Going Far by Going Together: James M. Buchanan's Economics of Shared Ethics

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We explore themes in Nobel Prize–winning economist James M. Buchanan's work and apply his *Ethics and Economic Progress* to problems facing individuals and firms. We focus on Buchanan's analysis of the individual work ethic, his exhortations to "pay the preacher" of the "institutions of moral-ethical communication," and his notion of law as "public capital." We highlight several ways people with other-regarding preferences can contribute to social flourishing and some of the ways those who have "affected to trade for the public good" might want to redirect their efforts. We show how Buchanan's work has considerable implications for business ethics. Just as his economic analysis of politics changed how we understand government, we think his economic analysis of ethics can (and should) change how we understand business.

Key Words: James M. Buchanan, economics, business ethics, public choice, norms, values

The 1986 Nobel laureate James M. Buchanan (1919–2013), an heir to the Smithian tradition in economics, contributed important but overlooked insights that should inform business ethics. Despite his intellectual stature, his work has received little substantive attention in the business ethics literature. A search for Buchanan references in *Business Ethics Quarterly* yields few results, except occasional references to his classic works.[1] Buchanan's work, especially *Ethics and Economic Progress* (1994), has much to contribute to business ethics. Specifically, he argues that "economic content" embedded in ethics can help us

[1] Notable exceptions within *BEQ* include Pies, Hielscher, and Beckmann (2009) and Hielscher, Beckmann, and Pies (2014). A similar search within the *Journal of Business Ethics* yields similarly few references to Buchanan; exceptions including Luetge (2006), Boatright (2009), Jaworski (2014), and Valentinov (2019).

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overcome free rider problems and capture increasing returns from a finer division of labor (8).

In one of the best-known passages in his *An Inquiry into the Nature and Causes of the Wealth of Nations*, Adam Smith (1776/1981) introduces his "invisible hand" metaphor for the market process. Smith writes of the individual's everyday activity in the marketplace:

> He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it.… He intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this … led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for society that it was no part of it (456).

Is Smith invoking some kind of magic that turns our worst impulses into social benefits?[2] On the contrary, Smith follows this passage with a provocative and counterintuitive claim. He writes, "By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. *I have never known much good done by those who affected to trade for the public good*" (456, emphasis added). In other words, the unintended consequences of people pursuing their own interests are often better than the intended consequences of trying to advance the common good.

Buchanan appreciated this principle, and like Smith, he recognized the importance of a moral and ethical framework that promotes and coordinates market activity. Importantly, Buchanan pointed out that morals can be substitutes for articulated, formal rules (Brennan & Buchanan, 1986: 6). As he wrote, "ethical constraints or rules, as means of correcting or internalizing relevant externalities, are, of course, alternatives to possible legal-political constraints" (Buchanan, 1994: 28). Buchanan understood that there is much more to a flourishing society than a free market: as Evensky (2005a: 277) argues, Buchanan understood that merely "opening up markets and letting prices fluctuate freely cannot create a coherent, constructive, cohesive liberal society." Instead, he thought a flourishing liberal society required social cohesion and, therefore, an ethical foundation.

We explore three of Buchanan's ideas that are so far unconsidered in business ethics. First, Buchanan (1994) emphasized and analyzed the individual work ethic. Cultivating a strong work ethic within an organization may reduce shirking and monitoring costs, but it also improves others' fortunes by extending the division of labor.[3] Second, Buchanan argued that we have an economic interest in others' beliefs and values; therefore we invest in "preachers," the word Buchanan used as shorthand for "the institutions of moral-ethical persuasion" that help us overcome free rider problems. In this regard, compelling stories about identity and conduct help establish an organization's ethical culture and reduce monitoring

[2] Kennedy (2009: 240) points out that Smith uses the term *invisible hand* "only three times in over a million words published in his surviving essays and books, written between c.1744 and 1790."

[3] On the importance of increasing returns, see Buchanan and Yoon (2000). On the interaction between culture and economic behavior, see Rose (2011, 2019).

costs.[4] Third, Buchanan (1975) stressed the importance of maintaining the society's "public capital," which includes emergent and evolutionary institutions like law, ethics, and norms. Whereas honest dealing and virtuous behavior serve to maintain a healthy ethical environment, dishonest dealing and cheating erode public capital. Buchanan feared that past some point, society might lose this public capital permanently.

