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Pilot Study of the Effect of Commercial Ethics on Distribution

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The effect of cultural values on the operation of markets tends to be overlooked in economic theory. Western theory assumes a utility maximizing economic agent, which may be consistent with Western culture, but is foreign to many other peoples. This study is an exploration of the impact of cultural values, as commercial ethics, on economic distribution.

The theory and literature is briefly reviewed and a pilot experiment described. The experiment involved a six-sector economy that was operated within two cultural paradigms. The two paradigms approximated to Western individualism and pre-industrial traditional culture following Tönnies’ concepts of Gesellschaft and Gemeinschaft respectively.

The pilot study revealed that the Gesellschaft economy was more attractive to most members of the economy and returned short-term benefits, but it generally underperformed the Gemeinschaft economy for most sectors in the longer term. The behaviour of the land sector was especially significant.

The Discussion includes linkages to historical and anthropological findings and makes suggestions for further research. The experiment raises important methodological issues regarding the nature of economic agents and positivist epistemology. These are dealt with including pedagogical and future research implications.

Keywords: free market, economic behaviour, economic methodology, positivism, epistemology, political economy, Gesellschaft Gemeinschaft

BACKGROUND

Modern economic theory assumes individualistic, utility-maximizing agents. This foundational assumption appears to be the reflection of a particular cultural orientation rather than a universal statement about human nature. The resilience of certain traditional practices regarding commerce and land appear to be indicating that some accommodation is needed for non-Western commercial values and their implications.

The sociologist Ferdinand Tönnies distinguished between industrial and pre-industrial peoples. Pre-industrial, or traditional, people were connected through a strong sense of responsibility and interest in the social other that Tönnies termed Gemeinschaft, or community. Industrial people viewed society and their economic relations within it in terms of an association of self-interested individuals, that Tönnies termed Gesellschaft (Tönnies 1887/1937). The political economist Rourke (1997) explored the differences between community and association as applied to the economics of the common good. The classical economists, especially from John Locke onwards, implicitly adopted the associative paradigm for commercial relationships and its operation is consistent with the social contract theorists such as Hobbes (1651/1989). It was given moral sanction by the moral philosopher and political economist Adam Smith in his assertion that self-interest acted as a metaphorical invisible hand ordering economic activity towards the common good (Smith 1778/1910). The effectiveness on this mode of economic order is evident in the historical performance of nations that had adopted it and especially England in the eighteenth and nineteenth centuries.

Sociologically, these same nations evidenced other sets of identifiable traits that can be seen to follow from the ethic of self-interested individualism. The sociologist Emile Durkheim studying European society was fascinated with what he called anomie. By anomie, Durkheim meant the psychological alienation that was evident in many modern industrial societies. His study led him to identify two types of social ordering, which he referred to as organic (Western, modern, industrial) in contrast to
traditional societies that he referred to as mechanical (Durkheim 1893/1964). Both sociologists were identifying approximately the same set of values and traits that appear to set a divide between modern-Western social values and more traditional societies. The significance of this division has been considered by many as an indication of social evolution, or progress, with the modern West as the more highly evolved (Robinson 1987). The implication of this notion of progress is that less traditional societies will eventually develop the more evolved traits and any initiative to encourage this should be encouraged. This theme is evident in the work of economists such as Milton Friedman (1980) and Michael Novak (1984). Conversely, with respect to land, Ezigbalike (1994) was critical of the apparent imperialism of the Western notion of economic evolution.

Historically, European culture effected the major part of the transition from Gemeinschaft to Gesellschaft between the sixteenth and eighteenth century. It is current the common perception that the pre-modern economy of Europe was stagnant (Little 1978). However, Rogers (1884/1949) found that in England wage levels with respect to prices were higher at the beginning of the sixteenth century than any time up until the beginning of the twentieth. This is despite England being the world economic leader through the latter part of that period. This suggests that evolution towards Gesellschaft does not improve economic distribution, despite possibly improving gross economic output.

