

Wisdom and Virtue

Russ Roberts

How Adam Smith Can Change Your Life

An Unexpected Guide to Human Nature and Happiness

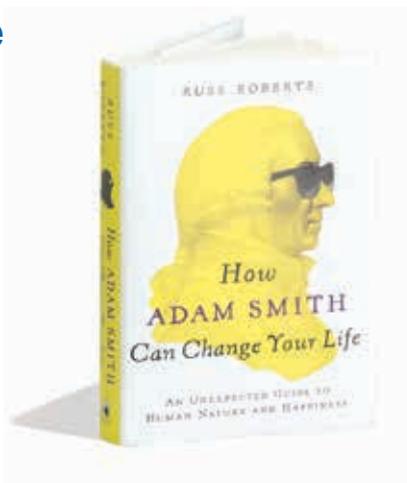
Portfolio/Penguin, New York, 2014, 272 pp., \$27.95 (cloth).

Ethics in economics seems to be back in vogue today. This is undoubtedly because of the global financial crisis, which exposed a startling degree of malfeasance and unethical behavior in the financial sector—with catastrophic consequences for the global economy and people’s lives. But it also reflects a deeper dissatisfaction with the utilitarianism and narrow technocratic focus that holds sway in so much of modern economics. It is no accident that more and more people are seeking—sometimes demanding—a broader approach to the study of economics, one that incorporates key elements of philosophy, psychology, and history.

Given this zeitgeist, a book on the moral philosophy of Adam Smith is timely indeed. While Smith may be the founder of modern economics, he was first and foremost a professor of moral philosophy. Yet his major philosophical work, *The Theory of Moral Sentiments*, remains largely unknown. In his new book, Russ Roberts strives to fill the gap—to bring to light the hidden wisdom contained in a much-neglected classic.

Roberts writes with the Christmas-morning wonder of a child embarking on a new and exciting adventure. His enthusiasm is infectious as he describes his immersion in a book he simply cannot put down. The book is jam-packed with memorable stories and colorful vignettes. Altogether, it is an easy and engaging read and a good introduction to Smith’s moral philosophy.

In Roberts’ telling, Smith’s morality boils down to simple life rules: “Seek wisdom and virtue. Behave as if an impartial spectator is watching you.”



While the first part of the book is more about—to speak somewhat anachronistically—“self-improvement,” the second focuses on how we interact with each other in society. Here, Roberts points to a key insight of Smith—while we may be naturally

“Behave as if an impartial spectator is watching you.”

inclined to put our own happiness above that of others, it would be wrong to live life in such a manner, to hurt or exploit others out of mere self-interest. Why? Because the impartial spectator—the ultimate arbiter of Smith’s morality—would not approve.

The idea of the impartial spectator as a motivator of morality is a profoundly powerful idea. Nobel Prize-winning economist Amartya Sen, for example, stresses the advantages of this simple and practical reasoning over the more dominant philosophical approach, which focuses on systems of perfect justice and perfect institutions. Yet Roberts never really teases out the full implications of this way of thinking, being too inclined to treat *Moral Sentiments* as a self-help book.

In his last chapter, Roberts does touch on the implications of Smith’s ethical standpoint for the functioning of the modern economy, but this is his weakest chapter.

An enormous amount of ink has been spilled over the years over the famous “Adam Smith problem”—how to reconcile the emphasis on benevolence in *Moral Sentiments* with the emphasis on self-interest in *The Wealth of Nations*. The most obvious answer is that the latter focuses on the bare minimum conditions for beneficial market exchange, while the former focuses on the deeper underpinnings of our broader social interactions.

As Sen put it, Smith’s insight was narrowly confined to exchange, ignoring equally important concepts like production and distribution. And even in pure exchange, self-interest can take us only so far and must be supplemented with shared trust and mutual confidence in the ethics of all involved. In other words, moral sentiments are never too far from the surface.

Roberts takes a different tack. He argues that Smith’s two books are about different and nonoverlapping spheres of human interaction. Borrowing from economist and philosopher Friedrich Hayek, he argues that “we need to inhabit two different worlds at the same time to interact within our families and then move into the commercial sphere and interact with strangers.” Thus *Moral Sentiments* is about our “personal space”—the world of friends, family, and close acquaintances—while *The Wealth of Nations* is more about interpersonal exchange in a “world of strangers.” Different worlds, different norms of behavior.