In the next section, we present a brief overview of Buchanan's career along with his other ethical considerations for the firm. Section 2 explores Buchanan's analysis of the economic effects of the individual work ethic. Section 3 develops Buchanan's notion of "paying the preacher" and other ethical considerations for the firm. Section 4 develops the idea of a market-wide ethic in light of Buchanan's notion of "public capital." Section 5 concludes.

1. BUCHANAN'S LIFE AND WORK: A BRIEF OVERVIEW

In 1948, Buchanan earned a PhD in economics from the University of Chicago. He entered graduate school with socialist inclinations but became a "born-again economist" and a "zealous advocate of the market order" due to the influence of his professor and mentor Frank Knight (Buchanan, 1999a: 15). His academic career spanned nearly seven decades, and in 1986, he won the Nobel Prize for the "development of the contractual and constitutional bases for the theory of economic and political decision-making" (Nobel Foundation, n.d.). According to Romer (1988: 165), Buchanan played a "central role in the gradual transformation of the way economists and political scientists study governments and their relationship to the governed." He was more than an economist and political theorist, however. He described himself as a "social philosopher," and in 2006, he received the National Humanities Medal from the National Endowment for the Humanities. He passed away in 2013 at the age of ninety-three.

Buchanan is best known for his book *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (1962), coauthored with Gordon Tullock.[5] It originated from Buchanan's concern that democratic majority voting reduces decision-making costs but is susceptible to exploitative majority coalitions. Buchanan and Tullock developed a two-tiered approach consisting of the "constitutional" and "ordinary" stages of politics. They argue that once people reach unanimity at the constitutional stage of politics (i.e., decisions regarding the meta-rules within which ordinary politics takes place), unanimity need not be required at the ordinary stage of politics (i.e., the business of legislatures, often done by majority rule due to external decision-making costs). Rules agreed upon unanimously at the

[4] This point is closely related to the central thesis of *Ethics and Economic Progress*, of which Buchanan (1994: 1) wrote, "Ethical or moral constraints on human behavior exert important economic effects, measured in positive or negative economic values."

[5] Buchanan's Google Scholar page indicates that *The Calculus of Consent* (with Gordon Tullock) has been cited nearly fourteen thousand times, while his other works, such as *The Power to Tax* (with Geoffrey Brennan), *An Economic Theory of Clubs*, and *The Limits of Liberty*, have each been cited more than four thousand times (as of May 2021).

constitutional stage would protect minorities from majorities' appetites at the ordinary stage of everyday politics (Buchanan, 1999b: 442–54). In 1966, Buchanan and Tullock founded a journal, *Papers on Non-Market Decision Making*, that eventually became *Public Choice* (Buchanan & Tollison, 1984: 4).

Buchanan described public choice as "Politics without Romance" (Buchanan, 1979) because it applies the theories and methods of economics (rational maximizing behavior subject to constraints) to nonmarket settings like the political arena (Shughart, 2008). Buchanan (2003: 11) summarized the origins and development of public choice as follows:

> Public choice is like the small boy who said that the king really has no clothes. Once he said this, everyone recognized that the king's nakedness had been recognized but that no one had really called attention to this fact. Public choice has helped the public to take off their rose-colored glasses when they observe the behavior of politicians and the working of politics.

From this perspective, Buchanan pointed out that politicians and bureaucrats are "simply like the rest of us" (Buchanan & Brennan, 2001). If people are rationally self-interested in market and nonmarket settings, then differences in market and nonmarket behavior emerge from different incentives (Munger, 2018: 156).

In his work, Buchanan also emphasized institutional details. To Buchanan, economic inquiry should concern "a particular group of individuals who have organized themselves socially solving their economic problem" (Buchanan, 1964: 215). Reflecting Knight's influence, he started from the conviction that no claim is beyond the boundaries of intense inquiry (Munger, 2018: 164).[6] In *Ethics and Economic Progress*, Buchanan (1994) explored the origins and utility of ethics. In particular, he argued that there is substantial "economic content" in "Puritan" virtues like a societal work ethic.