Separate constellations of social values surround Gemeinschaft and Gesellschaft. Gemeinschaft societies typically see society as modelled on the family and often emphasize brotherhood between members and a market ethic of not taking more than is needed. This is evident in indigenous and other traditional societies. Traditional peoples as diverse as Australian aboriginals and Arab Moslems commonly refer to others of their people as brothers. Also evident is a moral sanction against greed. Rakai (1995) illustrated this with respect to land tenure, where Fijians traditionally hold land personally, but only in quantities sufficient to sate personal, or family, needs. Historically, the pre-modern concept of just price reflects the same moral aversion to commercial gain beyond legitimate need (Aquinas 1981). The related notion of just wage suggested that persons engaged in commerce had a just call on an income appropriate to their station in life, but income in excess of that level verged on theft, a form of usury.

By contrast, Gesellschaft societies are individualistic and have negligible emphasis on social relations modelled on familial ties. The fundamental question of why society holds together is answered differently in the two systems. A family is cohesive by its nature and the charitable intentions that are natural to it. This forms the basis for Gemeinschaft cohesion. By contrast, Hobbes (1651/1989) saw people as basically antagonistic, and aggressive but who surrender their war-like inclinations for the personal benefits of peace. This theory of human association typifies the Gesellschaft social vision. It can also be seen in Smith, Hegel, Marx and even Freud. Economic relations in such a society are based on an institution of property that is a positive legal construct and carries negligible obligations or limitations. Commercial pricing relies on market process, which in practice prices by utility, only distantly limited by costs. Harmonious and effective relations, both social and economic, are assumed to result from the positive and democratic action of self-interest, informed by a reasonable awareness of outcomes in both the short and long terms.

AIM AND OBJECTIVES
The aim of this study is to investigate the connection between social values and economic distribution. The immediate objectives are to demonstrate differences in market behaviour dependant on the social mores of economic agents within it and to propose the parameters for further research.

METHOD
An experimental method was employed using a simulation/game as a pilot study.

SUBJECTS
Subjects were taken from a class of first year university students from a property course. They were selected with no further qualification. Six subjects were chosen at random to make decisions for the six sectors and the remainder of the class acted as observers, free to discuss the game, advise players, or change places with active players if they considered they could be more successful.

PROCEDURE
Six subjects were chosen from a group and allocated positions within a simplified economy with the following sectors:

1) Land owner
2) Wage Labourer
3) Manufacturer
4) Wholesaler/transporter
5) Retailer
6) Consumer

The game operated within the following economic assumptions and rules:

i) A single notional product with utility value of 50 bags of gold (₦50) was assumed.

ii) Sectors (1) to (5) were assumed to have income needs of ₦5 for a comfortable life and ₦3 for marginal subsistence.

iii) Parallel to real societies, players (1), (3), (4) and (5) were all given the choice to either earn income through their own sector, or as (2) by their labour.

iv) Wage labour was aware that income was necessary for subsistence and no alternative form of income was available.

v) Full employment was not assumed.

vi) Land is spatially fixed; hence, it is in limited supply and absorbs the marginal product (demonstrated experimentally in (Small and Oluwoye 1999)).

Two cases were explored, broken into five runs as follows:

First case: Gemeinschaft (as historically antecedent):

Run 1) Players were told that there existed a strong social ethic of brotherhood (moral obligation of care for the other). In this case, income was considered licit, and due at the ₦5 level unless unavoidably constrained by physical factors, but excess income of ₦6 and above was heavily sanctioned. Sanctions included personal conscience and social rejection. Price at each stage was then negotiated.

Second case: Transition to Gesellschaft. This was done in the following steps:

Run 2.1) The retailer was asked to describe his position and interpret it in terms of modern commercial ethics. The retailer was then permitted to frame the commercial ethic of the game according to his interests and to negotiate price according to market tolerance. It was assumed that other sectors (1-4) did not have access to the new ethic in the first instance, because of spatial isolation. The issue of monopoly was not addressed in the game, but it is considered in the discussion.

Run 2.2) The wholesaler was then permitted to adopt the new commercial ethic developed by the retailer, but sectors (1-3) would not have access to it due to spatial isolation.

Run 2.3) The manufacturer was permitted to adopt the ethics of the retailer and wholesaler, similar to run 2.2.

