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REVIEW PAPER

Joseph Heath's *Ethics for Capitalists*: The Market Failures Approach 2.0

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Abstract
In his latest book, *Ethics for Capitalists*, Joseph Heath draws on his many years of thinking about business ethics to propose, as the book's subtitle indicates, "a systematic approach to business ethics, competition, and market failure." He develops his argument carefully, draws on a wealth of interdisciplinary work, uses valuable and insightful examples, contrasts his views with important alternatives, and provides responses to compelling objections. In this review article, we argue that his book revises and sharpens many of Heath's earlier ideas, addressing important criticisms raised against them. We highlight that the book also offers a broad macro-level framework for market design, an explanation of how current corporate governance structures fit such a framework, and concrete responses to micro-level questions about what businesses and individuals ought to do. By doing all of this, his book shifts the scope of the "market failures approach" (MFA) from what used to be a narrow focus on the obligations of professional managers to an encompassing "ethics for capitalists" that ought to guide any economic actor within a capitalistic system. Despite the many merits of his book, we conclude by discussing some concerns we have about its scope and methodology.

Keywords Joseph Heath · Market Failures Approach · Ethics for Capitalists · Theories of Business Ethics · Theories of the firm

Introduction

Ethics for Capitalists, Joseph Heath's latest book, is one of the best business ethics books we have read.[1] He draws on his many years of thinking about business ethics to propose, as the book's subtitle indicates, "a systematic approach to business ethics, competition, and market failure." He develops his argument carefully, draws on a wealth of interdisciplinary work, uses valuable and insightful examples, contrasts his views with important alternatives, and provides responses to compelling objections. The book has influenced our research and teaching. We have read it several times and it does not get old; even though we disagree with many of its claims, we found fresh and valuable insights every time we came back to it. *Ethics for Capitalists* should have a privileged place in the library of anyone interested in business ethics.

Heath has suggested that *Ethics for Capitalists* is "an updated statement of the Market Failures Approach to business ethics" (Heath 2023b). To call it an update, however, may be an understatement. The book certainly revises and sharpens many of his earlier ideas, addressing important criticisms raised against them. But it does a lot more than this. Heeding his own injunction about how business ethics should be conducted (Heath, Moriarty, and Norman 2010, 441), *Ethics for Capitalists* also provides a broad macro-level framework for market design, an explanation of how current corporate governance structures fit such a framework, and concrete responses to micro-level questions about what businesses and individuals ought to do. As such, it shifts the scope of the "market failures approach" (MFA) from what used to be a narrow focus on the obligations of professional managers to an encompassing "ethics for capitalists" that is meant to guide any economic actor within a capitalistic system.

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The book can be divided into two parts: the first provides an account and moral justification for market institutions; the second articulates how this account applies to firms and those who participate in them. We divide our review accordingly.

Jus ad Mercatum and Jus in Mercatu (Chapters 1–8)

Ethics for Capitalists starts by analogizing business to war, both of which involve "forms of behavior that are normally regarded as anti-social" (2). Just like we need to develop principles to identify when going to war is justified (*jus ad bellum*) and how a just war should be conducted *(jus in bello*), so we need to explain when the institutions that make business possible are morally justified (*jus ad mercatum*) and how one should conduct oneself within the business context (*jus in mercatu*). Chapters 1–3 highlight the necessary moral compromises required by markets and business activity. Chapters 4–6 provide an account of *jus ad mercatum* and Chapters 7–8 of *jus in mercatu*.

Unlike many others in the field, Heath accepts that we live in societies dominated by markets and seeks to develop "the moral principles that should guide the conduct of economic actors *within a capitalist economy*" (1, italics in the original). These moral principles, he argues, require navigating a middle course between the Scylla and the Charybdis of business ethics, finding an account that "neither permits business people to act like devils nor requires them to act like angels" (16).

Chapter 1 ("Tensions with everyday morality") confronts the Scylla. Heath rejects the view, defended by authors such as Albert Carr (1968) and Milton Friedman (1970), that following the law is all that business ethics requires. Chapter 2 ("The search for a moral framework") confronts the Charybdis. Heath attacks theorists who hold that business ethics should be guided by standard applications of certain traditional moral theories that are "functionally incompatible" (18) with markets—e.g., he argues that the categorical imperative would not permit price competition, and that luck egalitarianism would prohibit firms from paying higher wages to their more productive employees. He concludes that by applying those theories to markets, these theorists can be "accused of providing, not a conception of business ethics, but rather a moral argument for socialism" (22). Chapter 2 also takes issue with ethical theories that seem more business-friendly. Heath argues that while neither libertarianism nor act utilitarianism overturn markets, they are nevertheless too permissive. And rule utilitarianism, while potentially justifying the standard workings of the market, does not adequately account for the moral tensions that we sometimes experience in competitive business exchanges.

