

Free Enterprise: Values in Action

Gruter Institute – John Templeton Foundation Program

1st Working Conference

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Report by Angela A. Stanton, Claremont Graduate University

This workshop, the first in a series of 4 working conferences under the Free-Enterprise: Values in Action program, was co-sponsored by UCLA School of Law and The UCLA - Sloan Foundation Research Program on Business Organizations. The workshop's purpose was to begin the focused process of constructing a scientifically rigorous description of the values at the core of economics cooperation. The conference was able to build on initial work done at two preliminary workshops convened in 2004 and 2005 as part of the program.

INITIAL QUESTIONS:

One of the helpful results from the preliminary workshops was the development of a list of questions which helped to focus the preparation of the participants in the First Working Conference. This list was circulated among the participants:

1. Is there a biological basis for values shared by a group of people?
2. How are shared values reflected in formal and informal institutions, including systems of law?
3. What shared values play critical roles in free enterprise, and how do legal systems and other institutions facilitate or hinder these values?
4. How do shared values affect economic performance?
5. How do people in business view the role of values in creating positive or negative outcomes?
6. Is it reasonable to equate "values" with psychological commitments to principles of character and action, commitments that may require sacrifice and self-denial?
7. How can the methodology of your discipline help test the idea that values are important elements in a free economic system?

8. What is the role of "narratives," such as the free enterprise / selfishness story, in creating norms, institutions and behavior?
9. Is the U.S. narrative on free enterprise contracted or confirmed in other cultures?
10. Evolutionary biology and economics: is there is a biological component of morality and it can help us understand how good and bad things happen in free markets?
11. What are the dynamics that create and reinforce the selfishness cartoon? Who benefits?
12. What behavioral values do markets create? Encourage?
13. Are there differences in the values, and the institutionalization of values, which underlie free exchange in markets and in non-market transactions?
14. What is mercantile culture, and what are its common properties, usages, and values?

WORKING CONFERENCE FORMAT AND PARTICIPANTS:

The format of the workshop was a guided roundtable discussion. Each participant made a 15-minute presentation that was followed and surrounded by general discussion and "brainstorming." The participants were clustered loosely into groups relating to shared expertise, who presented together. The goal was to keep discussions focused so that progress could be made toward a deeper engagement with the subject matter and with the different approaches being put on the table. Each day ended with a review of the effectiveness of the workshop in achieving its goals and with a discussion of what could be added in the future to improve the rate of progress.

In addition to the speakers, three special guests participated by observing the presentations and providing guidance on methods of information dissemination built into the longer-term program structure. Ms. Katya Krausova from Portobella Media Ltd, London, UK, provided guidance for future debates; Mr. Ted Weinstein from the Ted Weinstein Literary Management, San Francisco, CA, provided guidance on the development of books coming out of the program; and Ms. Evelyn Iritani from the Los Angeles Times observed the discussions.

WORKSHOP PROCEEDINGS – DAY 1:

Welcome and Introduction

Oliver Goodenough and Monika Gruter-Cheney opened the workshop on the first day, welcoming all guests and presenters and describing the purpose of the workshop. They challenged the participants to help us to understand how free

economic systems work, exploring also why they don't always work well, or the same way, everywhere. All too frequently, little attention is paid to factors other than self interest as motivating force in businesses; few studies ask what *values* are involved. Cooperation is often ignored. Studies of businesses also frequently measure success by the Western business view for what is required to make a business work. Universals and international components are missing.

After this introduction, each of the round-table participants introduced themselves to the group at large.

Professor Goodenough chaired the morning session and Prof. Zak the afternoon. In launching the discussions, Prof. Goodenough reminded the participants that this is an ambitious interdisciplinary experiment with the goal of re-describing free economic systems. This new description requires a better understanding of what makes cooperation work, and it is likely to modify the pervasive paradigm of un-alloyed self interest. He admitted that it would be a challenge to put together the pieces of the puzzle systematically. All of this work must be completed within a 30-month deadline. "We have a dream-team to do all this. In academia it is rare to have such collaboration."

Insights from Behavioral and NeuroEconomics

Professor Paul Zak (Claremont Graduate University, Department of Economics) discussed the basis of shared values. He questioned why we should care about others. Why donate money to people hurt by hurricane Katrina? People make decisions quickly and on an emotional level. Emotional decisions are formed in the deeper, more primitive, parts of the brain. The standard economic model doesn't work in social decision settings because it assumes that decisions are based on rational thought. Human values vary greatly across people and within a person over time as the individual and the environment change. Every decision is economic. Is it necessary to have other-regarding behavior? Other-regarding behavior can accommodate self-interest providing it makes no harm. There is a positive feedback between the larger life and "me;" the stock market is a good example. In Europe there is a sense of people trying to get as much of the pie as possible for themselves versus the size of the pie, while in the US it is "how does the economy do as a whole"? This may be related to trust levels. Stock returns are higher in high-trust countries.