Run 2.4) The labourer and landowner were permitted to adopt the same ethic, subject to the recognition that the labourer was in direct competition the others.

Subjects were not forewarned about the parameters of future runs, but only given the conditions for each run as it began.

RESULTS

The incomes to each of the sectors (1) to (5) and the retail price for each of the runs described above are as shown in Table 1 below:
In addition to the data above, the attitudes of the participants were gathered through the game and will be described through the discussion section below.

**DISCUSSION**

**Gemeinschaft**

Run 1 conformed to the *Gemeinschaft* ethic and returned desired returns of $5 to all productive sectors. Price was constructed from below, based on costs. Market theory suggests that, at equilibrium, price should equal the normal cost of production. Hence, the outcome is consistent with that expected from a liberal free market. However, normal costs of production may mean subsistence ($3), not the more comfortable preferred wage of $5.

Full knowledge and the free exchange of knowledge was a comfortable part of the game in run 1. The issue of monopoly trading in the sectors was not raised by the players or observers.

At the conclusion of the first run, all sectors were asked how they felt about their particular outcomes. Initially (1) through (5) expressed satisfaction. The consumer was very pleased to have a product available at half its utility value. In response to this, the retailer expressed regrets that there was a missed commercial gain that he (in this run the subject was male) had forfeited in the run. To some extent, this response was expected, given the culture from
which the subjects were drawn. What was notable was the fact the other sectors (1) - (4) were less concerned by the outcome. This may have been because the retailer was the only sector where the direct client appeared to benefit inordinately.

The new ethic

The attitudes of the retailer were discussed and related to those historically evident in the Mercantilist writers of early modernity (Roll 1942). The retailer was allowed to create an alternative ethic on the condition that it provided equal opportunity to all, and did not unjustly injure any party.

The retailer suggested the following:

1) That the consumer actually had the largest implicit income of any player because he (the consumer was also male in the game) enjoyed a product of utility value B50 for a cost of B25, that is an effective benefit of B25.
2) That it would be fair for the consumer to enjoy an effective benefit of B5 like the other sectors.
3) That income should be seen as a reward for providing a (net) benefit to clients, but that there was no need for that benefit to be excessive.
4) There was no need to negatively sanction higher income levels.

Run 2.1

When the retailer was permitted to act guided by the new ethic (run 2.1) his income increased to B25. The price of the product increased to B45. The consumer accepted the new price and recognised that it still represented a net benefit. Discussion included the usefulness of secrecy in maintaining prices and the problem of monopoly. The retailer mentioned the usefulness of not publishing retail profits.

The problem of monopoly was explored based on the possibility that the retailer may be replaced by one of the observers. For the sake of this run, the other sectors continued with the old ethic, thereby simplifying the decisions at the retailing level. Under the new ethic, in a fully competitive environment, a retailer who over priced would be replaced by others. However, the price would still move up, perhaps to half way to close the gap with utility, because price was now influenced by demand, and demand was very strong. Hence, even though this game used a monopolistic retailer for simplicity, a competitive retailing sector would evidence similar results, in that the retailer would earn some economic rent. While the competitive situation would moderate the outcome in the current instance, its impact should be viewed in viewed in the context of the results of the subsequent runs.

Run 2.2

The next run allowed the new ethic to be communicated to, and adopted by, the wholesaler. The negotiation in this run was interesting. The first proposal of the wholesaler to the retailer was a new wholesale price of B42. The retailer then raised the retail price to B48 and the wholesaler responded by immediately raising the wholesale price to B45. The consumer offered no objection. It would have been obvious to him that his supplier (the retailer) was only earning a subsistence income, so there was no latitude for negotiation and in any case, there was still a B2 net benefit between price and utility.

This run is significant for the question of monopoly. Assuming a horizontal monopoly, the monopolist may still have monopoly profits eroded by escalated factor costs. Again, the problem is not fully dealt with, and in any case it may be considered to have been pushed back into the production and supply chain.

