Chapter 2

Some Principles of Ethical Economy

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Aristotle states that everything worth doing is worth doing well. The economist James Buchanan claims that this is not the principle of economics, which states rather that it is not worth it to do everything well. Aristotle founded his ethics on the principle of *arete* or excellence, literally bestness.

The human being should aim at excellence in all actions. Economics, however, is founded on the principle of efficiency. Everything worth doing should be done efficiently. It is not efficient to do too well, and there are actions and things that should not be done or made too well. Therefore, not everything worth doing is worth doing well. It is worth making mass products, but it is not worth making them in such a way that they are as good as possible. It would be rather beside the point to make mass products so well. They would be too expensive and not mass products anymore. The economist has to adopt his actions to economic demand, not to conceptions of intrinsic excellence. It is also, economically speaking, not good to produce goods that are excellent but do not succeed in the market.

Ethics and economics seem to be inimical brothers.[1] They are brothers since they are both theories of human action and decision-making. They both ask the questions: "How can I make sure that I will act appropriately" and "Have I acted appropriately?" And both, ethics and economics, have a prospective and retrospective dimension.

Ethics and economics are inimical brothers since their normative content seems to be contradictory. In ethics, the task of the human, *to ergon tu anthropu* as Aristotle says, is to realize the best. In economics, the task is to realize the efficient; in technology, to realize the effective. If we look closer, however, ethical and economic theory are not as contradictory as first appears. Doing the best for mass demand means not producing the best but producing the best suited to the needs of the market, i.e. consumer demand. On the other hand, it is also a postulate of ethics to consider the circumstances that might distinguish the best in a given situation from the best as a whole. It might under given circumstances, for instance, be the best to realize a solution that is considered to be only second best if circumstances are improved. It is worth realizing mass production well, although the result of the action will not be the best possible product but a mass product.

1 The author uses arguments in this paper from his earlier publications (see Appendix). The present paper is the revised version of the inaugural lecture that the author gave as Professor of Philosophy at the Vrije Universiteit Amsterdam in Amsterdam on 9 December 2005.

I. The Good and the Speculative as Bridges Between the Ethical and the Economic

The concept of the good as the moral good and as the economic good leads to the link between ethics and economics. The good as the common ground of ethical and economic reasoning is the first phenomenon that makes the intrinsic link between ethics and economics visible. The other phenomenon is the not-well-structured decision and the inevitability of the speculative in economics and ethics. The lack of well-structuredness of many decisions causes the paradox of choice that we only know the consequences of our actions precisely when they do not have many consequences, if they are well-structured. We do not know them well, however, if they have grave consequences and are, therefore, badly structured. Decisions can be badly structured and uncertain in its consequences for two reasons: first since they are badly structured in economic respect as the arguments of the utility or profit calculus are not well-defined, or secondly since they are morally relevant and touch upon something unconditional. The two bridges towards the synthesis of ethics and economics, the good and the speculative will be discussed in the first part of this paper.

In the second part, the synthesizing theory of ethical economy will be analyzed as comprising two fields, the economic theory of ethics and the ethical theory of economics. The first part of ethical economy discusses the impact of the economic method for ethical theory, the second part the impact of ethical principles for the theory of individual decision-making and for the coordination of human action in the market.

1. The Principle of the Threefold Nature of the Good: the Unconditionally Good, the Effective, and the Efficient

Plato discusses the question in *Hippias Minor* whether a bad person can do bad well. He comes to the conclusion that this is possible and that it aggravates the problem of evil. The good person can do good badly and can do good well. The bad or evil person can do bad or evil excellently and badly. If the bad person does bad very well the outcome will be worse than if the bad person does bad poorly. The worst case is that the very bad person does very bad things very well. The proverb *corruptio optimi pessimum*, the corruption of the best is the worst, captures this perversion of good and bad in doing bad excellently. Apparently, it is not sufficient to do something well. It must also be the right thing that is done well. The intention to do something well matters. Intentionality does usually also imply the taking of position, the *Stellungnahme*. In acting consciously, human beings take a position to their action and to its consequences. They are not neutral towards their actions. Human beings take an affirming or disapproving position to their actions. *Stellungnahme*, taking position, is, as Eduard Spranger showed, a key concept of the humanities.