Discussion:

Self-interest and other-interest are in opposition. There is a mechanism that selects for self-interested perspectives. For example, provide an alpha figure and others will follow. Is altruism an instrumental value? What is self-interest? What is other-interest? The definition of other-regarding: to care about the outputs and inputs of the other – care doesn't have to be positive. The same person can be other-regarding sometimes and not other times. Experiments have been done with Oxytocin (OT), a hormone that temporarily induces trusting behavior. Subjects who receive large OT dose and don't show increased levels of trust; they may be sociopaths. At the same time there are autistic individuals who lack empathy but it is because autistic tend not be very empathetic, partially due to

lower central OT. But replacing OT does not change this because they likely also have fewer OT receptors in the brain that the feedback mechanism is not present. In a social setting, a waiter who touches the guest gets bigger tips—touching induces OT release. Do all functioning people in the society possess empathy? Compare Ted Turner (bipolar) who builds great companies and Mother Teresa whose life was committed to helping people—this shows diversity. Stalin was a successful sociopath; though rare, they have to fake the emotions of others because they do not feel them themselves. Temporary attachment through OT is not necessary to have a successful enterprise. One may want to play hardball and hire a hard-head who has no empathy. Does OT provide a rewarding experience for all? Do “bad” people get good experience from OT? OT facilitates dopamine release but across species, and even human beings, respond differently to social stimuli. Tests show that the reason it is fun to punish people is that punishment releases dopamine. But punishing-type people break social norms. Tests show that 100% of males but only 40% of females have murderous (punishing) fantasies. Reputation sustains cooperation and environmental settings guide moral values by providing strong institutions.

Professor Herbert Gintis (Emeritus at University of Massachusetts, Department of Economics, Santa Fe Institute and Central European University) discussed the behavioral basis of fairness and reciprocity in humans. Humans are neither self interested nor purely altruistic but are strong reciprocators. Strong reciprocators are predisposed to cooperate with others and to punish those who undermine cooperative norms, even if it is not in their material self-interest to do so. In a team enterprise, if there are many free-riders (people who benefit from the effort of others, but do not themselves contribute), even strong reciprocators cannot sustain a high level of cooperation, because they become angry at the behavior of the free-riders, and retaliate by withdrawing cooperation themselves. However, if strong reciprocators are offered the option of punishing free-riders, they do so even at a cost to themselves, and a high level of cooperation can be maintained in the long run.

Our work is based on what we call the "beliefs, preferences, and constraints" (BPC) model. This is the economist's "rational actor model," without the assumption of selfishness or the assumption that information is costless to obtain and process. Values in the BPC model are simply non-self-regarding entries in a person's preference function. To value fairness, for instance, is to be willing to pay more to get it. To value honesty is to be willing to sacrifice other things to preserve it. Why do we give money to hurricane victims? Empathy is one reason.

We infer values from the behavior of the people in the game. To reveal human characteristics, we use behavioral game theory. For example, in the prisoner's dilemma, if everyone is self regarding, both players lose. But, when people value fairness, the high-return cooperative payoff can be attained. Models that assume self-regarding preferences cannot explain human cooperation but those with strong reciprocity and such "constitutive" preferences as a taste for honesty and trustworthiness do explain it well.

Experimental games show that team settings where punishment of free-riders is permitted achieve a high level of cooperation, but when punishment of free-riders is not permitted, cooperation unravels. The ultimatum game was tested in a cross-cultural international experiment with fifteen small-scale societies (hunter-gatherer and others) on four continents. The measure of cooperation was the size of proposed offers in the bargaining game. We found that strong reciprocity is universal, although the norms of fairness differ widely across societies. Like "shame," and other human emotions, strong reciprocity appears to exist everywhere, but what triggers cooperation and punishment differs from culture to culture. As with "shame", the input side (what give rise to the behavior) is culturally specific, but the output side (the physiological response) is a human universal.

Discussion:

Why do we vote? People claim they vote because they want this or that person to win the election. But, except in the very smallest communities, one vote cannot matter, so this explanation cannot in fact explain why people vote. In fact, voting is a constitutive value, like honesty and trustworthiness. Without such moral predispositions as strong reciprocity and constitutive values, a democratic society could not function.

Insights from Behavioral Biology I

Dr. Sarah Brosnan (Emory University, Department of Anthropology) discussed her research about what non-human primates tell us about values, fairness, and empathy. Primates experience face-to-face encounters but most discussion so far has been about interactions between people that do not involve face-to-face interaction. What do primates do when they run into other primates whom they don't know? Primates pay attention to the interactive nature of food and play by the rules of reciprocity so long as there is a territorial separation. When the mesh between two monkeys is removed, cooperation drops, unless both members "play fair" and allow the other to receive some benefits. In non-face-to-face encounters, chimpanzees will attack if the other party is smaller; in fact, they will kill members of the other party. Even if territorially adjacent groups know each other, they will still kill each other. Even within the group, however, there is aggression and females will kill other females' infants and eat them.