Chapter 3 ("A Theory of Justice") draws inspiration from Rawls to propose a contractualist argument to justify an economic system that (1) encourages people to cooperate to generate social benefits and (2) distributes those benefits and the burdens of producing them in an acceptable manner. The dilemma is that even though equality is the most broadly accepted principle of distribution, such principle may not create the incentives necessary to generate cooperative benefits because of the human tendency to defect from cooperation and free ride. Thus, any contractualist theory of justice requires resolution of the tradeoff between economic efficiency and distributional equality. Heath proposes a resolution that prioritizes efficiency over equality but recognizes that it will result in a distribution of the cooperative surplus that can be highly unequal and, therefore, may appear morally objectionable.

His justification of markets in the face of that inequality begins in Chapter 4 ("*Jus ad mercatum*"). Following the tradition of many contractualists, he develops a pseudo-historical account of the evolution of markets from small communities of hunter gatherers, through agricultural societies, feudal systems, and *laissez faire* decentralized markets, to regulated markets. His account is meant to show that as the division of labor in society grew more complex, efficient allocation of production became possible only through the coordination of prices in decentralized regulated competitive markets.

In Chapter 5 ("Competition"), Heath takes a deep dive into the nature of cooperation and competition. Cooperation, in theory, can produce the greatest social surplus. However, he argues that "[u]nless actions are observable, it may be difficult or impossible to enforce cooperative expectations. Absent some intrinsic motive to cooperate, individuals will free ride, even though the result is collectively self-defeating" (55). Thus, he argues, procuring the greatest cooperative surplus will require engineering incentives to overcome the human tendency to defect from cooperation. A well-staged competition, he argues, provides such incentives.

In Chapter 6 ("Capitalism"), Heath argues that, because of the extensive division of labor required by modern economies, the staged competition of a competitive market—which enlists people's self-interest to guide pricing decisions—is morally justified because it produces a larger cooperative surplus than the alternative of a planned economy. He demonstrates this superiority through an extensive analysis of the significant and unavoidable information, calculation, and incentive problems of Michael Albert's participatory economics proposal (parecon)—a sophisticated, centrally planned socialist economy based on cooperation.

After his arguments establishing the overall justice of competitive markets, we reach Chapter 7 ("*Jus in Mercatu"*), arguably the book's core. Here, Heath presents his updated "market failures approach" (MFA) to business ethics. In line

with prior work, Heath argues that in light of the efficiency of competitive markets in producing a cooperative surplus, participants are released from the general moral obligation to act impartially so long as they act in ways that are "broadly consistent" (92) with the goal of market competition. When the market functions as it was designed (which includes having antitrust, environmental, and other laws that promote healthy competition), playing by the rules is generally all that is required; however, when the market fails in some way, an ethical business person must temper her naked self-interest so as not to exacerbate or take advantage of that failure.

He lists three practices that are permitted without reservation: self-interested decisions about (1) how much to produce or purchase, (2) what prices to charge or pay, and (3) whether to shift the supply curve (e.g., by increasing production efficiency). He also lists four obligations for market actors, generated by what he considers the four major sources of market failure: (1) avoid anti-competitive practices such as collusion or price fixing and, more generally, "exercise constraint in circumstances in which they enjoy market power" (99); (2) refrain "from, or at least minimize the [] production of negative externalities" (100); (3) refrain "from creating or exploiting information asymmetries" (100); (4) avoid behavior that increases contracting costs, even if permitted by law (100). Careful readers of Heath will notice that these descriptions of MFA's permissions and obligations differ from his prior formulations (Heath, 2014, 37, 111–113). We find them more reasonable even if not "entirely straightforward" in application (102). He illustrates one such application in Chapter 8 ("An Application: dishonesty"), where he analyzes what MFA says about dishonesty in sales.

The Firm (Chapters 9–15)

The second part of the book, chapters 9–15, discusses how the efficiency logic that Heath used to justify his account of markets also provides an explanation of and moral justification for the existence and nature of for-profit firms.

