
Lesson 3 – Do Markets Need Ethical Standards?

The students play the roles of doctors and patients to see how enlightened self-interest, duty and virtue improve economic efficiency.

OVERVIEW

Economics

One of the powerful insights into the economic way of thinking is how people respond to incentives that affect their personal well-being. Consumers and producers each attempt to enhance their own self-interest in purchasing and producing. Yet people's concern for fairness and justice also affects their economic choices, especially in situations that involve fiduciary responsibilities. People who operate from a perspective of duty or character can enhance economic efficiency in markets where asymmetric information and moral hazard exist.

Ethics

Ethics is the study of right and wrong behavior, or how people think they ought to live. Three main types of ethical systems can guide behavior:

1. Acting to produce outcomes that best satisfy some criterion (for example, human welfare)
2. Acting in a manner consistent with your duty to a rule or principle (for example, the Ten Commandments)
3. Acting from a habit of character consistent with your notion of virtue

Economists are most familiar with the first type of ethical system, which is based on the desirability of producing outcomes consistent with a goal (for example, satisfying consumer preferences). While self-interest is often the dominant motive for many economic actions, considerations of a different nature sometimes play a role in the actions of economic agents in certain market settings. Both duty and character at times provide equally strong rationales for action.

LESSON DESCRIPTION

The students participate in an exercise that demonstrates the motives of self-interest, duty and character in economic transactions. Playing the roles of doctors and patients, the students experience how asymmetric information can lead to a moral hazard. They experience how differing incentives and moral frameworks can alter the behavior of doctors. Based on the results of the role-play, the students will see how enlightened self-interest, duty and virtue play a role in improving economic efficiency in health-care and other markets.

CONCEPTS

Asymmetric information
Character
Competition
Duty
Enlightened self-interest
Fiduciary duty
Incentives
Moral hazard
Self-interest

CONTENT STANDARDS

4. People respond predictably to positive and negative incentives.
9. Competition among sellers lowers costs and prices, and encourages producers to produce more of what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.
10. Institutions evolve in market economies to help individuals and groups accomplish their goals. Banks, labor unions, corporations, legal systems, and not-for-profit organizations are examples of important institutions. A different kind of institution,

clearly defined and well enforced property rights, is essential to a market economy.

OBJECTIVES

The students will:

1. Analyze how economic actors at times operate from different ethical perspectives.
2. Participate in an activity that illustrates how different ethical perspectives can produce different economic outcomes.
3. Demonstrate how ethical behavior can enhance economic efficiency when asymmetric information creates a moral hazard.

TIME REQUIRED

75 minutes

MATERIALS

1. Visuals 3.1 and 3.2
2. Two copies of Activity 3.1 for two or three class “doctors”
3. Enough copies of Activity 3.2 for the rest of the students in the class to have two Patient Charts
(**Note:** Before class, make two copies of Activity 3.1 and cut them so you have two instruction sheets for each doctor role. Make enough copies of Activity 3.2 for the rest of the students to have two Patient Charts. Randomly select and record a pain level on each Patient Chart. (The game doesn’t require an equal number of pain levels, but make sure all the levels are represented among the patients.) Use one set of doctor instructions and Patient Charts for Round 1 of the game and the second set for Round 2.)
4. One copy of Activity 3.3 for each student