The Bonobo is a different type of chimpanzee; the females support each other against the males and are dominant. Females use sex to cement social bonds and will even have sex with the females in neighboring social groups, although adult males are more wary of males from other groups. Video recordings of interactions between primates show their "emotional" nature. In tests for "inequality," when a capuchin monkey gets cucumber (a less preferred food) in exchange for the same effort as the partner but the partner receives grape (a more preferred food), the one receiving cucumber often throws the cucumber at the primatologist. Equitable pairs are more successful in cooperative situations. Apparently the perceived intention of the partner matters in cooperation.

Discussion:

Males may behave differently than females because in natural groups there is only a single dominant male and he has no reason to discriminate against social partners because everyone is related to him (offspring) or mating with him (adult females). New males entering the group kill all infants. Is their social system fair? In chimps "sharing of reciprocity" is noticed. Chimps can be seen handing a grape to a subordinate but not capuchin monkeys. However, successful capuchins pay attention to the need of the partner; this is similar to "other-regarding" behavior in humans. For example, Dr. Brosnan showed on video her experiment when one capuchin was not able to pull the lever close enough to reach the food. The capuchin partner in the other cage pulled it for her after considerable crying and complaining. Experiment with rats showed such "other-regarding" behavior; one rat was given painful electric shocks when the other rat ate. The rat stopped eating when it associated eating with the cries of the other rat; this shows an empathy-type behavior. But our perception of animal behavior is not necessarily equivalent to the actual intention of the behavior.

Because of unforeseen circumstances, Professor Carl Bergstrom switched places with Professor Peter Richerson:

Professor Peter Richerson (University of California at Davis, Division of Environmental Studies) discussed cultural evolutionary theory - human nature, Darwin's theory of evolution, spirit of patriotism, sympathy of Adam Smith, the theory of adaptation, and other-regarding values. He argued that group selection at the tribal level shaped human social instincts by gene-culture coevolution. The ongoing evolution of moral systems in complex societies depends upon sympathy trumping patriotism.

Loyalties to tribal scale entities have been partly replaced by institutions that encourage the sympathetic treatment on an ever larger scale. Humans depend massively on other people because the society forms economies, moral systems, and the languages change at a very fast pace. Some people think that cultural evolution is for those not scientifically inclined... Humans have an elevated sensitivity to social systems; humans are better imitators than chimps. In humans symbolic boundaries have evolved. Rather than discussing other-regarding behavior, humans have group-regarding behavior. About 1-3% of the population is deceptive defectors - sociopaths. But if such defectors don't get punished, cooperation collapses.

Insights from Law and Philosophy

Professor Oliver Goodenough (Vermont Law School) questioned what it is that makes cooperative behavior work in humans. Over time, different, multiple, and simultaneous solutions are provided by the social/economic structure. What will lead to an optimal solution on an output perimeter? The public goods game falls apart at one point; it is not sustainable over time. Patterns of cooperation should persist over time. The question is similar to that posed by the balance between traits favored by natural selection and those by sexual selection; stability conditions v. output solutions.

Much of the focus of traditional economics has been stability in two-player transactional circumstances. The factors (values?) that help to keep a deal stable include factors like reputation for honest, etc. A more complicated picture is presented by social stability i.e. a stability of membership in the trading group; are people going to stay in the game or are they going to leave or be kicked out? Long term buy-in to the game is also a matter of values. This could be a possible definition of fairness: is the game played such that I stay in it as a matter of minimally constrained choice?

Discussion:

Game theory equilibrium is not stable; output constrains of a stable solution might be lower than that of an unstable one. But why are the Americans playing the game? It is against them and they are still playing? They cannot opt out; they only have power in real options against the partner. The framework was developed in zoology. Pack animals can hunt down large animals. Reproductive skew: what is the evolutionary stable set of solutions? What is the minimum that the last animal will buy in? There are opportunities for both defecting and staying in; the opportunity for reproduction has to be as good in the team as alone – wolf is one example. The amount of skew in wolf-pack is high. Humans have a similarly evolved capacity to evaluate when to stay in and when to opt out. However, vast run of social systems have been quite unfair – slaves, feudalism. Systems that are fair are more stable and have higher outputs. Is the theory of fairness normative or relative?

Professor Robert Solomon (University of Texas at Austin, Department of Philosophy) discussed altruism at work with the example of New Orleans: people offered to share homes with those they never met. Adam Smith and David Hume insisted that ethical value judgments are based primarily on moral sentiments. Kant, by contrast, viewed ethics as duty-bound; ethics depends on rules and principles that are derived by from reason. The moral view depends on the way it is thought out. John Stuart Mill viewed it through the lens of utilitarianism: ethics depends on consequences.