Ethics and Economic Progress continues Buchanan's larger intellectual project, which is grounded in the insight that people do not always act the way we (or they) think they "should." We prefer politicians and public officials who direct all their attention toward the public interest. However, as human beings, they tend toward self-interest and self-preservation. Throughout his career, Buchanan emphasized rules that allow people with different tastes and talents to coordinate and live well together. His insights remain largely untapped sources of fresh ideas for business ethics.

2. THE INDIVIDUAL ETHIC

> How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it (Smith, 1790/1982: 9).

[6] On this, Munger (2018: 155) points out, "This tension between a faith in emergent norms and the claim that nothing is sacrosanct is at the very core of Buchanan's political philosophy."

> The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgment with which it is any where directed, or applied, seem to have been the effects of the division of labour (Smith, 1776/1981: 13).

These statements open *The Theory of Moral Sentiments* and *An Inquiry into the Nature and Causes of the Wealth of Nations*. They help us understand Buchanan's *Ethics and Economic Progress*—the first section of which he noted could be retitled "The Economics of Ethics" or "The Economic Value of Ethical Norms" (Buchanan, 1994: 1). Here Buchanan explores the economic effects and utility of ethical norms, suggesting that "Puritan ethics" related to work evolved in part to solve collective action problems like labor shirking and the negative externalities or spillover costs resulting from these issues.

A dilemma led to *Ethics and Economic Progress*. One weekend in 1987, Buchanan wanted to watch fifteen hours of NFL playoff football but could not in good conscience let himself be "idle" for that long, as this, in his mind, would amount to an economic loss and a moral failing. He solved the problem by spending the day cracking walnuts while he watched football (Buchanan, 1994: 7–8). His introspection during and after the day of football and walnut cracking led him to ask about "the economic content of the work ethic" (Buchanan, 1994: 8). How, he wondered, might the work ethic affect the macroeconomy?

Buchanan builds his argument on Adam Smith's original analyses of moral sentiments and the division of labor. People are interested in others' well-being, and specialization improves others' well-being by extending the division of labor. Buchanan thought economists had made a mistake by abandoning—or at least deemphasizing—increasing returns to a finer division of labor (Cachanosky & Lopez, 2020: 2–3; Munger, 2020: 9). As he and Yong Yoon put it, "Adam Smith's elementary notion that the division of labor must depend on the extent of the market, a proposition that can only be sustained in the presence of generalized increasing returns, was somehow relegated to analytical irrelevance" (Buchanan & Yoon, 2000: 43–44). Increasing returns means that supplying more labor generates a positive externality. In *Ethics and Economic Progress*, Buchanan identifies shared social convictions—the work ethic and "paying the preacher"—that help people capture increasing returns to the division of labor. The result is a virtuous circle where specialization creates more wealth, which encourages further specialization. As Buchanan (1994: 132) explains,

> clearly, the extent of the market can be expanded endogenously by choices made by participants to supply more inputs to the market and fewer inputs to themselves, in nonmarket uses. As individuals supply more inputs to the market nexus, specialization is increased, and the productivity of inputs increases. The quantity of outputs, appropriately measured, that is purchasable from any given input is increased.

Potential improvements that might result from increased labor supply are substantial, as even slightly higher productivity growth means large improvements in standards of living.

Increasing returns to higher labor supply and a finer division of labor presents a classic collective action problem, however. Because benefits spill over onto others, people underprovide labor as measured by labor time, labor effort, or both.[7] To work "more," for our purposes, means to supply some combination of additional time and effort. The work ethic—the notion that it is virtuous to forsake leisure and embrace labor—solves the spillover problem to at least some extent and generates the increasing returns to a finer division of labor. Buchanan's argument is both descriptive ("the work and saving ethics evolved to solve collective action problems inherent in increasing returns") and prescriptive ("you and I should work and save more"). Societies that develop "Puritan" norms about work, he argues, will do better than societies that do not. Likewise, a strong work ethic serves to advance the socially conscious firm's values, generating symmetry between its stated values and actual conduct.