PROCEDURE

1. Tell the students that they are going to play a game that illustrates how ethical conduct can affect economic efficiency. In health care, for example, consumers do not have the same information as doctors about treatments and costs. Moreover, since insurance pays most of the bills for many people, consumers have little incentive to get more information. The students will see how transparency, *competition*, *incentives* and ethical values affect market outcomes in this situation.
2. Pick three students to play the roles of Doctor A, Doctor B and Doctor C. All other students will play the part of patients. (**Note:** In classes with fewer than 18 students, use only Doctor A and Doctor B.)
3. This step is key. Give each doctor the relevant instructions from Activity 3.1. Separately review with each doctor how you expect him or her to behave, as indicated on the instructions. Tell Doctors A and B that they must follow the very precise instructions they’ve been given in all cases. Tell Doctor C that he or she has some discretion in each case. Make sure each doctor is clear about the instructions.
4. Choose a student to be record keeper (or do this yourself). Give each of the remaining students a Patient Chart from Activity 3.2 with the pain level already filled in. Tell the patients they have health insurance that will pay 95 percent of the doctors’ treatment costs.
5. Position the doctors around the room. Randomly assign patients to the doctors in roughly equal numbers. Doctors will examine the patients’ charts and fill in each patient’s treatment and cost. The patients then bring their charts to the record keeper, who fills in pain level and cost information on Visual 3.1.
(**Note:** Do not display Visual 3.1 until the record keeper has filled in all the data.)

6. After all patient data have been recorded, display the completed Visual 3.1. Tell the students that all patients suffered from a backache of varying pain intensity. Review the correct treatments and costs for each pain level as shown on Visual 3.1.
7. Inform the students that “waste” is generated when a market produces something of no value. Use Visual 3.1 to calculate the amount of “waste” for each doctor: the difference between the cost of the treatments the doctor “prescribed” and the cheapest treatment for each pain level. For example, if a patient had a Level 1 pain, the correct treatment was medicine that cost \$100. If the doctor charged the patient \$500 for an X-ray, this was a waste of \$400. Have the record keeper total the amount of waste for each doctor at the bottom of Activity 3.1 and then calculate the total waste for all doctors combined.
8. Ask the students why some doctors had more waste than others. Accept all answers, and write them on the board or on a transparency. This sets the stage for the discussion that follows.
9. Now tell the students that all the doctors had the same training and experience and they were not concerned about malpractice lawsuits. Ask the students playing doctors to state the goal they were instructed to achieve in treating their patients. Make sure the students understand that each doctor had different instructions, and ask them if they think the instructions had any impact on each doctor’s waste. Doctor A was instructed not to consider profit in deciding which treatment to choose and to charge only for the correct treatment, so Doctor A had no incentive to prescribe more-expensive treatments that would create waste. Doctor B was instructed to maximize short-run profit and prescribe a more-expensive treatment for all patients, which created waste. Doctor C was instructed to maximize long-run profits and could choose any treatment for each patient. If Doctor C isn’t greedy, this doctor would likely prescribe the appropriate treatment for most patients, creating little waste.
10. Ask the following questions to lead a class discussion about the characteristics of this particular market that enabled some doctors to overcharge.
 - A. Compared with doctors, how much do patients know about the correct treatment for backache? *Often very little. Studying medicine requires eight or more years of education and training beyond the high school level. Thus, there is a market condition of asymmetric information.*
 - B. How hard is it for patients to get better information? What search costs are involved? *Patients can read books, search the Internet and talk to other patients. They can seek a second opinion from another doctor. However, if patients are in great pain or have a life-threatening injury, they will likely want immediate treatment from the first provider they see, and searching is very costly in terms of time and money. Sometimes a major cost to patients is the opportunity cost of taking time off from work to visit alternative doctors. Some medical plans make it difficult to get a second opinion because patients must go through a primary-care provider. In a small town there may not be competing doctors. Some patients may also feel embarrassed about getting a second opinion, as this may suggest a lack of confidence in their primary doctor.*
 - C. What economic incentive do patients have to get good pricing information in this market? *The economic incentives will be weak as long as insurance companies pay most of the expenses. To some extent, patients understand that insurance premiums will rise as these expenses increase. But this understanding probably won’t have much effect on patients unless they*

feel some sense of ethical responsibility about not overusing medical resources.