Chapters 9 ("The Firm") and 10 ("The Constraints of the Market") provide what Heath himself calls a "market failures theory of the firm" (124). Relying on transaction-cost theory, originating in the work of Coase (1937), he seeks to provide an explanation of why firms exist. He highlights that because some market transactions involve high transaction costs, a market failure, it will often be more efficient to organize labor through organizations that use authority relations to direct production.[2]

He elaborates on his account in Chapter 10, where he emphasizes, in what is a recurrent topic in the book, that the absence of markets where one would expect them is one of the most important market failures. In particular, he notes that few insurance markets exist for individuals who want protection against many life risks they can face as independent contractors (137). He argues that the fact that firms provide employees with important insurance-like arrangements goes a long way to explain why individuals join firms as employees rather than interact with them as independent contractors (138).

Heath claims that firms' key comparative advantage is their capacity to cultivate social capital and high-trust relationships (130). This leads to another recurrent topic in the book's second part: firms can be seen as "an oasis of cooperation in a desert of market relations." This feature explains an important bifurcation in business culture: "At the one end, there is 'business strategy,' which is inevitably hard-nosed, Machiavellian, and often vaguely militaristic.... At the other end there is 'human resources,' which is sensitive, caring, and often vaguely spiritual" (133).

Heath emphasizes that the cooperative dimension of the firm entails that "managers make liberal use of appeals to everyday morality as a resource to promote cooperation, seeking to promote diligence, honesty, and self-sacrifice among their employees" (132). While he highlights that this cooperative dimension requires the firm to recognize some minimal obligations owed to employees (such as advance notice and severance packages), he also emphasizes that labor relationships remain "constrained by the functional imperatives of the market, and in particular, the need to maintain a lower profile of transaction costs" (141).

Chapter 11 ("Ownership") provides an explanation (and moral justification) for structuring the corporate governance of firms to give investors ownership rights, i.e., the right to "appropriate any surpluses in the form of disbursed profit [and to] elect the board of directors" (143). Following Hansmann (1996) and Boatright (2006, 2015), he characterizes the standard for-profit firm as a member-owned cooperative, whose members are neither workers nor consumers but investors. He also argues that investors end up having ownership rights because they are the constituency with the lowest costs of ownership. Two main features go a long way to explain this. First, investors "are often in the best position to shoulder the risks associated with having a residual claim, because it is so easy for them to diversify their holdings by buying shares in many corporations" (156). Second, the relative homogeneity of the input that investors

[2] In an insightful parenthetical passage, he clarifies that his "market failures" theory of the firm could also be called an "administrative failures" theory of the market: one can say that firms exist because

Footnote 2 (continued)

markets are not perfect, but one could also say that markets exist because administration is not perfect (124).

provide to the firm "tends to reduce the number of conflicts that arise when they advance their interests, which in turn reduces the number of opportunities available for managers to play divide and conquer against them" (157). This chapter also highlights some feasibility constraints that explain why worker cooperatives and worker democracy proposals are seldom successful.

Chapter 12 ("Occupational business ethics") discusses important moral features of principal-agent relationships within the firm. Heath reminds us that a hierarchical firm is "a set of recursively embedded principal-agent relations" (166), where principals (i.e., bosses) have authority to give orders to agents (i.e., subordinates). It follows that understanding the principal-agent relationship is critical to understanding the moral obligations of those participating in such a hierarchy. Heath argues that such relationships involve a deontic strengthening ("[a]ctions that are merely permissible for the principal become obligatory for the agent once delegated"); that the agent owes loyalty not to the person of the principal, but to a "circumscribed set of objectives" given by the goals of the organization (166); and that the obligations of both principals and agents are circumscribed by the pursuit of "healthy competitive strategies" (167). In the second part of this chapter, Heath provides a taxonomy of the most prevalent forms of (1) agent misbehavior, (2) principal misbehavior, and (3) second-order principal-agent obligations that help to prevent agent's and principal's misbehavior.

In chapter 13 ("Labor relations"), Heath revisits the topic of labor relations. In particular, he reflects on what he identifies as a central tension between the firm as an ocean of cooperation, where employees are inside and suppliers are on the outside, and the legal model of corporations, where employees are on the outside and only owners are on the inside (177). He highlights that, due to the incompleteness of the employee contractual relationship, employers often have moral obligations beyond the letter of their contractual arrangements (179). After discussing the complex problems that this poses for analyzing the firm's obligations toward gig workers, Heath provides an insightful discussion of the limitations of two plausible strategies to address this tension, worker cooperatives and unions, concluding that "the only real solution to the problem lies in the domain of public policy, and in particular, an expansion of the social safety net in areas where market substitutes cannot be organized efficiently (a useful reminder that not every problem that arises in the world of business is one that can or should be solved by business.)" (192).