Values are the combination of motivation, virtue, ethics, reason, rules, principles, consequences, character, and integrity. Even one-shot deals obey long term stable character traits and predictable behaviors over time. Complementary approaches to value; virtue-ethics does not stand alone. Virtue ethics is the same as character. Situationism: people will behave according to the situation they find themselves in. According to *Situationism*, a situation can override the character of the person - for the time being. This presents an important challenge. How robust does a character trait of a person in an organization have to be to withstand his/her integrity if the organization is corrupt?

Emotions: moral sentiments. Nothing is "value" free. According to William James, emotion is a physiological disturbance that is accompanied by sensations. An emotion is also an experience; emotions are engagements in the world. Emotions are strategies; they are for a purpose, to get attention. Were you really angry or did you get angry to achieve the purpose of getting their attention? Are

emotions something a person does or does it just happen, like lightning? This is an aspect of the free will question. Furthermore it is one thing to have emotion and another to recognize that we have it. This allows for self deception and self-consciousness. What is the natural basis of our value judgments? Suppose we have a definitive answer... so what? The search for natural values is important but what do we do with it?

Discussion:

When and under what circumstances do people tend to follow rules? This falls under situational ethics; virtue ethics – business students say that under no circumstances would you ever violate the rules... but in reality, some of us just have higher prices than others. Humans regulate their “biology” with institutions. Institutions cultivate characters. Virtue is difficult to achieve because we also have to control our emotions. But who you trust, who you marry, etc., is typically based on chemistry.

Insights from Economics and Political Science

Professor Bart Wilson (Associate Professor, George Mason University Interdisciplinary Center for Economic Science) discussed his collaboration with Vernon Smith investigating the building blocks of free enterprise using experimental economics. He first discussed the trust and reciprocity exhibited by anonymous individuals in an investment game. In other research on the dictator game, when all social context is removed, the first decision makers nearly always keep all the money.

In 1956, Vernon Smith (Professor, George Mason University Interdisciplinary Center for Economics) ran his first experiment, an open outcry double auction. He found that the markets converge quickly to 100% efficient competitive equilibrium. Such markets have been replicated thousands of times. How do we move from personal social exchange to impersonal market exchange? His experimental economies appear spontaneously discover exchange and consequently, specialization. Based on a variety of sessions conducted in Dr. Wilson's and Dr. Smith's laboratory, four-person economies quickly discover exchange and specialize to the point where they are 50% efficient. On average, one pair of individuals achieves the competitive equilibrium and the other pair does not. Players of two-person economies are either 100% efficient or they fail to exchange altogether. Eight person groups that are one group throughout the experiment range from 0-50%, whereas eight person groups that build up from four pairs, to two groups of four, to one group of eight range in efficiency from 50-100%.

Discussion:

There are gains from specializing; creates a more realistic situation. Specializing makes exchanges risky because finding the prices is hard. It was believed that larger groups will end up with better prices but they were concerned with partner selections instead; trading became secondary, partner connection came first. Personal relationships with buyers are seen to be important even in 3rd world countries. Context is important; is there something besides familiarity that

is going on? Or is it that because "I know you and trust you" in one situation does not mean that "I trust you" in another? But partners did not switch even if they had a bad partnership situation because it is hard in the 8-person groups to switch. It is the social signaling that enables the bond; personal v. impersonal trust. What are the tradeoffs? How do we describe them? Trading is between partners with shared beliefs.

David Schwab (Indiana University, Department of Political Science) discussed the forgotten Adam Smith of the *Theory of Moral Sentiments*. Shared strategies are attributes of participants who act under specified conditions. Norms are defined as a world of obligation.

Discussion:

What do we mean under norms? Do we include external and internal norms? Both the forbidden and the permitted? We have norms without rules. For example, we put into our shopping cart only the items that we purchase. Why not more and just empty the cart for others to put the items back to the shelf? But wouldn't the society criticize you if you didn't go by the norm? One might feel obliged by the people around; these are socially enforced rule. There is also our conscience, and the law.

Rules have the "or else" term. What do we mean when we talk about norms, rules, and shared strategies? The ecologists agree to disagree on this one. Definitions should be in terms of models; we should argue about definition or empirical facts. The realists' tradition is to define a term at the end. One can distinguish science from non-science; the reason science is progressive is because they don't define terms. This is looser, more operational, and yields better results. However, a definition must be functional. We have a purpose and need to stick with that.

End of day one; Commentary and roundtable discussions.

Professor Goodenough led off the discussion with a preview of other aspects of the program. We should learn from each other. We are aiming for publications of at least one popular book, support the development of a text book, perhaps an economics class at the undergraduate level, although Dr. Wilson's recommendation for a high school level book, to help form the mind of the youth might even be better. We will have two high profile debates next to continue discussion along these lines, one in London and the other in New York.