People often have powerful incentives to shirk, and they are all individually better off if they can free ride on others' extra labor. Maintaining the work ethic, Buchanan argues, requires some mechanism to reinforce people's beliefs in the propriety of working more. He therefore emphasized the economic role of "the preacher," or "the institutions of moral-ethical persuasion."

3. PAYING THE PREACHER

The organization and activities of firms play a central role in Buchanan's analysis in *Ethics and Economic Progress* and other works. In "Moral Community, Moral Order, and Moral Anarchy," Buchanan (1981: 188) suggests that a firm is a "moral community," an entity that exists among a set of individuals "to the extent that individual members of the group identify with a collective unit, a community, rather than conceive of themselves to be independent, isolated individuals." Conversely, "moral anarchy" exists, according to Buchanan, when an individual in a community "treats other persons exclusively as means to further his own ends or objectives," thus representing "the negation of both moral community and moral order" (190). The culture of the "moral community" encompassed by the firm—particularly the question of improving upon those cultures—deserves attention.

Throughout *Ethics and Economic Progress*, Buchanan (1994: 60–61) highlights the differences between the choices we make when bound by ethical constraints and "those choices that might simply be dictated by naked preferences," arguing that "the presence of these ethics … is economically functional." Buchanan's analysis of the work ethic shows how we have an interest in others' morals. If others' beliefs and values can affect us materially, we have incentives to modify them by investing in "preachers," the shorthand Buchanan used for "the institutions of moral-ethical persuasion." In the third chapter of *Ethics and Economic Progress*, Buchanan explains why we all have an interest in "paying the preacher," as it were, who works to persuade others to adopt norms and values conducive to our interests as well as the broader interests of society.

As Buchanan (1994: 70) writes, if such practices "are even marginally effective, each party to a potential interaction will have some incentive to 'pay the preacher,' that is, to invest in bringing the orderings of others around to the directions that will generate the

[7] See Kremer (1993) for analysis of work quality.

spillover or external benefits promised." Furthermore, to "pay the preacher" need not strictly mean paying actual money to a literal preacher; instead, it means upholding, respecting, and investing in the institutions of moral-ethical persuasion, particularly those that exhort others to work hard, keep promises, and develop integrity and other traits that support ongoing productive and cooperative behavior.

Buchanan's (1994: 68–70) simple thought experiment in which he considers the opportunity to exchange a quarter for an apple highlights preachers' value. If A prefers an apple to a quarter and B prefers a quarter to an apple, they can gain from trade. Buchanan argues, however, that the analysis is incomplete, as there are other alternatives. A's first choice would be for B simply to give her the apple so that she has both the apple *and* the quarter. B's first choice would be for A simply to give her the quarter so that she has both the quarter *and* the apple. It is then rational for A to invest up to a quarter to persuade B simply to *give* her the apple. B faces a similar incentive to invest up to one apple to get A to give the quarter.

This simple example shows how we have an interest in others' beliefs and, therefore, incentives to try to modify them. It is to our advantage both individually and collectively to pay a "preacher" to persuade others that exchange is better than zero-sum or negative-sum begging and pleading. The value comes from the commitment to exchange, in other words, to see another as a moral equal deserving of value in exchange for value rather than *just* as a source of an apple. "Paying the preacher" cultivates an environment that encourages reciprocal exchange between moral equals rather than opportunistic exploitation of a moral inferior by a supposed moral superior. To the extent that we recognize this, we have incentives to pay the preacher, and Buchanan highlights how cultivating a preacher-paying norm mitigates the incentive problem inherent in relying solely on people's "naked preferences."

Buchanan argues that these ethical norms emerge as people ask, "How do I want others to behave, both in general and toward me in particular?" This question is Buchanan's (1994: 62) "starting point for ethical norms or precepts." People who join a firm agree to a small-scale social contract, and "paying the preacher" is an investment in encouraging people to uphold that social contract. People might "find it advantageous to invest resources in modifying the preferences of others so as to produce the desired behavioral changes" (70). He argues, "Each participant has, in this sense, an incentive to pay the preacher, even though free-ridership may emerge here as with all publicness relationships" (74).