Economics and ethics are also concerned with the conflict between intention and success, effort and outcomes. Intention and outcome might diverge. The good person intends the best but achieves a bad outcome. The bad person intends the not-so-good and realizes the good outcome. This divergence between intention and outcome or between moral intention and economic success has prompted questions of theodicy since the story of Job. Why does sometimes the not-so-moral person meet with economic success in life whereas the moral person often suffers economic disadvantage? The problem of theodicy concerns, strictly speaking, the suffering of the innocent that is not caused by individual moral shortcoming or guilt but by circumstances beyond the moral intention of the individual. In the case of Job, the person struck by mischief is described as being particularly moral. The contingency of happiness and economic success upon moral worth is one of the central topics of religion as the activity of mastering contingency, or *Kontingenzbewältigung* as Hermann Lübbe coined it. The contingency of the harmony between merit and success is a central problem in ethics and is therefore also an aspect of ethical economy: Why is the ruthless (business) person sometimes economically more successful than the moral one?

There are theories of economic ethics, such as the one introduced by Karl Homann, which claim that the contingency of the disharmony between intention and success can only obtain as long as the right economic order is not yet installed (Homann 2002). In the right economic order, the proper institutions would make sure that intentions and rewards would not diverge. Although it is the necessary and legitimate aim of the economic order to create incentive-compatible business norms and business ethics, it seems likely that conflicts between intentions and results and between moral motivation and economic incentives will persist.

There are two kinds of divergences between morality and advantage possible: firstly, systematic divergences: An immoral action can appear to be and be more advantageous than the moral one. This is the more serious case for ethical economy. Secondly, accidental or contingent divergences: A moral action that appeared to be advantageous can turn out to be disadvantageous due to a change of the circumstances of the action in question. The change of circumstances might be brought about by changes in the behavior of others as will be discussed below.

A totally incentive-compatible economic order and business ethics is yet another economic utopia. For now, it seems to be a realistic economic and ethical premise to assume that economic incentives and moral motivation or economic and moral motivation do not always converge and are likely to be in conflict from time to time. It is as wrong to assume that moral and economic imperatives always diverge as to assume that an economic order is possible in which they never diverge. Even if moral intention and incentive on the one hand and economic motivation and incentive on the other are harmonized and point to the same choice of action, the problem of evil remains. Evil can be intended against moral and economic imperatives and incentives. Free will can intend the immoral and the non-economic, and evil will usually intend the morally and economically bad.

The economic dimension adds a third dimension to human action beyond the technically and morally good: the dimension that something is done efficiently in relation to the demand of others. The good person can do good effectively and still fail to satisfy consumer demand of those for whom the action is done. Someone might produce a good car with good technology, but the car fails to satisfy consumer demand. The action of producing it is therefore inefficient and not good.

There are three dimensions of good: the moral good, the effective, and the efficient. A good action should be done well in the sense of morally good, effectively good and efficiently good. Three imperatives correspond to these three meanings of good: the categorical imperative, the technical imperative, and the economic or pragmatic imperative. The moral good is categorically, not hypothetically good in the sense that its being good is not conditional or hypothetical on a given good or goal like the economic. It is not sufficient when realizing good to follow only one of the imperatives. To follow the goal of the categorically moral good without consideration of the technical and pragmatic or economic imperatives is as bad as following the technical or economic/pragmatic imperatives without consideration to the categorically good.

The simple word "good" is the unifying concept of the moral good, the technically effective, and the economically efficient. G. E. Moore contended that the word "good" cannot be defined and has only an intuitive meaning. This impossibility theorem about the definability of the word "good" is exaggerated but it does point to the fact that good has three dimensions that are to be distinguished and sometimes hard to recognize in the concrete case. The central one of these dimensions is the morally or ethically good, which defines an ultimate and unconditional or categorical norm that is the measure of higher commitment as compared to the other meanings of good.[2] The other two meanings of good, the technically good and the economically good or efficient, are good only under the condition that the morally good is not violated.