Ted Weinstein (Ted Weinstein Literary Management) discussed what is necessary to create a successful book for general interest ("trade") audiences. The literary agent's job is to play matchmaker between experts and editors, who in turn are acquiring books they think will appeal to a large potential audience. What does it take to sell a book? The seven most important words in publishing: "It's nice to see you again Oprah."

Less jokingly, however, opportunities where the insights and focus of the Gruter Workshop participants might point toward viable trade books include large,

global situations, such as "Nation building in Iraq: how do you create an economy?" Another approach is to focus on how to apply the group's insights to the lives of ordinary readers (cf. FREAKONOMICS, BLINK). Hold up a mirror for them, give them info on how to make their lives happier, better, more entertaining. If you can tell me that I can get into your head with fMRI (functional Magnetic Resonance Imaging) and know if I can trust you - now that would make me buy the book.

Often it helps to emphasize whatever is controversial. What is the debate? Who is debating? Where are the group's insights really arguing against the common consensus? The audience for this book is different from the readership that this group had before, which was generally academics only. We have been using too much jargon; we must learn to speak and write in short form, to general audiences, before we can write successful trade books.

Evelyn Iritani (Los Angeles Times) found the discussions very interesting material to work with. She thought that it would probably produce more than one book. The biggest task will be to reduce the areas of focus to a manageable few.

Katya Krausova (Portobella Media Ltd., London, UK) discussed how to create a talk show, a debate, on PBS. She suggested an old fashion Oxbridge idea: think of controversial motions. Need to decide who the "particular" public of interest is. Who are the favorite adversaries? First run a story in LA Times in the middle, on double page. Tie the title to some major controversial current issue.

General discussions:

What do we want this book to do? We should get information to the wider audience as a general view; present a subject matter for general engagement. Why is it important for the audience? Think of writing about how the book might help improve chances for prosperity for poor countries. The ENRON-like companies might also benefit by changing the norms of the expectations and the atmosphere to help people to increase corporate responsibility. The values taught in business schools could be collaborated on. Enron did not happen because people were taught in business schools. What motivates us to do this work to create a book? We introduce new knowledge and don't apply it to anything specifics. We may influence legislators. We should be very cautious about being cautious. There is a direction already to this; the emphasis on self interest is overplayed. We should not hide controversy. Everyone should write down his/her favorite book title for suggestions.

The first day ended on a high note with a walking tour of the gardens of the Getty Center, reception, and dinner.

WORKSHOP PROCEEDINGS – DAY 2

The sessions on the second day of the workshop were chaired by Oliver Goodenough.

Insights from Business and Economics

Professor Lynn Stout (UCLA, School of Law) discussed how legal scholars need to understand the force of conscience; including how to cultivate conscience and how law can work better when the force of conscience is taken into account. Professor Stout started by outlining what she called Holmes' Folly. In this view, that law works only by imposing material sanctions and that people pay no attention to law if it doesn't punish. This view assumes that people would never obey the law out of conscience, an odd assumption. Why do so many experts adopt it? Although unselfish behavior is quite important, it is a counterintuitive thought to many experts. Why? She suggested there are two general reasons for this: (1) it takes a model to beat a model; an unselfish model is emerging now. (2) for a variety of reasons we don't recognize unselfish behavior at all, because people say that unselfish things are done with selfish motives.

Many experts distrust the idea of morality because they associate it with idiosyncratic rules of diet, dress, and sexual deportment. Yet there are universal moral values. Some of these are: don't murder anyone in your in-group; do not rape members of your in-group. These are human universals. We take universal values for granted. Politeness, niceness, and generosity are not universal values because they might be dangerous to a society. There is some evidence that cheating is salient to people. We focus on cheating and are insensitive to unselfish behavior.

Discussion:

An example: money is falling out of the back of the truck and the man who finds it returns it. Is it unselfish behavior? Not necessarily: he calculated the likelihood of being caught and returned the money. This was a one-shot game; he might have gone through the calculation but this is not rational. Another example is the mail-drop experiment, in which money is sent to people in Envelopes. 40% of the mail is returned with the money in it. People focus on the motive and look to understand unselfish motive. Many people don't believe in unselfish motive. Nevertheless, People can act altruistic.

External sanctions are correlated with what we call values. We reward moral good other-regarding behavior; punish bad other-harming behavior. This makes it easy to assume the sanctions are the only cause of the behavior. Yet no one knows all the motives that go into an action. Ted turner's donation; why he did it is beside the point. We should not worry about the motive; only look at the behavior.

Who studies homo economicus? Not the natural scientists, but the people who come up with the rules and they are likely to overestimate the accuracy of that model. They spend a good deal of time studying selfish behavior. Lawyers spend all the time studying cases of bastard behavior. Identifying with selfish behavior is more common by these people because they focus on that. An actor with selfish behavior is rational but irrational when nice. People who study homoeconomicus are unrepresentative of the field. Economists act more selfishly

than the general population. We are not making any calculations but moral sentiments; the law constrains. The law is a marginal, not a major force. In Markets we don't have to think about being nice; it is built in the infrastructure to make predictions. However, in stock markets people may trust the institution but the institution does not back them up. The trust in the system is not based on rational Calculations.