Employees value workplaces as "moral communities" in which individuals treat one another as moral reciprocals (Buchanan, 1981: 188). For instance, one study that surveyed employees at more than one thousand US firms found that perceived integrity correlates with higher productivity, profitability, better industrial relations, and a higher level of attractiveness to prospective job applicants (Guiso, Sapienza, & Zingales, 2015: 61). These results suggest that a culture of integrity is in the employer's interest (through higher profits) and the employee's (through a more desirable workplace). "Paying the preacher" helps reinforce a company's culture.

Reciprocal relations encourage organizational citizenship behavior (OCB) norms within firms. OCB refers to workers' actions that make an organization more effective, even though the organization does not formally or directly reward them

(Organ, 1988).[8] Employees reciprocate: they will provide OCBs for those who provide OCBs for them. A key finding as to what contributes to the existence of OCBs within firms is the extent to which employees receive OCBs from other coworkers. Reciprocity norms within firms are a kind of social exchange (Deckop, Cirka, & Andersson, 2003), and these findings dovetail with Buchanan's exchange paradigm and his argument about the economic effects of ethics.

When evaluating social ethics, it is not enough to consider the values we want to have. We also have a rational interest in asking what values we want others to have. What norms do we want them to follow? How do we want them to treat us? Adam Smith pointed out that everyone "is practicing oratory on others thro [*sic*] the whole of his life" and explains how markets are fundamentally efforts in persuasion (Smith, 1762–63/1982: 352). We have incentives to persuade others to adopt beliefs conducive to what we want.

In Buchanan's examples, this oration includes persuading people that it is good and right to *make* rather than *take*, for we cannot long endure as a society of thieves and beggars. It includes persuading people that it is good and right to work and save more than they otherwise might. As he emphasizes, all hold an interest in maintaining "institutions of moral-ethical persuasion" that look down on loafing and prodigality. Therefore a "preacher" of "Puritan" virtues provides a valuable public service.

Just as the work ethic has free rider problems, there is a free rider problem associated with "paying the preacher." That is, some individuals stand to gain if everyone else works harder, saves more, and pays the preacher while they shirk, spend, and withhold. This challenge suggests an important moral-ethical-*social* role for the firm in that it can mitigate at least some of this collective action problem. A "pay the preacher" ethos helps overcome some of the free rider problems stemming from imperfect monitoring by cultivating internal ethics in firms to reduce shirking (Buchanan, 1994: 81). A firm can mitigate the free rider problem by bringing people together under a single "preacher"—the firm's culture.

Investing in corporate culture is one way to pay the preacher. The accompanying reduction in shirking increases the firm's productivity and thereby the social good it can provide. Cultivating high-quality management is another—and as Cowen (2019: 3–4) points out, superior management separates American businesses from businesses worldwide.[9] Sometimes the preaching is deliberate, as when a firm brings in an outside consultant or motivational speaker. While at first glance, this might look like classic exploitation—capitalists get workers to work harder and then skim the spoils—a well-taught and enthusiastic "congregation" within the firm can accomplish and earn more. There is, Buchanan (1994: 82) points out, "active ethical discourse that encourages individuals to surmount the large-number cooperative dilemma" in cases like voting and contribution to public goods. "Ethical discourse" and good management help mitigate free rider problems at the firm level.

[8] On organizational citizenship behavior, see Organ (1988), Farh, Podsakoff, and Organ (1990), Eatough, Chang, Miloslavic, and Johnson (2011), and Newman, Schwarz, Cooper, and Sendjaya (2017).

[9] On management practices across countries and productivity differences, see Bloom, Genakos, Sadun, and Van Reenen (2012) and Bloom, Sadun, and Van Reenen (2016).

We are not arguing that "paying the preacher" is the *only* reason firms exist. It is one among many transaction costs firms reduce. In Buchanan's (1981) framework, a firm is a moral community that reduces transaction costs, maintains moral-ethical institutions, and helps people capture gains from specialization that might otherwise go unrealized. By applying his analysis to questions in business ethics, we uncover some of the mechanisms contributing to more widespread prosperity.[10] Firms enable collective action by providing moral communities.