It is not always clear – and there is certainly no consensus about – what the categorical imperative implies in the real choice of actions. The definition of the moral is subject to disagreement and historical development. It belongs, however, to the grammar of the word "good" that we cannot subordinate the moral to the economical. The economic good is conditional on the non-violation of the moral good, rather than the other way around. The moral good is not conditional on the economically efficient. If someone said that it is immoral to kill an innocent person and at the same time claimed that it is economic to apply euthanasia and kill someone for the good economic reason of saving resources, he would be considered not to have understood the meaning of the word "good". The economic good cannot overrule the moral good since the economic good is conditional on an end, whereby the consumption of means for attaining this end should be minimized or the goal attainment for using the given means should be maximized. The moral good is not to subordinate the moral good to the economic good, although it is furthered by the efficient action adopted to realize it. It is a category mistake to overrule the moral good by the economic good.

Good cannot be exhausted by describing a functional relationship, i.e. of being functionally good for fulfilling a function. In the case of a knife, the good can be described by a functional relationship: a good knife is a knife that cuts well and thus fulfills the function of cutting well. With human beings, it is more difficult. They cannot be described by one function alone. A good person is not a person that fulfills a function well. The function might

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2 In this sense, the moral good can also be described as a „hypergood" (CHARLES TAYLOR 1989) or „hypernorm" (DONALDSON/DUNFEE 1994, p. 264).

be a perverse function but be performed excellently, or it might only be one function among many.

If the quality of the ethical and the economic coincide in the word "good", they must be related, even if they are not identical. The theory of ethical economy aims at understanding this interface of the economic and the ethical in the word "good". It insists that there can be neither a lasting opposition between the economically and the ethically good nor a simple identity between them. The moral is the unconditionally good in the sense that is not conditional on a given goal as the economic good is. Its concretization will, therefore, always be debated and contested since it is not conditional on something else. The morally good and ethical is, as Niklas Luhmann has rightly stated, "polemogenous", "generating war", or, if not war, so at least generating moral strife. The polemical character of the moral is due to its character of being the unconditionally good.

The unconditional character of the morally good promotes questionable features of morality such as moral aggression or the aggressive moralization of morally neutral realms of action. The economy, on the other hand, is not usually a field of moral contention for the unconditionally good, but of economic contest over goods or commodities, which are conditional on the demand of individuals and not conditional on violating or not violating moral norms. It is a category mistake to moralize economic efficiency conditions of human action if the unconditional is not touched.

To argue morally against firms that move their production to countries where labor is less expensive, for instance, is a category mistake since it is not immoral to lower one's costs. Since it is not expected of workers that they make economic sacrifices to maintain the firms for which they work, it cannot be expected of the firms' owners that they sacrifice their wealth to maintain the production sites. None of the two parties, neither the employer nor the employee, can be expected to make economic sacrifices for the long-term survival of their firms. Both can undergo reductions of their future remunerations in wages or in profits, but they both cannot accept a severe loss of wealth by subsidizing their firm.

The semantics of the word "good" imply that ethics cannot be introduced merely functionally, in order to attain something completely outside of the moral. The ethics must be generally valid at core, not simply specific to a firm or a single group, be it employers or employees. There can, of course, be firm-specific forms of corporate culture,[3] habits, customs, etc. But the general rules of business ethics cannot be firm-specific in the sense that they are valid only for the firm in which they are created because they are good only for this firm. Attempts to introduce firm-specific codes of business ethics that are only useful functionally for the financial goals of the firm in question face the same objections as functionalist foundations of ethics in general.