D. How transparent are the transactions in a doctor's office, in terms of treatments ordered and prices charged? *By "transparent" we mean that consumers can readily see what other patients are paying for similar services. Medical treatments are usually not publicly known because of patient confidentiality. Since third parties (insurance companies) usually pay a large percentage of health-care bills, patients are often unaware of the total cost of their own treatments. The Internet, however, provides an excellent way for patients to more easily find and communicate with each other about medical providers.*

E. What different motives might different doctors bring to these transactions? *Many doctors adhere to the Hippocratic Oath (Activity 3.3) because they believe it is part of their duty to put the patients' interests first. Other doctors might be motivated by greed, focusing on personal, short-run profit and ignoring their moral obligations to others. Other doctors might follow enlightened self-interest, which is to behave honestly so they can attract more clients in the long run. Other doctors behave honestly because they genuinely desire to have this virtuous character trait.*

11. Play the second round of the game. Select two or three new doctors, based on the size of the class. On Visual 3.2, label each new doctor by the student's name, for example, "Doctor Mary" and "Doctor Joe." Give each new doctor a set of instructions from Activity 3.1. Do not let patients know who is assigned the roles of Doctors A, B and C. Position the doctors in different areas of the room.
12. Give each patient a new chart with the pain level already filled in. This time tell the patients that they and not their insurance company will be responsible for paying all treatment expenses. Tell them that after their treatment, they will give their chart to the record keeper, who will immediately post the cost information on Visual 3.2.
13. Start by having only one patient visit each doctor. (If there are three doctors, there should be only three patients.) Immediately record the pain level and the cost each doctor charges his or her patient on Visual 3.2.
14. Allow the other patients to select the doctor they want to visit. Reinforce the idea that patients now pay the full cost. The goal is for patients to use the information on Visual 3.2 to help them pick a doctor. (**Note:** If the class is small, you can give each patient two Patient Charts to get more information.)
15. After all the patients have turned in their charts, ask the record keeper to total the waste for each doctors and then for all the doctors combined. Ask the students to explain why the total waste for all the doctors is less in this round. *It is likely that patients will gravitate toward doctors who provide the correct treatment at the lowest cost for their pain level. Bring out these key points:*
 - *Consumers who pay their own bills have an economic incentive to search for better service at lower prices.*
 - *Competition acts as a powerful force to make sellers behave honestly as long as no collusion is possible.*
 - *For competition to work best, market transactions must be transparent or the market must have some way of transmitting honest intent such as providing extended warranties.*
 - *When transparency does not exist, or when third parties such as insurance companies pay the bills, ethical conduct or enlightened self-interest is needed to promote greater economic efficiency.*

16. Distribute a copy of Activity 3.3 to each student. Allow a few minutes for reading. Discuss the answers to the questions.

Question 1. Define these terms: asymmetric information, moral hazard and fiduciary relationship. *Asymmetric information exists when one party to a transaction has better information than another party and it is expensive or impossible for the less-knowledgeable party to get this information.*

Moral hazard arises when an economic agent has an economic incentive to behave unethically. For example, a doctor has both the ability and an economic incentive to impose higher costs on health insurance companies for personal gain.

A fiduciary relationship arises when one party to a transaction is a dominant party and the other is vulnerable because of confidential information or other disparity. The dominant actor is entrusted with fiduciary power over a weak party in return for considerations of fairness and trust.

Question 2. Give examples of situations in which people expect fiduciary conduct. *Answers will vary and include a lawyer and a client, a priest and a confessor, a teacher and a student, a psychologist and a patient, an engineer and a construction company, a certified public accountant and the public, a chairman of a company and the company's shareholders.*

Question 3. What motivates many professionals to adhere to fiduciary rules of conduct in serving their clients?

Duty: They adhere to the intellectual principle that it is their obligation to put their clients' interests first.

Outcomes: They have an enlightened self-interest and know that if they treat clients well, they will attract more customers and profits in the long run. Also, by adhering to fiduciary standards, they do not need to worry about the penalties of getting caught for fraud.

Virtuous Character: Many people like to see themselves as honest and upright. They would not enjoy the extra money they earned if it came from taking unfair advantage of people who are in weak or vulnerable positions.