Professor Richard Shreve (Dartmouth College, Tuck School of Business) talked about values in business. The cartoon is that people in business are driven by greed and are indifferent to the harm they cause. More accurately put, a business is a moral enterprise that is critically dependent on the mutual expectations of the participants. Normative is what we all would criticize if it did not happen and may praise if it did happen. Path to the cartoon: self interest - greed - heartless disregard for others - causing harm. Is it sufficient for a business to “do no harm” or does it have to have the responsibility proactively to try to do good? This goes back to the stakeholder theory.

Discussion:

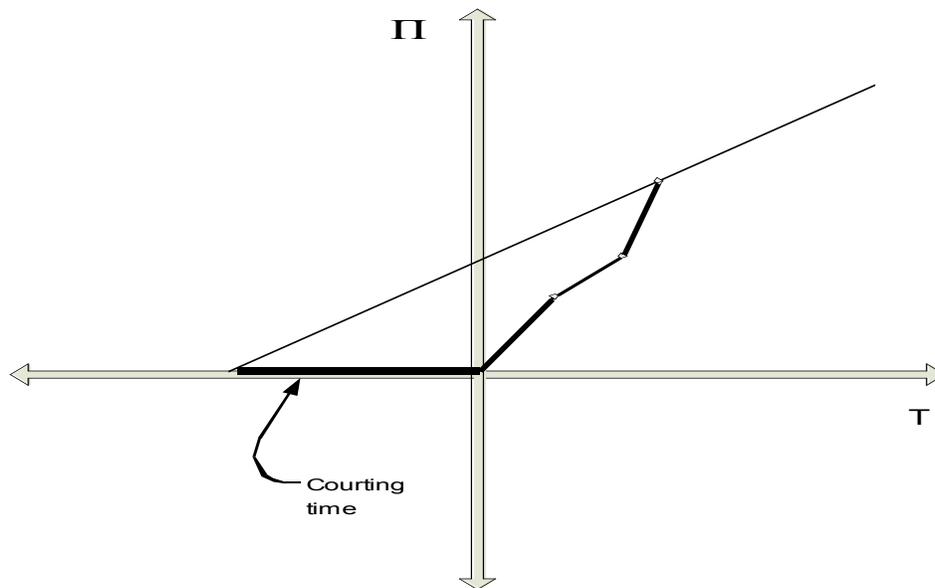
What does it take to proactively do good? Can we say that Merck should develop the cure for river blindness because they have the technology to do so? We need to compare what is morally required v. what is morally praiseworthy. Altruism is praiseworthy but is not required. But this is inconsistent; if a man is trustworthy, he is not a bastard. In a repeated game, I don't need to be nice to be trustworthy. There is no need to be nice to follow through a contract. If you defect on the last deal, would you be trustworthy? A selfish model predicts all the behavior.

We are talking about a commitment to a certain behavior. Business is a tough game and people can be mean and nasty but reliable. Trustworthiness is a commitment of making promises. Trustworthiness also implies to deliver on commitment even when not required to do so. This is like other-regarding behavior; incur sacrifice in helping or harming someone else. Self-regarding is when you don't incur harm. We are talking about two things: motives and results. We ought to accommodate the self-interested person in business. But everything involves part of the whole community; we cannot totally divorce what the other person does; at some point we destroy the social ecology. Strip-mining public property is not a social good. These are question of degree.

Professor Carl Bergstrom (University of Washington, Department of Biology) posed the question how we stabilize pro-social cooperative behavior; free markets can do it. What roles do values play in answering this? What are the strategic mechanisms in place? We may describe one mechanism: how conventions and institutions create norm-creating values.

Waste is inefficient; we want to create optimality but end up wasting a lot of time. If structures and patterns are actively evolved, there should be no waste. However, we actually build trust by wasting time. In nature, we find that animals have extended courtship period even when the window of copulation is very short. Firms engage in a type of courtship, otherwise known as contract

creation, even though contracts are much enforceable. We might look at courtship as information exchange, rather than waste. Functions of courtship might have nothing to do with information transferred. Suppose a game, like prisoner's dilemma is played repeatedly. What is the value of time? Recipient has the option to opt out, stay in, and there are the aspects of partner choice. Let's add in one more option: waste time. Wasting time stabilizes cooperative behavior; there will be a higher rate of return if first we court by wasting time and then cooperate. Wasting time is not information exchange but it is a signal.



Discussion:

Wasting time is sometimes negative information. It is like an engagement – if it is only a one-night stand, the guy will not wait; you acquire information that is otherwise not needed. The ring is an incentive but it is also an up-front hit until there is a contract. Wasting time is an efficiency cost here, sort of like a preemptive punishment. The length of the courtship is the exact punishment needed to discourage defection later. It is inefficient because everyone gets punished but it works. We just created a norm of having a courtship and with this we created values as well.