Run 2.3

Allowing the new ethic to penetrate back to the manufacturer, sector (3), mirrored the progression from mercantilism to industrialism in Western economic history. The result was parallel to run 2.2. What was interesting was the retailer's lack of interest in raising the price to appropriate any more of the remaining B2 net benefit enjoyed by the consumer. The retailer apparently recognized that the ethic that he had instigated would mean that any benefit that he extracted from his customer would be eroded by future escalation in wholesale prices.

The wholesaler also did not press for an increase in wholesale price to compensate for being reduced to a subsistence income. The mechanics of the new ethic appeared to have been rapidly comprehended.

The manufacturer earned an income of B32 on this run, the highest income of any player in any run to date, and the wholesaler and retailer both had incomes stabilize at B3.

Run 2.4

The employee bid a modest B10 for wages at the start of Run 2.4, however discussion of the situation caused an eventual agreement of B3. Two issues confronted the labourer that were unique to that sector. Firstly, persons from sector (3), (4) or (5) could be expected to exchange places with labourers for any bid in excess of B3, since their incomes were at that
level and they were all free to labour for their living rather than act as wholesalers or retailers, etc. Secondly, the labourers could not choose not to work since labour was their only source of income, hence sustenance. In consideration of these issues, and the absence of full employment, it was apparent that a wage bid in excess of $3 would fail.

The landowner on the other hand had no competition from others, except from other landowners. Small and Oluwoye (1999) established that in a perfectly competitive market land tended to absorb the marginal product very efficiently. That study confirmed what was first stated by Smith, that land always behaves as a monopoly. It is apparent that land is spatially fixed and limited, which limits substitution. The question of competition in land supply is complex, and not the focus of this study, but it remains that land is a fundamentally different factor to labour and in general cannot be replaced by it.

In the game, the landowner quickly computed the rental value under the new ethic. Importantly, the return to land of $36 did not directly cause normalization of the returns to the other sectors, except perhaps the manufacturer, the normalization had been achieved by the new market ethic. Land capitalized that normalization. The result was entirely consistent with Smith’s (1778/1910) classical description of land as the ultimate monopoly, Ricardo’s (1817/1973) law of rent and George’s (1879/1992) belief that land would be the passive beneficiary. The normalization of wages is essentially ethical, with land as the passive beneficiary. The results from run 2.4 would appear to represent a stable equilibrium.

Monopoly and competition effects.

Through the game, monopoly rights tended to be given to the sectors accorded access to the new ethic. This would appear to be a major shortcoming of the game as a modelling of modern market process. However, it has been argued in the case of run 2.1 that a purely competitive retailing sector may still have returned an outcome that would have represented a partial move to the new pricing paradigm because of the new ethic. This can be understood by use of a hypothetical exploration of the possibility of runs 2.1-2.4 in a competitive environment.

Beginning with run 2.1, retaining the assumption that the old ethic set the wholesale price at $20, a practical, moderately competitive, retailing sector could expect a price somewhere between $25 and $50. The more competitive the market the closer to $25 the price will remain. However, in run 2.2, whatever gains were enjoyed by retailing would be absorbed by wholesaling. This would begin an upward spiral between these two prices. This spiral effect was observed in run 2.2 when the retailer increased retail price to recoup losses resulting from the escalated wholesale price, only to have the latter increased again.

A similar upward spiral could be expected between wholesalers and manufacturers that would see supernormal wholesaling profits eroded by manufacturers. For reasons that have been discussed most fully in the socialist literature, labour will always be in a weak negotiating position. By contrast, land is ultimately in fixed supply and limited substitution is possible. Whatever supernormal profits manufacturers glean will be reason for an escalation of rents. This has been noted in history such as the tendency of rents to outperform other price escalation (Ball and Wood 1995). Harrison (1983) quipped that if one were to enter a room containing the one hundred wealthiest men in England at the end of the nineteenth century, the observer could be excused for thinking that the industrial revolution had never happened. The room would have been filled with landowners, contrary to the popular belief that the manufacturers were the economic winners in the industrial revolution.