Question 4. Which do you think best promotes honest behavior and economic efficiency: government regulations and penalties, enlightened self-interest in markets or ethical character? *People respond predictably to negative incentives such as harsher government penalties for getting convicted and stronger regulations for monitoring business fraud; so, stronger regulations could promote more honest behavior. However, this is a costly way to achieve the objective. There are explicit and implicit costs associated with government regulations. Explicit costs include hiring staff (police, prosecutors, judges and jail keepers) and increasing taxes to pay for the new employees. Companies also incur explicit business expenses to comply with rules and regulations (hiring extra staff to monitor and fill out reports). Implicit costs to society include the loss of business freedom and the potential for corruption of government officials. Hence, while it is possible to rely on negative incentives to promote ethical behavior, it is expensive to do so.*

By contrast, relying upon enlightened self-interest and ethical character enhances both efficiency and freedom. Competition rewards providers who behave honestly. In markets that lack transparency, however, even enlightened self-interest may fail to promote honesty. This is because a greedy person is always calculating whether it is profitable to be honest, and changing circumstances could change behavior. A person of ethical character is always honest, because this is the right thing to do.

CLOSURE

17. Ask the students to review the types of market situations in which fiduciary duty arises. *Fiduciary duty arises in situations where asymmetric information and moral-hazard problems exist and there is a strong need for public trust.*
18. Review the characteristics of fiduciary duty. *Fiduciary duty involves a confidence or trust. It arises when a dominant party has power over a weak or vulnerable party. For more than 2,000 years doctors have taken the Hippocratic or a similar oath, which obliges them to put their patients' interests ahead of the profit motive. Accountants, lawyers, teachers, engineers, journalists, priests and many other professionals, in theory, maintain an allegiance first to their profession and its fiduciary standards and second to the specific organization for which they work. Chief executive officers of companies must also demonstrate fiduciary conduct by putting the interests of shareholders ahead of their own interests.*

The bottom line: Ethical standards create the institutional framework within which businesses operate. Trust generated by ethical conduct enhances economic efficiency by reducing transaction costs and waste.

ASSESSMENT**Multiple-Choice Questions**

- 3.1 Markets are more efficient when the following characteristics are present:
- A. Economic actors are self-interested.
 - B. Market activities are transparent.
 - C. Economic actors uphold ethical standards of behavior.
 - D. *All of the above*
- 3.2 A company board of directors hires a chief financial officer to carry out activities on behalf of the stockholders. This situation reflects
- A. a corporate hazard.
 - B. *fiduciary duty.*
 - C. ideology.
 - D. none of the above.
- 3.3 Frank learns that an inherited genetic disease affects people in his family. This disease will likely cause early death. Frank immediately applies for a large life-insurance policy without disclosing this genetic fact. This situation
- A. is economically efficient because Frank gets to buy the insurance he wants.
 - B. is economically efficient because Frank's family will need the money when he dies.
 - C. *is economically inefficient because of asymmetric information.*
 - D. is economically inefficient because of a fiduciary relationship.

Essay Questions

- 3.1 Analyze the extent and impact of fiduciary conduct in the operation of business. *Fiduciary conduct greatly aids the efficiency of all organizations, including for-profit businesses. Fiduciary conduct is an integral part of the work done by accountants, lawyers, financial officers and company chief executives. It is also an integral part of the expectations of company managers and workers at every level. Every worker holds a fiduciary trust.*

3.2 Analyze how transparency affects the efficiency of markets. In markets that lack transparency, what role does ethical conduct play? *Transparency is a key tool to making markets work efficiently for consumers and producers. If some prices are not disclosed openly (as in health care), then it is harder for consumers to protect themselves. In such cases, ethical conduct is required — hence, virtually every professional society maintains an ethical code of conduct (see Going Further).*

GOING FURTHER

Doctors and Profits: Some doctors earn higher profits when they order expensive lab tests and imaging procedures for patients. While such kickbacks are illegal, they are hard to discover, and there are also technical maneuvers around the laws. See David Armstrong, “MRI and CT Centers Offer Doctors Way to Profit on Scans,” *The Wall Street Journal*, May 2, 2005, A1.