Major William Casebeer (National Security Affairs, Naval Postgraduate School) discussed stories and values and how free markets achieve cooperative behavior. A framing device is necessary to put stories into systems. System-thinking is important. Values are systems; they are open systems, they exchange matter with their environment. The question is how organizations create and act within the environment. Stories and narratives play a role. Think of systems of value, the thing valued, by whom, in what environment, using what mechanism, and for what reason. There is always a setup, climax, and resolution. Narratives activate the same brain regions as moral reasoning does. How do we translate this to the mechanism of the brain? Maybe stories are miniature drugs; people like to hear them; like tiny pieces of cocaine. Who is delivering capitalism? Etc.

surrogate consciousness by picture without words. We have the "ethos, logos, pathos" model. Certain stories will be more likely to be accepted than others. Stories that tap salient events in people's lives will more likely be accepted.

Discussions:

Organizations want publicity. But that may not serve the organization's goals. Is the Hezbollah organization other-regarding or selfish? It seems to be an other-regarding organization but it is strange. Does capitalism change the stories of what we value? Does capitalism changes who the players are in what we value? Why were Marxist ideas so popular? It was so disastrous. Was it because the Soviets were so powerful that we needed to accommodate?

The cleavage between the US and Islamic world is more important. The Islam world is a hierarchical society with strong sense of identity and membership. There is a fair amount of commodification; markets transform everything. Most people believe in their own propaganda. We should not impose our narratives on others. The same arguments we make about lies, we can make about altruism. Economists have not shown that people are selfish; selfish and altruistic people behave the same way. What matters is not just what the story is but who is going to present it. Who is the right audience? Choose an immigrant who was unable to trade in his country but is trading here regardless of his beliefs.

Professor Erin O'Hara (Vanderbilt University School of Law) discussed the role of contract law in a free enterprise system. In law, contract refers to a promise or agreement that is enforceable in court. Most people perform their promises for reasons having nothing to do with law. At best, contract law represents a last ditch effort to encourage people to perform their promises. While contract law is intended to encourage people to trade with strangers, in several respects the damages rules applied to breaches of contract leave the aggrieved party undercompensated. In fact, some claim this undercompensation actually encourages breach.

Professor O'Hara argued that contract law damages should undercompensate as a general default rule because it is often optimal to force the aggrieved party to incur a co-payment in the event of breach. Damages should be large enough to encourage small trade steps with strangers (that way trust might grow in this new relationship to support larger agreements), but not so large that trading partners are inclined to ignore trust-relevant information about one another. There are circumstances where the optimal co-payment in a particular situation is lower than it might be as a general rule. In some of these circumstances, courts switch to tort remedies or relax restrictions on contract remedies to adjust the aggrieved party's co-payment. In other cases, the parties contract around the damages rules for a more complete remedy. In both cases (court and party remedy adjustments), specific performance can be a mechanism used to reduce the co-pay.

Discussion:

Is specific performance the same in the US as elsewhere? What about liquidated damages? Determine in advance what the damages will be. You pay a certain

amount up front—this is the same idea that Dr. Bergstrom discussed in his discussion of “courting-time.” Parties can choose what the damages will be. Penalty clause is off the table; there is a strategic incentive. This is the “efficient breach hypothesis” but the goal of the law is not to breach. Might the law not want contracts to be too efficient?

Professor Mark Grady (University of California, Los Angeles, School of Law) noted that modern people are used to comparing market systems with socialism. Some people still think that socialism can promote better values than free markets, though people who have actually lived under socialism disagree. Another historical benchmark exists, however, for the values produced by markets, that is, feudalism. Figures of the Enlightenment, during the 18th century in France, often wrote about how markets or “commerce” improved values relative to the prior feudal society. They noted that commerce seemed to have a softening effect on manners and transformed the rude and haughty into people who were more humble and willing to serve their fellows.

Professor Grady also noted that, although nonhuman animals lack markets, different animals seem to possess different dispositions depending on how much they have to cooperate with conspecifics. For instance, the *patas* monkey, which relies upon its own speed and agility to escape predators, and which does not live in groups, seemed to him to be a less mannerly animal than chimpanzees, which rely upon group defense and which live in highly social groups.

Discussion:

In China, McDonald’s had to train its employees to smile and to greet. Before commerce, people killed each other; commerce is a way to mediate. While the mercantile exchange in Chicago is rude, the NY stock exchange is nice. What exactly does manner mean? Moving from a large city to a small one involves a whole change of “manners.” The Renaissance was an intermediate state to evolve “modern human society” that came out of commerce. In search of homo-economic studies of Dr. Gintis; when there are mutual gains from trade, there is mutual consideration; in a society where there are no gains from trade, no reason to become cooperative. Commerce is not on kin-based relationships. Sometimes you value rudeness and don’t want politeness. Free enterprise does not produce manners in all aspects. The different manners depend upon incentives.

