage of real-world evidence exists to buttress Gintis' theory. Successful non-proprietary projects, such as open source code or the emergence of socially responsible investments, wherein people accept lower returns to fund ethical projects, can't be explained by standard economic models. So while a new theory like strong reciprocity isn't a panacea, it could expunge the cynicism corrupting economic thought. Gintis offers a simple prescription: Teach business and economics the same way as law and medicine. "Doctors and lawyers learn that a moral code is a vital part of their profession, and that their profession is part of a broader human puzzle," says Gintis. "This doesn't prohibit them from making a good deal of money."

It could work. Dan Ariely, a behavioral economist at **Duke University** in North Carolina, explored how society can foster honesty in his book ***Predictably Irrational***. He conducted experiments that showed cheating could virtually be eliminated by prompting students with the Ten Commandments or asking them to sign an honor code before taking tests. "When faced with the opportunity for material gain, people will bend the situation so it aligns with their moral values," says Ariely. "Setting ethical benchmarks, so long as they are repeated at the right moments, keeps people from straying into dishonesty."

One of the grand creeds associated with standard economic theory is trickle-down economics, the idea that wealth flows down through society. But it appears that what has been trickling down is plain old greed and cynicism. It's worth noting that in the 19th century, this construct was known as the "horse-and-sparrow model." Feed a horse enough oats and it will eventually deposit some on the road for the sparrow. Standard economic theory feels an awful lot like that lump of sparrow's lunch.

For 200 years, economics has slandered humanity. The claim hasn't been that there are a few bad apples like Bernard Madoff, who has pleaded guilty to perpetrating the biggest financial fraud in history, but that everyone is a bad apple who will cheat, bully and manipulate to maximize personal wealth. Fortunately, we now have a critical mass of studies and a swath of real-world evidence that debunks this malicious smear. The truth is, there are a great, great many good apples out there.

As depressing as this recession is, it does provide an opportunity to review and rewrite certain economic principles. As Duke University's Ariely says, "It's a very sad event for the world, but it's been very good for behavioral economics because now more people are willing to listen."

And the voices for change are rising on all sides. In Britain, Cardinal Cormac Murphy-O'Connor declared, "Capitalism needs to be underpinned with regulation and a moral purpose." In Australia, Prime Minister Kevin Rudd published an essay insisting that "neo-liberalism and the free-market fundamentalism it has produced [have] been revealed as little more than personal greed dressed up as an economic philosophy." And in the same speech in which he praised workers' selflessness, President Obama condemned the "greed and irresponsibility" that weakened the American economy.

In economic jargon, an "externality" is an unexpected cost or benefit that falls beyond the scope of the original transaction. The externality of the current recession that benefits us all is that it takes an eraser to the false notions that have been scrawled across the economic chalkboard. A fleet of economists is studying altruism and cooperation, and the blossoming of behavioral economics has filled both the halls of academia and the corridors of power with men and women who look beyond outdated models of human behavior.

It's not that this new breed of economists will be Pollyannas or usher in a financial revolution, but they could help us transcend the poisonous lies of standard economic theory and build a truer foundation for our fiscal policies. And if this comes to pass, what comes trickling down from the economic heights will be far more appealing than the sparrow's lunch of greed and cynicism we're currently being served.

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Getting to the heart of money