Reading Smith through these Hayekian bifocals is not at all convincing. Imposing Hayek’s crimped philosophical worldview on Smith does him a disservice. It narrows the scope of his contribution far too much.

Ultimately, Smith is concerned with virtue—especially benevolence, courage, temperance, justice, and prudence. Indeed, Deirdre McCloskey argued that Smith is the last of the virtue ethicists, following in a long tradition that began with Aristotle. And when we start with virtue, we are naturally inclined toward human flourish-

ing—in all aspects of life. There are no bifurcated or disembodied virtues!

Because Roberts draws such a fine line between the different spheres of life, he never really teases out the implications of Smith's moral philosophy for today's economy—what we really should care about. This is a pity, because Smith's insights would

be especially valuable right now.

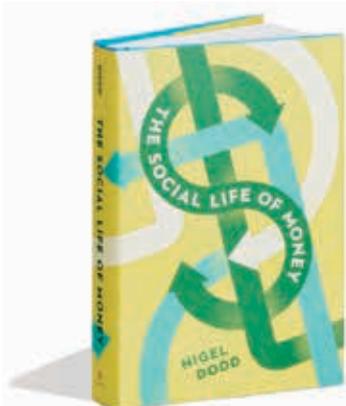
For example, what would the impartial spectator say about the behavior of the financial sector in recent years, when extreme recklessness and short-termism swamped all notions of virtue? Or more generally, what would she say about a business model that puts short-term profit

above duty to stakeholders like workers, clients, the natural environment, and society in general? These are the important questions that are not really answered in this book.

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Two Cents' Worth



Nigel Dodd

The Social Life of Money

Princeton University Press, Princeton, New Jersey, 2014, 456 pp., \$35.00 (cloth).

What is money? That is what Nigel Dodd, professor of sociology at the London School of Economics, leads us to explore in *The Social Life of Money*. Along the way we are presented ideas on money from the greats in literature, philosophy, sociology, and many other disciplines. This book is more modern art than science. It takes us out of our comfort zone—especially those of us schooled in economics—and unsettles us, and the question is, deliberately, unresolved.

The author leads us from insights into one aspect of money from people not typically considered monetary theorists, including Jorge Luis Borges, Jacques Derrida, Michel Foucault, Keith Hart, Friedrich Nietzsche, Jean-Jacques Rousseau, and Ferdinand de Saussure, to other, somewhat contradictory but equally insightful, notions. As you are trying to make sense of it

all—and this is not a light read—Dodd proposes that these ideas all have something to offer. Money is too protean to be captured by a single idea.

Dodd does not offer a new perspective; he seeks to enlighten us with many. In that sense, his message is already a sacrifice: the myth that money is driven by cast-iron laws understood by hard-nosed practitioners is shattered. Instead, the author offers a reminder that money in general, and particularly government-issued paper money, is a social construct. We do not question the \$100 printed on a bit of cotton and linen that costs 12.5 cents to produce because we trust the U.S. government will honor its liabilities, given its ability to tax its citizens and resources and its attendant military might. Even where there are plentiful resources and resourceful people, absent faith in a society, the value of money collapses—as in Venezuela today, Argentina and Brazil in 1990, and the Weimar Republic in 1923.

To say that money is a claim on society is not original, Dodd reminds us with references to Georg Simmel and others. But he is right to say it again. The traditional view still traces the origins of money to some unrecorded, primeval way to barter more efficiently. This airbrushes the plunder and bloodshed too often at the origin of society. The dawn of money has more to do with tribute from the vanquished and profits from slavery than with more efficient peaceful trade. Money does not have clean hands.

Dodd tries to probe the subject further. Social construct need not mean the state. It could be the fluid,

anarchic social networks of exchanges through which people swap their labor or even the decentralized payment system called Bitcoin.

In trying to move forward, however, the author ends up giving up ground. Sometimes, for instance, it

Money is too protean to be captured by a single idea.