Buchanan's argument is consistent with the historical record. As Fishback (1992, 1997) shows, "company towns" provide empirical evidence showing that contrary to popular belief, West Virginia coal labor markets were not monopsonistic. Workers did not necessarily owe their souls to the company store—and speaking of workers' souls and the things provided by employers, many employers provided church houses and paid preachers. Critics of nineteenth- and twentieth-century "company towns" argue that these were means of labor control; however, Fishback's evidence suggests that they solved collective action problems and were relatively easy for workers to enter and exit. In this case, they literally paid preachers—and Buchanan's argument in *Ethics and Economic Progress* explains one reason why this made sense for the workers themselves.

A manager's "preacher" function is essential in team production. Building on this point, Buchanan (1994: 87) argued that societies constrained by "Puritan ethics" would be more productive than others: "it follows as a matter of course that there are purely economic reasons for trying to instill or imprint this set of norms in all persons who may participate in the network or production, distribution, and exchange."

4. THE MARKET ETHIC

Up to this point, we have explored Buchanan's analysis of the economic effects of ethics across individuals and within the firm. This section explores law and business ethics as public capital. In *The Limits of Liberty*, Buchanan refers to "law" in an evolutionary, Hayekian sense:

> Hayek suggests that "law," which is equivalent to what I have called constitutional contract, is not contractual in origin but emerges from an unpredictable evolutionary process. He advances this argument in opposition to the "constructivists," who are alleged to think of law as willed by someone. In historical fact, evolutionary elements may explain much of the emergence and development of "law" (Buchanan, 1975: 37).

Law here refers to a fundamentally complex, emergent phenomenon—the by-product of an evolutionary process of human interaction over time—rather than merely the de jure statutes handed down by legal authorities (what Hayek, 1973, called "legislation"). Law, conceived as such, cannot be rationally constructed, as it is the result of human action but not human design. This is not to say that legislation

[10] Cf. Evensky (2005a, 2005b), McCloskey (2006, 2010, 2016), and Carden, Caskey, and Marshall (2020).

and institutions can never be designed. As Boettke, Coyne, and Leeson (2015: 338) argue, "institutional stickiness"—the credibility and effectiveness of an institution among local agents—is a by-product of whether the institution in question is grounded in people's experience and local knowledge.[11]

Modern business ethics is a kind of public capital. Business ethics, as practiced by merchants in the marketplace, carries information and knowledge making up a body of unintended rules that are the result of centuries of commercial activity. The public capital constituted by this emergent body of unintended rules is used by many and therefore is in need of maintenance. Incentives to maintain public capital, however, are weaker than incentives to maintain private capital. A commercial society's ethical foundation deteriorates with neglect. In *Limits of Liberty*, Buchanan recognized that self-constraint is the key to ethical, law-abiding behavior. Such behavior, Buchanan (1975: 41) wrote, is one's obligation as a part of the overall legal-social contract between oneself and others in the community. That is, in obeying the law, one forgoes some private utility otherwise gained by cheating. When people refrain from infringing on others' rights and conduct themselves with high standards in ethical gray areas, they maintain and improve the public capital stock. This can only happen if people limit themselves.

Buchanan was acutely aware that while this sort of law could not be rationally constructed (in the manner of emergent, endogenous informal institutions), it *could* be lost. What is more, the loss may be irreversible. It is in this sense that Buchanan viewed law as a form of "public capital." Individual actions produce positive and negative spillovers, and in dealing fairly and honestly with others in the marketplace, one engages in "maintenance" of the public capital stock. Dishonest behavior or cheating "erodes" the public capital stock.

Like law, "business ethics" as public capital emerges and changes over time. What commercial society accepts—and how this affects generalized trust, both in commerce and in society more broadly—is subject to an evolutionary process more complicated than what de jure statutes can anticipate.[12] Historical evidence suggests that appropriate property and contract rules can emerge without being explicitly designed. To the extent that gains from trade exist, individuals have incentives to work out creative institutional arrangements to see that those mutually beneficial exchanges are not, like twenty dollar bills, "left on the sidewalk." Benson (1989), for example, illustrates how European merchants in the tenth through twelve centuries developed their own system of international commercial law in response to these political constraints.[13]

[11] In their analysis of "institutional stickiness," Boettke et al. (2015: 338) utilize the ancient Greek concept of *mētis*, or "local knowledge resulting from practical experience," including "skills, culture, norms, and conventions, which are shaped by the experiences of individuals." Importantly, "the further an institution falls from *mētis*, the less sticky it will be" (338).