Ethical theories that are introduced in order to serve functionally a purpose that is outside ethics per se are always in danger of not achieving their purpose, because people see through their purposefulness, with the consequence that the ethics are not accepted as binding. Functional foundations have the weakness that they argue – and must argue – with functional equivalents. Something is good for the fulfillment of a function. But something else can likewise fulfill the function, so that something *else* can always take the place of that which the function fulfills. If ethics are introduced only in order to attain something external to ethics, i.e. the purpose at hand, like in the case of the firm higher profits, the ethics will have no power of persuasion with the workers. If ethics is not also acknowledged as valid in itself and desirable by all members of a firm, including its managers and owners, it will not be convincing and effective. If ethos and ethics are used as means for something completely different and are not recognized as intrinsic and unconditional, as a challenge for the person's free moral decision, they have no power of persuasion.

Functionalistic foundations are insufficient for the development and expansion of a theory of economic ethics, since – in business ethics as in general ethics – human freedom must be at the same time acknowledged as an end in itself. Ethics must portray the fact that, in Kant's words, one must never regard oneself or others simply as a means, but always, at the same time, as an end in itself. That does not mean that one may *never* consider other persons and ethics as a means to something else. Such hypermoralism would make the idea of economic cooperation and the division of labor impossible.

Kant stated that the categorical imperative is only one and one among all of its formulations "Do not use another as a means only, but always consider him or her as an end in itself". The categorical imperative demands that one

3 Cf. for the ethical aspects of institutionalizing a corporate culture in a firm VAN GERWEN (2000) and on personal, moral and professional integrity MUSSCHENGA (2002).

may never use a person and ethics *only* as a means. When applied to economic ethics, this means that business ethics can and should be beneficial to economic purposes, but that they may never be founded only on economic purposes and may never be made completely instrumental to business purposes.

To use a person as a means only implies in the business context severe violation of business morals, such as breach of contract, fraud, systematic discrimination on the grounds of race, sex, religion and age, and systematic exploitation.[4] It does not imply minor and nonsystematic variations in the price ratio (such as underpaying or overcharging at a minor rate), laying staff off due to a lack of demand, or relocating production. Changes in business relationships, such as laying workers off, might be economically disadvantageous or unpleasant, but they are variations in contractual relationships that are due to economic, not moral, reasons. They should not be moralized over since they do not conflict with the moral dignity of people. Business ethics cannot be used to argue against changes in the market conditions and in favor of compensation for damages caused by these changes. Business ethics are a means to argue against non-compliance with the rules of the economy, not against economic changes in market conditions.

2. The Speculative as a Bridge Between Ethics and Economics: Choice as Transcending the Infinity of Opportunity Cost and Negation

Ethical economy is not a hybrid of subsystems of a different kind or genus, but a conceptual synthesis. It is a combination of the ethical and the economic mode of thinking. Both methods have to overcome their mistrust of each other. Economics is notoriously suspicious of ethics since it assumes that it will interfere with its assumed clarity and univocal character. Economics is based on the economist D. H. Robertson's warning that the economist must economize on love and ethics, i.e. economize on unselfish motives since they are not robust, but weak, and are a most scarce resource. We just do not have such a wealth of unselfish motives that we can waste them. Ethics in turn must overcome its suspicion of economics, of the "dismal science"

4 Whether the Kantian principle to treat human persons never as means only requires "a vast democratization of the work place" (BOWIE 2002, pp. 12ff.) and the adoption of the stakeholder approach to corporate governance (EVAN/FREEMAN 1993) as Bowie as well as Evan/Freeman postulate is very doubtful. It is rather a negative principle of excluding actions than demanding positive action.

which reduces everything to scarcity and money. Since any course of action excludes another opportunity for action, every action has a cost which can, in one way or another, be expressed by its opportunity costs in terms of money.

It must be acknowledged not only by economics but also by ethics that in a finite world every course of action excludes other actions and opportunities and that this opportunity cost is of ethical and economic relevance. The cost for an opportunity forsaken is not the same as a cost actually occurred since we never know exactly how much another opportunity would have cost in real terms since it has not occurred yet and will never occur. Nevertheless, opportunities forsaken imply a forsaken utility and therefore an opportunity cost for economic and an opportunity forsaken for ethical theory. This is particularly true for irreversible decisions in which the opportunity cost of the decision cannot be revised at any cost. Irreversible decisions are particularly ethical decisions since they encounter prohibitive costs of revision.