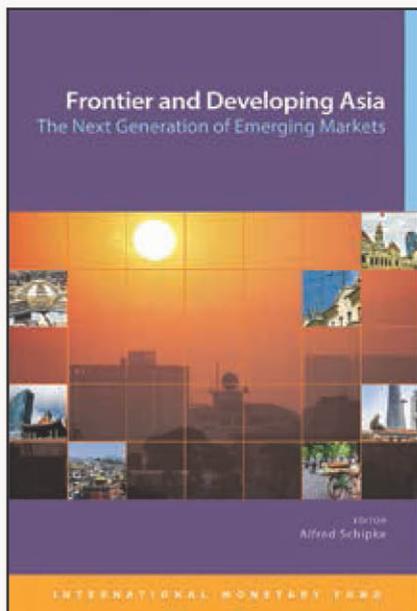
feels as if he is blaming money for the global financial crisis and other recent ills. Yet money as a social construct is a more convincing, predictive theory. The structure of society and the way power is organized within produced the incentives that drove the boom and its inevitable bust. Those incentives were cast in money, but could have been in any currency of power. The case that money has a life outside of the social construct is conceivable but is not made convincingly. Bitcoin will fail because it is not backed by the state's power of taxation and falls foul of the international anti-money-laundering rules—not because it is digital currency with no reserves.

The real insight to be teased out of this book is that form follows structure. If we want “better” money, then tinkering around with its form will have little impact unless we change the incentives that are often built in to society's structure.

Avinash Persaud

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New Publications from the IMF



Frontier and Developing Asia: The Next Generation of Emerging Markets

edited by Alfred Schipke

With a combined population of more than 350 million people, frontier and developing Asia, which includes countries such as Vietnam, Cambodia, and Bangladesh, is located in the world's fastest-growing region and has favorable demographics. Despite their heterogeneity, the countries share a number of common macroeconomic, financial, and structural challenges. The book addresses issues related to economic growth and structural transformation, as well as the risk of a poverty trap and rising income inequality. The book also analyses a number of financial sector and monetary policy framework issues.

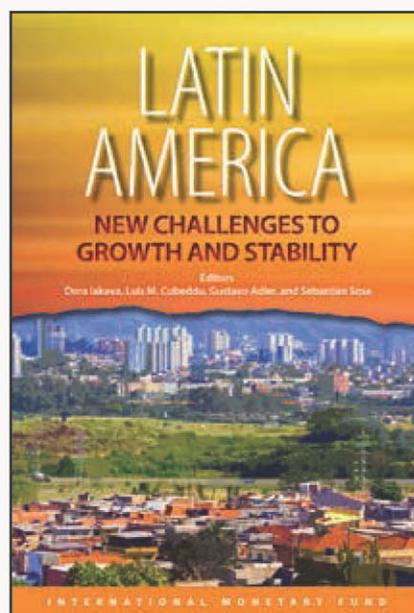
\$25. ISBN 978-1-47559-551-2. ©2014

Latin America: Sustaining Growth and Stability in a Changing Global Landscape

*by Dora Jakova, Luis M. Cubeddu,
Gustavo Adler, and Sebastian Sosa*

Over the past 15 years countries in Latin America made tremendous progress in strengthening their economies and improving living standards. Although output fell temporarily during the global financial crisis, most economies staged a rapid recovery. However, economic activity across the region has been cooling off and the region is facing a more challenging period ahead. This book argues that Latin America can rise to the challenge, and policymakers in the region are already implementing reforms in education, energy, and other sectors. More is needed, and more is possible, in Latin America's quest to continue to improve living standards.

\$25. ISBN 978-1-49832-816-6. ©2014.

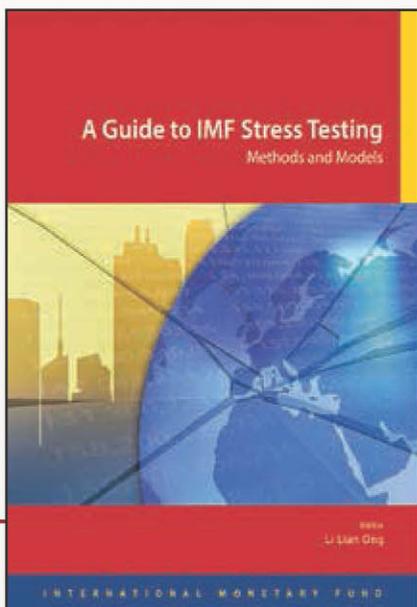


A Guide to IMF Stress Testing: Methods and Models

edited by Li Lian Ong

The global financial crisis has put a spotlight on the stress testing of individual banks and entire financial systems to see if they have sufficient capital and good enough procedures to get through hard times. The IMF has had extensive involvement in the stress testing of financial systems since the launch of its Financial Sector Assessment Program (FSAP) more than a decade ago. This book offers a suite of methods and models that can be used for the monitoring and supervision of both individual institutions and financial systems around the world. It is based on a wealth of hands-on experience with stress testing techniques and their practical application.

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