Dr. John Clippinger (Harvard University, Berkman Center for Internet & Society) discussed the challenge of human nature and social networks. We find asymmetric threats, scalable trust and cooperation. How do you create a scalable institution in the digital world? Gift exchange—you take something and put something back. Like the notion of open source. It has a huge impact. For example: hacking. One individual is able to make a huge disruptive change. Another economic model is eBay where people actually trust each other.

The new thing is a network role-based sense-making inter-network; this is an identity layer under construction; ready mid 2006. Everything you do on the net now can be tracked and controlled. This is a user-centric identity management

distributed in a self-organizing way. We each will have multiple identities, can stay anonymous in one world, but be authenticated in another. It will be part of next generation of operating systems. Community based commerce – the users have control over the information themselves. EBay is a trust network, in which users rate the system.

Discussion:

What will be the number of passwords one will need? There will only be one sign-on, passwords will be gone; everything will be by biometric ID, trust chips to see if everyone complies with digital rights management, etc.

Closing discussions:

Professor Goodenough closed the workshop. He thanked the participants, encouraged them to keep the development going and asked all presenters to send a formal write-up of a few pages and introduction to see where we are heading. In June, the finished paper will be finalized. Georgetown Law School is co-sponsoring the next meeting. The last meeting at Harvard Business School is now planned for the last two weeks of June. Do we want to write with multiple perspectives? We can also find a way to connect. On the next meeting we might have panels; perhaps that is more efficient. Certain problems, mostly semantics, came up repeatedly: what is self or other regarding and the other altruism versus selfish in a black-and-white way and that altruism is not always good. What do we mean by *values*? Should we set the definition for character values for the book? If there is zero contradiction among the authors, it is dictatorial. It is OK to have some disagreement over a subject that has not yet been resolved. But they must refer to each other; cite one another.

Professor Goodenough then asked the participants to undertake the **final task** for this workshop. The participants were divided into groups and asked to discuss the following proposition and questions:

1. Proposition: values are more important than selfishness in a successful system of free enterprise.
2. What facts would help us pro and con?
3. What analysis would help us pro and con?

The smaller groups discussed these, and then reported back. The results of the reports were then ranked by the participants. The following contains the list of all of the answers in order of decreasing importance, as chosen by the participants. The “importance score” set out in bold parenthesis reflects the number of participants listing it as one of the most important (a larger score means more importance):

1. There should be no explicit self/other-regarding distinction in the book **(6)**
2. Values are constraints and not preferences in models **(3)**
3. Values are not heuristics because they may evolve and emergent **(3)**
4. How do we promote cooperation and competition; strength and weaknesses based on the following questions: **(2)**

- a. What is *free enterprise*?
- b. What is *value*?
- c. What is *success*?
5. Cooperation and exchange in firms; is it the same everywhere? (2)
6. Values matter (2)
7. Values only – we need a common language (2)
8. Analytical methods, post Nash Equilibrium concepts, philosophy. Talk to anthropologist to understand *what is missing from game theory* (2)
9. If homo-economicus is the same as selfishness, then the model is wrong (2)
10. Selfishness equals self interest:
 - a. We need self interest.
 - b. Also need trust and respect for property. Any one of these values missing, the market won't work. (1)
 - c. Fairness (1)
11. Selfishness is more important on the one hand but on the other hand it does not justify the free enterprise system. The only reason people promote it because it produces good values; better than altruism (1)
12. Situational and non situational, proximate and evolutionary role of trust (1)
13. Many economic relationships are personal (1)
14. The cognitive costs to changes in values are sub-optimal to environment and generate value inertia (1)
15. How does the move from industrial trade to corporations change the behavior of preferences and beliefs
 - a. Values are equivalent to self interest
16. The market will not function without the three values (see 10. above); pro and con: challenge to create a market where the one out of three are not present.
17. What is *success* for the enterprise?
 - a. How do we measure success, happiness index, and fairness?
 - b. Can we get data from living communities about trust and happiness?
18. What is the game (game theory) within and cross firms; can we do event studies around ENRON and how these affected the stock market?
19. Can we do cross country studies like looking at the listing of Chinese companies at the US stock exchange? Does that change their values?
20. We should study non-market spontaneous cooperation
21. People respond to incentives; sufficient change in the environment leads to change in values.

In conclusion Professor Goodenough asked if we achieved what we wanted to achieve. The consensus was that we got the “lay of the land.” Should we get an organizational physiologist? Small groups were very useful at the end. In the future, perhaps we should pair people and let them work with each other. We should invite people who are explicitly against our position but wait a little longer before that happens because these meetings force through new thoughts to help us learn and view things in a different way. Address the fundamental question: values. We will start and put these notes on a *blog* to help everyone remember and work through details.