[12] World Value Survey data demonstrate a large degree of time-consistent heterogeneity in trust attitudes around the world. More than 60 percent of respondents in Nordic countries believed people can generally be trusted. In contrast, of respondents from Colombia, Brazil, and Peru, fewer than 10 percent responded that this is the case (Ortiz-Ospina & Roser, 2016).

[13] See also Milgrom, North, and Weingast (1990).

In what became known as the *Lex Mercatoria*, merchants settled disputes in their own courts, backed by their own law, with the threat of boycott sanctions imposed upon violating merchants. Constrained by the discipline of continuous dealings, merchants desirous of future trading opportunities thereby had incentives to engage in behaviors to "reduce social distance" (Leeson, 2014) between one another, thus cultivating a commercial system characterized by trust and behaviors aligned with the expectations of other merchants. Over time, actions other merchants came to count on became the substance of the law, in this case, the *Lex Mercatoria.*[14] For this process to be sustained, it's essential that businesspeople recognize their part in the evolutionary emergence and development of law.

Before Smith (1776), Mandeville (1732/1924: 35–49) recognized that the ordinary drives of individuals are socially beneficial, arguing that productive commercial behavior, previously regarded as a vice, was virtuous, socially beneficial behavior (Bragues, 2018: 28; Heath, 2017). Buchanan's notion of public capital is very much in line with this tradition. Law-abiding behavior creates "goods" because of the predictable order, security, and stability it generates for other individuals in the market. The opposite is the case for dishonest behavior—not only are those party to the exchange cheated but there are negative spillovers to other market participants in the form of reduced predictability and order.

To explain why established institutions like the law break down, Buchanan suggests that bad behavior generates spillover costs that erode public capital (Buchanan, 1975: 152–55). He gives the example of auto theft to provide some intuition. The theft itself does not create negative spillovers; it is merely a transfer. Instead, the "external diseconomy" comes from the additional cost third parties pay for policing services to maintain the same degree of social order. Dishonest business has similar effects: it increases transaction costs and thereby limits the division of labor. Buchanan dealt with this topic as seriously as one could, writing in *Limits of Liberty*, "For all practical purposes, public or social capital may be permanently lost once it is destroyed. It may be impossible to secure its replacement, at least on the basis of rational decisions made by individuals" (156–59). As Buchanan argues in *Ethics and Economic Progress*, rules and norms have economic effects in that they motivate us to do things we might not otherwise do—like working harder and paying the preacher.

5. CONCLUSION

Following in the steps of Adam Smith, James M. Buchanan proposes an innovative and heretofore unappreciated framework for business ethics. He identifies the division of labor as a likely source of increasing returns, and he argues that we are able to capture these returns by adopting "Puritan" principles like the work ethic and

[14] On the role of expectations and whence such emergent commercial law derives its true authority, Benson (1989: 645) cites Hayek (1973): "As Hayek explained, those who appear to have authority to settle issues of law need not actually determine whether certain actions have abused the will of the state, but 'whether their actions have conformed to expectations which other parties had reasonably formed because they corresponded to the practices on which the everyday conduct of the members of the group was.' "

the principle that we should "pay the preacher." Ethics, he argues, have economic effects insofar as they help us overcome free rider problems.

However, Buchanan develops a framework for analyzing the real implications of ethics and makes an important prescription for society founded in his economic analysis: we *should* work harder, save more, and pay the preacher, because we would most likely make ourselves better off. To the extent that this is the case, the "Puritan virtues" Buchanan analyzes may be better vehicles for sustained improvements in others' lives than other, more deliberate efforts to help.

We explored and applied some of the themes Buchanan identifies in *Ethics and Economic Progress* in particular. Buchanan suggests several ways to contribute to help society prosper and highlights some of the ways those who have "affected to trade for the public good" might want to redirect their efforts. Just as his economic analysis of politics changed how we understand government, we believe that Buchanan's economic analysis of ethics can (and should) change how we understand business, moral standards, and ethical behavior.

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