Doctors and Asymmetric Information: 1972 Nobel Prize winner Kenneth Arrow discussed the problem of doctors, asymmetric information and ethics in *The Limits of Organization* (New York: Norton, 1974). For an example of poor information leading to abuse, see Paul Davies, “Flawed Procedures: A Doctor’s Tale Shows Weakness in Medical Vetting,” *The Wall Street Journal*, September 21, 2005, A1.

Professional Codes of Ethics: Many professions have ethical codes of conduct. The students can do an Internet search for the phrase “code of ethics” to see the wide range of professions covered, from realtors to bankers to social workers.

Nobel Prize Winners: In 2001 George A. Akerlof, A. Michael Spence and Joseph E. Stiglitz received the Nobel Prize in Economics for their work analyzing markets with asymmetric information. For further reading, see <http://nobelprize.org/economics/laureates/2001/press.html>

Market Responses to Information

Problems: Ask the students how markets might respond when there is a desire for more information in a transaction. For example:

- When people apply for life insurance, what health tests must they take? Why is this information necessary for proper pricing in life-insurance markets?
- When someone sells a used car, how does the offer of a free warranty provide information to consumers? How does a free warranty affect market demand?
- If you are traveling through a new town and want to buy a hamburger, how do you know where to go? How does a franchise such as McDonald’s or Burger King provide information about quality?

VISUAL 3.1 PAIN, COST AND WASTE (ROUND 1)

<u>Pain Level</u>	<u>Correct Treatment</u>	<u>Cost</u>
1	Medicine	\$ 100
2	X-Ray	\$ 500
3	Surgery	\$2,000

Patient	Doctor A			Doctor B			Doctor C		
	Pain Level	Cost	Waste	Pain Level	Cost	Waste	Pain Level	Cost	Waste
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
Total Waste	Doctor A			Doctor B			Doctor C		
Total Waste All Doctors									

VISUAL 3.2 PAIN, COST AND WASTE (ROUND 2)

<u>Pain Level</u>	<u>Correct Treatment</u>	<u>Cost</u>
1	Medicine	\$ 100
2	X-Ray	\$ 500
3	Surgery	\$2,000

Patient	Doctor:			Doctor:			Doctor:				
	Pain Level	Cost	Waste	Pain Level	Cost	Waste	Pain Level	Cost	Waste		
1											
2											
3											
4											
5											
6											
7											
8											
9											
10											
11											
12											
13											
14											
15											
Total Waste Doctor:				Doctor:				Doctor:			
Total Waste All Doctors											

ACTIVITY 3.1 INSTRUCTIONS FOR DOCTORS

INSTRUCTIONS FOR DOCTOR A

1. There are three possible treatments for a BACKACHE. The chart below shows the "correct" treatment for each pain level. The profit you earn is directly proportional to the patient's cost. You do not need to worry about any of your patients suing you for malpractice.

<u>Pain Level</u>	<u>Correct Treatment</u>	<u>Cost</u>
1	Medicine	\$ 100
2	X-Ray	\$ 500
3	Surgery	\$2,000

2. Important! You must NOT consider your own profit in deciding which treatment to choose. Charge only for the correct treatment based on each patient's level of pain.

Example: Give a patient with Level 2 pain an X-ray and charge \$500.

3. Record your treatment and cost on each patient's chart, circle your name and give the chart back to the patient.

INSTRUCTIONS FOR DOCTOR B

1. There are three possible treatments for a BACKACHE. The chart below shows the "correct" treatment for each pain level. The profit you earn is directly proportional to the patient's cost. You do not need to worry about any of your patients suing you for malpractice.

<u>Pain Level</u>	<u>Correct Treatment</u>	<u>Cost</u>
1	Medicine	\$ 100
2	X-Ray	\$ 500
3	Surgery	\$2,000

2. Important! Your goal is to maximize your short-run profit. To do this, charge ALL patients for treatment at the next higher level of pain.