A second and very different argument regarding the effect of monopoly versus perfect competition and comes from the claim that in a perfectly competitive market prices will be bid down to normal levels. That is, prices that only just cover the costs of production. If any part of the productive chain charges prices above this level there is market failure. Hence, at each stage through the production process the incomes will be normalized. In the game, under the new ethic, this is exactly what happened for every sector except for land. In addition, land is the only sector that has no production cost (essentially considered), so for it to have any value at all would infer a market failure of some kind. The answer to the dilemma of land value is beyond the scope of this study, but this line of argument suggests that the game returned results consistent with perfect market operations, at least for all sectors except land.

It would appear sound to conclude that any increment above the sum labour cost of a product that is evident in a retail price will eventually be translated into primary land factor rents (and hence capitalized into land value). This conclusion would appear to be relatively
insensitive to the degree of competition (versus horizontal monopolistic control).

The actual mechanisms of monopoly versus perfect competition are not the focus of this study. While the above suggests that there are grounds for concluding that the outcomes would not be materially different in a game structured using a highly competitive design, this study is not intended to infer conclusions regarding the relative behaviour of monopolistic, versus perfectly competitive, markets.

**ECONOMIC DISTRIBUTION**

What are apparent are the two stable systems of incomes and price that emerge from the two ethics. The *Gemeinschaft* ethic returned high wages, low price and relatively low rents. The *Gesellschaft* ethic returned stable lower (subsistence) wages, higher prices and higher rents. In terms of economic distribution, one further observation can be made following Schumacher (1974) who stressed that in any society, the majority of producers are also the majority of consumers. Economic welfare is therefore a function of both wages and price levels. In the game, *Gemeinschaft* returned higher wages and lower prices than *Gesellschaft*, indicating that the ethical differences between these social forms have substantial impact on economic distribution. This is consistent with history. The tension that exists for agents within a *Gemeinschaft* society to evolve into the *Gesellschaft* ethic provides a potent motivator and one that is evident in many societies. If the findings of the study are valid, that incentive is short term, though the meaning of short and long term may be decades or longer. The irony is that the short-term incentive becomes a long-term burden that appears to become locked into the system, but the individual players still tend to think that they have the opportunity to benefit.

**METHODOLOGICAL ISSUES**

The experiment raises several significant methodological issues. The existence of communities of people who do not act according to the Western ethic is a sociological fact that. The currently accepted neo-classical economic theory is based on the claim that economies are composed only of utility maximizing agents amounts to a metaphysical statement about the nature of economic agents. This should not be surprising, as all sciences are based on sets of metaphysical statements that form their principles and axioms. The economic behaviour of communities of rational agents who are not motivated by the Western ethic of self-interest is not well explored, or even explicitly considered in contrast to the Western type. This constitutes a challenge to the currently accepted theory.

At the very least, more work needs to be done to explore the economics of communities that do not conform to the Western ethic. This is especially urgent in the face of the present challenge of customary tenure on Western property dealings. Not only do customary people follow a different ethic, they are growing in political strength behind a concern, not only to conserve their customary culture, but also to conserve their right to a superior system of economic distribution. Their difficulty appears to be that they do not have a developed capacity to assess the latter. There is also an opportunity here for Western thought. If non-Western commercial systems have the capacity for superior economic distribution, then exploration of them in comparison to the dominant economic theory would appear to offer great opportunity for practical improvement for economic theory.

Related to the metaphysical issue are two epistemological issues. *Gemeinschaft* and *Gesellschaft* societies exist. This is a sociological fact. It must be recognised by economics, especially as it has substantial economic implications. Economic knowledge is currently limited by its positivist methodology, consistent with empirical epistemology. This means that the only knowledge that is admissible it that derived from experience, by either observation of the world, or observation of contrived experiments. This is evident in way that only quantitative method tends to be acceptable for the introduction of new knowledge. The problem here is that this epistemology excludes knowledge that follows deductively from accepted metaphysical premises.