Chapter 14 closes by listing several business ethics issues that lie beyond the book's scope, such as the relationship between firms and the state; representation and discrimination; international trade; banking, finance, and insurance; price discrimination; and supererogatory corporate actions. This list brings out some important limits of this ambitious book. Chapter 15 concludes by summarizing the main arguments of the book.

Some Worries

We highly recommend *Ethics for Capitalists*. But this is not because we think that it provides the definitive business ethics framework for capitalists—we do not think it does—nor because we think that the arguments are unassailable. Allow us to focus on two we believe are important: the account is hard to apply and is one-sided.

By hard to apply, we mean it does not provide business people with sufficiently useful guidance—a significant problem if Heath intends his work to have a meaningful impact on the way business is conducted. For starters, recognizing the existence of a morally objectionable market failure requires sophisticated training in economics, political theory, and moral philosophy, possessed by very few academics and even fewer business practitioners. Furthermore, even if a manager were appropriately trained in these disciplines, it would be hard for her to know what Heath's "ethics for capitalists" would permit (or require) her to do. For instance, Heath recognizes that his account applies best to commodity markets (200), which are only a narrow subset of all markets. In the vast majority of markets, sellers have some power over the "price at which a good trades" (99), whether by virtue of brand recognition, the happenstance of geography, or other reasons. In those circumstances, Heath says, the seller is obliged to "exercise restraint" (99) in pricing. What that entails within his framework is unclear.

By one-sided, we mean that Heath's account does little to emphasize that other moral values beyond efficiency can (and should) shape an ethics for capitalists. Heath characterizes self-interested behavior in business as a "permission"—thus explicitly acknowledging that business agents and firms are not always required to promote their self-interest or pursue revenue-maximizing strategies (93, 141, 168, 222, 227). This suggests that the MFA allows market actors to occasionally operate on principles that are more aligned with ordinary morality.[3] However, Heath spends no time exploring these cases. Moreover, if the permissions that Heath discusses allow agents to sometimes align their business behavior with ordinary morality, there seems to be room to make it a moral obligation to behave in this way, at least in some of these cases. Finally, as the book develops its argument, it resolves most conflicts between ordinary

[3] In one revealing footnote, Heath notes " 'permissible' does not mean 'perfectly fine.' It may be permissible for a lender to foreclose on a loan, but also morally commendable to extend a grace period" (227, note 10).

morality and efficiency in favor of the latter. But efficiency cannot be all there is to business ethics (Moriarty, 2020, 116); some requirements of common morality that conflict with efficiency should "be at least partially satisfied without incurring morally intolerable efficiency costs" (McMahon, 1981, 276).

The one-sidedness of Heath's position comes up at several points in the book, but it is perhaps best illustrated by his discussion of dishonesty in sales in Chapter 8. Here, he argues that dishonesty in exchanges is permissible unless it strains the trust between buyers and sellers to such an extent that they avoid transacting. As we mentioned, the absence of a market caused by broken trust is a paradigmatic market failure. And although this provides a good reason for telling the truth in sales contexts, it seems extreme to think that this is the only circumstance in which lying to a customer would be objectionable. No customer gives a salesperson a pass because his lie does not impact the overall functioning of the market. Nor should she. Arguably, any adequate analysis of the ethics of lying in business needs to take into account, among other things, the breach of trust between customer and salesperson, salient differences in power and vulnerability and the potential harms that certain lies may bring about.

At the end of the book, Heath laments that everyday morality has not adapted to the market or rather to his description of the market's essential nature—a staged competition among self-interested persons. He blames that failure on business life being "too imbricated in every area of life to achieve the necessary separation" (208). We agree, but we do not blame people for their failure to separate business life from the rest of life; we blame Heath for not recognizing that a persuasive "ethics for capitalists" needs to take account of the fact that the efficient satisfaction of needs only reflects part of the role markets play in peoples' lives. He has created an elegant ethic for a world that does not now exist, one that appears too sharply bifurcated between business and ordinary life, where efficiency has too heavy a hand in determining the moral obligations of market actors.

Despite our concerns, we cannot overestimate the value of Heath's new book. He provides the most systematic and well-articulated account we have seen of how economic efficiency can explain and morally justify market institutions, firms, and those who interact with them. In working through the full implications of an allocative efficiency model for business ethics, Heath can be seen as doing for business ethics what Peter Singer has arguably done for moral philosophy. His account not only provides a welcome corrective to scholars who reject markets, sometimes unknowingly. It also, and perhaps more importantly, helps us understand how far efficiency can take us and the tradeoffs required to give it up. Because of this, we believe *Ethics for Capitalists* will become a central and authoritative reference in the field that will need to be read and cited by friend and foe alike.

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