Examples: Give a patient with Level 1 pain the Level 2 treatment: an X-ray costing \$500. Give a patient with Level 2 pain Level 3 treatment: surgery costing \$2,000.

3. Record your treatment and cost on each patient's chart, circle your name and give the chart back to the patient.

ACTIVITY 3.1 (continued)

INSTRUCTIONS FOR DOCTORS

INSTRUCTIONS FOR DOCTOR C

1. There are three possible treatments for a BACKACHE. The chart below shows the minimum treatment cost, based on pain level. The profit you earn is directly proportional to the patient's cost. You do not need to worry about any of your patients suing you for malpractice.

<u>Pain Level</u>	<u>Correct Treatment</u>	<u>Minimum Cost</u>
1	Medicine	\$ 100
2	X-Ray	\$ 500
3	Surgery	\$2,000

2. Important! Your goal is to maximize your long-run profit over many years. You can earn higher profits in the short run by charging a higher price than the minimums shown above.

Example: You could give a patient with Level 1 pain a medicine but charge \$200; or you could give this patient Level 2 treatment, an X-ray, and charge \$500.

Balance your desire for higher profits today with your desire to keep patients coming back to you in the future. Charge accordingly.

3. Record your treatment and cost on each patient's chart, circle your name and give the chart back to the patient.

ACTIVITY 3.2

PATIENT SYMPTOMS

PATIENT CHART

1. Patients: You are suffering from a BACKACHE with the pain level shown below. Present this chart to a doctor for treatment.

Pain level: (Low) 1 2 3 (High)

2. Doctor: A. Circle ONE Treatment: Medicine X-ray Surgery

B. Cost: _____

C. Circle your name: Dr. A Dr. B Dr. C

3. Patients: After visiting the doctor, please turn this sheet in to the record keeper.

PATIENT CHART

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Pain level: (Low) 1 2 3 (High)

2. Doctor: A. Circle ONE Treatment: Medicine X-ray Surgery

B. Cost: _____

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Pain level: (Low) 1 2 3 (High)

2. Doctor: A. Circle ONE Treatment: Medicine X-ray Surgery

B. Cost: _____

C. Circle your name: Dr. A Dr. B Dr. C

3. Patients: After visiting the doctor, please turn this sheet in to the record keeper.

ACTIVITY 3.3

ASYMMETRIC INFORMATION AND MORAL HAZARD

Directions: Read this information and be prepared to discuss the answers to the questions in class.

Sanjay goes to a doctor because of a severe and sudden backache. Brenda's car breaks down on the highway and is towed to the nearest garage. What is similar about these situations? In both cases, the consumers have much less information about the costs and benefits of the proposed service than the sellers. Both situations are examples of *asymmetric information*.¹

Sanjay's and Brenda's problems are potentially serious. The doctor and the mechanic can recommend very expensive procedures that provide no value. For example, the mechanic could replace the transmission when the old one only needed oil. This is pure waste to the consumer, and learning from this incident is not very helpful when it comes to future car trouble because transmissions are very different from, say, mufflers. More importantly, Sanjay and Brenda are presenting themselves to doctors and mechanics at a time of emergency. It may not be possible for a patient to seek a second opinion or for a stranded motorist to shop around for a garage. Customers may also be distraught and unable to think rationally.

Asymmetric information produces a *moral hazard* in which the doctor or the mechanic has an economic incentive to behave unethically by imposing higher costs on Sanjay or Brenda. One moral claim is to maximize company profits by charging the most the market will bear; the other moral claim is to treat Sanjay and Brenda fairly. Asymmetric information makes it difficult for consumers (and sometimes producers) to protect themselves. Some consumers also cannot be expected to make informed choices because of age or mental capacity. Ethical behavior is often expected in society when the potential for a moral hazard exists; think about the rules of behavior for judges, priests and teachers. *Fiduciary duty* thus relates to, or involves, a confidence or trust. A fiduciary trust arises when a dominant party is entrusted with power over a weak or vulnerable party. Most professional societies maintain ethical codes of conduct that address fiduciary duties.