The concept of opportunity cost resembles but is not identical with the principle of negation. Spinoza introduced the principle of negation of which Hegel made ample use: *omnis determinatio est negatio*. Every determination is negation. Hegel extended this Spinozan principle to the principle of determined negation, of *bestimmte Negation*, in his metaphysical logic. The world is nothing than the process of an original partition, *Ur-teil*, and the consecutive infinite process of negation. Translated into the logic of choice, Spinoza's principle implies that every decision is the negation of other decisions, every outcome chosen the negation of all other possible outcomes, every chosen profit opportunity the negation of all other possible profit opportunities.

The idea, however, that determination and decision are negation cannot stand philosophical and economic criticism as the critique of Spinoza's and Hegel's ontology demonstrates. If determination or decision-making is the negation of all other attributes, possibilities, or decision outcomes it will never reach the point of determinedness or decision since there are just infinite possibilities to be negated. Hegel's principle of determined negation implies that we know how often we have to negate to reach the positive. This is, however, just what we should like to know but do not know from the principle of negation alone.

The logic of determination and the logic of decision are similar in logics, ethics, and economics. In the logics of logics and in the logics of choice, negation is a central principle, but it is not the only and ontological or metaphysical principle of reality or decision-making. To make negation the origin of the totality of being implies to move the spirit of evil at the origin of being, as Immanuel Hermann Fichte, the son of the older Fichte, said. It identifies *den Geist, der stets verneint*, the spirit who always negates, as the origin of being. The Spinoza's pantheism of negation as the principle of reality is a questionable import and re-import by and from German Idealism from and to Amsterdam.[5]

By making an ethical or economic decision we do not negate infinite other possibilities but negate only a finite number of alternatives or opportunities. We negate the opportunities that we are able to imagine and that are actually open to us. It requires all our imagination and analysis as well as all our ethical honesty to recognize what our opportunities really are and which of these opportunities we shall forsake.

In the ontology of determined negation, on the other hand, we would face infinite opportunity costs as infinite alternatives forsaken. Infinite alternatives forsaken imply that we ought not and can not act at all since we only lose by any action taken. By not acting, however, we also face infinite opportunity costs. As a result, decision-making would be made impossible if non-acting implied infinite opportunities forsaken and a decision for a concrete course of action implied also infinite opportunities forsaken. Decision-making in ethics and economics demands to identify the relevant and real opportunities we actually have, it does not demand to negate all possible opportunities in all possible worlds.

As acting persons we are not omniscient negators of all the other possibilities we might have. Only for God is this determined negation possible. God is able to choose the best of all possible worlds by negating all other possible but suboptimal worlds, as Leibniz demonstrated in his *Theodicy* (cf. Koslowski 1985). God can negate all the other non-optimal worlds by choosing the best of all possible worlds which is the existent one since God can only choose the best. Therefore, the existent world must always be the best possible one. Only possible non-existent worlds can be suboptimal worlds.

Humans, in contrast, are decision-makers acting under relative uncertainty and facing the "paradox of choice" (Shackle 1979, p. 19). In his book *Imagination and the Nature of Choice,* G. L. S. Shackle formulated this deep paradox most elegantly. If our actions after a decision have no influence on the course of the world, we have no genuine choice. Everything is already

5 Abraham Kuyper, the founder of the Vrije Universiteit Amsterdam, already pointed to the Pantheistic common ground between Spinoza, Kant, Hegel and Schelling.

predetermined. If we have, however, genuine choice and our decision changes the course of the world, we cannot know in detail which effects our actions will have, since the determined course of the world is interrupted by our action. The decision is based on freedom, not on negation of opportunities. It breaks through the infinity of negated opportunities in favor of the one chosen opportunity. In this sense, Johann Gottlieb Fichte was right when he called freedom the rock at which the surge of the universe is broken: *Freiheit: der Fels, an dem sich die Brandung des Universums bricht.*[6]