Much of the present experiment could be inferred deductively from the premises regarding the ethics of the two conditions. This would make running the experiment unnecessary as a vehicle for acquiring knowledge. Conversely, in the absence of the experiment, it would be impossible to add the deductively evident knowledge it contributes to positivist economics. This leads to the absurd possibility that the obvious is the only knowledge that is to be excluded from economic discourse. Two escapes from this possibility are available within a positivist paradigm. Firstly, one may look to the world for other observational data that could be marshalled to lead to the same knowledge outcome. This could include a comparative survey of rental, wage and price data in various Western and non-Western societies. The shortcoming here is
that such data may be awkward to distil, costly and ambiguous. The second strategy would be to appeal to Popper’s insistence on falsifiability in scientific method. On this basis, the experiment is valid epistemologically because it may not return the results that it did. It had the capacity to fail, but it happened that it did not, so it is epistemologically acceptable. In a sense, the experiment did not meet the deductive expectations because the price never rose to the rational level; it remained $2 below the expected price. This small error may appear insignificant, but it was useful in identifying the way that the price psychology tended to operate only across immediate commercial relationships.

PEDAGOGICAL AND RESEARCH ISSUES

Given that the experiment is epistemologically valid, it may be assessed as a teaching instrument. An experiment is a learning tool; hence, its presentation to a naive group may be expected to have the capacity to communicate the knowledge displayed in its execution. This strategy is widely used in science and is recognised by educationalists. Since the experiment has supported the deductively anticipated outcome, it would appear to constitute a reasonable way of communicating an understanding of the effect of cultural difference on commercial outcomes.

The related issue is whether learning about the comparative behaviour of non-Western societies is appropriate in property education. Current real practice does not appear to be related to deep cultural issues; they can be omitted without affecting vocational ability. This approach would appear to contradict the very purpose of university education. The experiment illustrates a very real instance of theoretical deficiency, both in general economics and property theory. The issue relates to contrasting cultural values, hence a future change in cultural values may embody issues consistent with those in this study.

Hence, both in order to crucially assess existing theory, and in order to be prepared for future change, property students would benefit from the opportunity of exploring these issues. In addition, there would appear to be an important research agenda implicit in the prospect of exploring further an alternate economic system of outcomes that appears possible within a society where the external commercial mechanisms of an unconstrained market place are visibly identical to those operating in the liberal West.

CONCLUSION

The study has set out to explore the effects of a change of ethics on commercial behaviour using an experimental methodology based on a simulated commercial environment. The simulation presented is a pilot exercise only.

The pilot study has provided evidence that a simple change of ethics can have an effect on incomes, prices and land rents. The study adopted two ethics based on the values common in two sociologically recognized types of societies and found that the results are consistent with historical data.

The study was undertaken as a pilot work and although successful in demonstrating the connection between ethics and economic distribution, it would appear to suggest many more questions to be researched than it answers. Amongst the directions for further research are the following:

1) Development of an experimental exploration of the pilot game that contrasts monopolistic and competitive environments within a Gesellschaft society.

2) Exploration of the land rent increases in the Gemeinschaft society.

3) Exploration of land rents, especially their spontaneous generation.

Usually, the alternative to a liberal market economy is believed to be statist command economies. This experiment has demonstrated that the Gemeinschaft ethic has the capacity to produce a very different pattern of economic distribution despite operating within an unconstrained marketplace. This would suggest that there is at least a third possibility for price setting. This conclusion also accords with history, especially the observation that pre-modern Europe was a free market structure that was never the less a very different configuration to the later capitalist economy.

The experiment has raised important methodological issues. It would appear that current positivist economics has difficulty with admitting certain types of knowledge. The issue explored in this experiment is one such case. By contrast, this line of enquiry has been shown to relate to very live problems in economics and property. Hence, it appears to point to the need for an epistemology broader than the current positivist approach. Linked to this is the problem of the nature of the economic agent, which again has been shown deficient in practice.

Finally, in addition to using the game as an exploratory tool, it also has the capacity to act
as a teaching aid. All the participants in the game and its attendant discussion appear to have come away with a new insight into a mechanism that is dynamic and would appear to be beyond the scope of conventional economic theory. Economics does not normally deal with internal issues pertaining to the ethical positions of economic agents, except in such limited areas as marketing (behavioural economics). Even in this area, investigation tends to be limited to consumer behaviour rather than investigations of the impacts of ethics on the entire economic process.

Reference List