Problems of asymmetric information are often handled adequately by *enlightened self-interest* in the marketplace. Consumers, for example, have an ethical duty to use reasonable diligence in selecting products and providers. The phrase *caveat emptor* captures this idea: Let the buyer beware. In addition, the mechanic at the car-repair shop may not seek to take advantage of Brenda's vulnerability, hoping to earn a reputation for honesty. Repeat business is a powerful reason to put consumers' interests first.

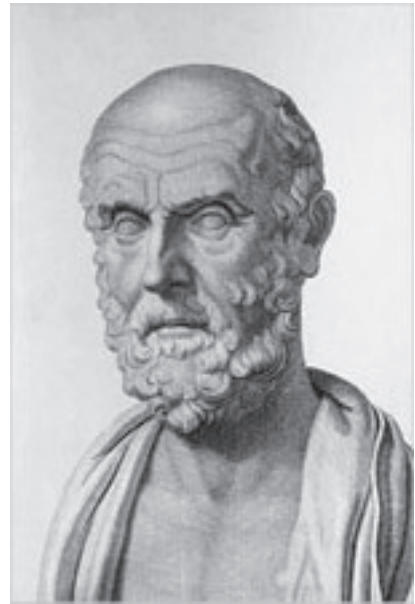
ACTIVITY 3.3 (continued)

ASYMMETRIC INFORMATION AND MORAL HAZARD

But in some settings it is not enough to rely upon enlightened self-interest or consumer vigilance alone. Unbridled greed can lead to problems of inefficiency. Society seeks to minimize opportunistic greed through the use of *incentives*. Positive incentives arise through socialization and the rewards for good conduct. Doing the “right” thing for the sake of doing the right thing — and not for a cost/benefit calculation — is the foundation of many ethical systems today (Kantian, Christian, Jewish and Islamic codes).

Negative incentives hold unethical behaviors in check through fear of public exposure and through judicial penalties for fraud. However, it is expensive for government to monitor markets, and even more expensive to prosecute people and companies that engage in deception. Government regulations act as a “tax” on all businesses, even those that are honest. Moreover, the existence of “Big Brother” may create a sense of paternalism, which reduces the public’s own watchfulness. Hence, relying mainly upon negative incentives in the form of regulations and penalties is an expensive way to deal with moral hazards. There are not enough police or judges to promote honest behavior unless most citizens desire honesty. If internal self-command exists, government resources can be focused on the “outlier” bad cases.

Hippocrates (460 to 377 B.C.) outlined the moral rule for physicians that stresses their duty to act in the interests of patients and disregard their own private gain. While many of Hippocrates’ specific rules are considered outdated by modern practitioners, the concept of requiring an ethical code for doctors is accepted today in virtually every medical school. “I will keep [my patients] from harm and injustice In purity and holiness I will guard my life and my art.”²



¹ Some differences in information are trivial. For example, a maker of aspirin stuffs a large bottle with cotton, and the buyers gets fewer pills than anticipated. This merits little attention because the stakes are low, and consumers can easily adjust their behavior in the future without much cost. It is also important to note that in some cases buyers have better information than sellers, for example, in the market for life insurance.

² From Ludwig Edelstein, *The Hippocratic Oath: Text, Translation, and Interpretation* (Baltimore: Johns Hopkins Press, 1943). Translation from the Greek by Ludwig Edelstein. Source: http://www.pbs.org/wgbh/nova/doctors/oath_classical.html

ACTIVITY 3.3 (continued)

ASYMMETRIC INFORMATION AND MORAL HAZARD

Questions

1. Define these terms: asymmetric information, moral hazard and fiduciary relationship.
2. Give examples of situations in which people expect fiduciary conduct.
3. What motivates many professionals to adhere to fiduciary rules of conduct in serving their clients?
4. Which do you think best promotes honest behavior and economic efficiency: government regulations and penalties, enlightened self-interest in markets or ethical character?