Applied to the problem of economic choice according to a maximization rule, the paradox of choice implies that when genuine opportunities for choice exist, the maximization calculus, understood as a precise calculation procedure, is not applicable, since the arguments of the equation for the utilities of the future outcomes are unknown. When the maximization calculus is, on the contrary, applicable, it is of little use, because the equations of the constraints of the maximization by the environment are completely known and the environment is parametric. The decision problem is then not a real decision problem at all, but instead a transformation of known relations between parameters and variables that are not really unknown. We can choose the option with the highest expected utility or the minimum opportunity cost only in well-defined contexts of decision-making. When our decision is of real impact on the environment of our action this environment ceases to be parametric and the isolation of the one opportunity cost minimizing decision becomes impossible or at least very difficult.

To act in the real economy or in business as a producer and consumer implies more than being an economizing individual, a cost minimizer or goal attainment maximizer. The economy, the world of business, as a realm of human interaction and of innovation in production and in consumption is not a calculating machine but a realm with a speculative side, a realm in which calculation and speculation interact. The speculative element cannot be reduced to calculation since the arguments of the calculation are not completely given ex ante. By the creation of new production techniques, new markets and new goods, the entrepreneur engages in an activity that is characterized best as speculative. The entrepreneur calculates on the basis of given knowl-

6 KRINGS (1980) expressed this problem by the dialectics or paradox of freedom and system thereby referring to SCHELLING (1809). Freedom requires a system of freedom and rationality and must at the same time be free of it.

edge about reality and speculates on that a new economic reality may materialize which will yield a future profit.

If we look at a long-run investment from the short-run point of view of returns on investment and of economizing means for given ends, new goods and new techniques imply creative destruction of given structures and the expenditure of more means than the continuation of the habitual production scheme requires. Investment is speculative since it assesses that a new detour in production will yield a higher return on investment in the future. In the reality of updating the mode of economic production, a highly uneconomic, ever renewed effort of recreation and innovation is necessary and is, indeed, encountered. Economic progress is the result of a permanent effort of recreation that is uneconomic in the short-run but might prove to be superior in the long run.[7] The mere application of the economy principle to realize the optimum or the greatest success with the least outlay is a technique oriented on formal rationality and economizing. It is not the speculative work of re-creating the conditions of production. Business is the effort of re-creation, the process of creative destruction and recreation – to use a Schumpeterian term –, it is not just rational calculation.

Speculation is the anticipation of a reality that cannot be recognized by mere empiricist experience or by conclusions from given axioms and observations. If one compares speculative philosophy and theology (cf. Koslowski 2003) with speculation in the economic context the common speculative element in theological-philosophical and in business and financial speculation becomes visible. Both modes of knowledge and speculation try to gain knowledge from limited empirical observation, to imagine new possibilities from this incomplete empirical knowledge, and to draw "speculative" conclusions without having complete knowledge or data. The observation of the incompleteness of the data for far-reaching strategic business decisions does, however, not refute the business rule: "In God we trust, everyone else brings data to the table."

7 MAX WEBER (1922, p. 199) identified art as the frequently "most uneconomic product of a permanent labor of recreation and simplifying reduction to the essential" (*Kunst … ein höchst unökonomisches Produkt immer erneuter vereinfachender Umschaffensarbeit*) and distinguished the economy of art from the economy of business. In contrast to the economy in Weber's time, the contemporary economy has become more and more artistic, imaginative and "creative".

II. Ethical Economy as a Synthesis

Ethical economy is a theoretical synthesis of ethics and economics. Most deep choices have an ethical and an economic dimension. The optimization of a decision requires doing justice to both of these dimensions, to the ethical and economic one. Ethical economy is the theory of this synthesis. It is more than applied ethics. Rather, it is a foundational theory of its own kind, not an application of ethical principles to concrete cases. A number of general and rather abstract principles are derived from this theoretical synthesis and serve in turn to make the combination of ethical and economic criteria operational. They will be developed in the following second part of the paper.

1. The Double Nature of Ethical Economy as the Economy of Ethics and the Theory of the Ethical Presuppositions of the Market Economy

The principles of ethical economy can be applied to various fields of decision-making, particularly to business and medical decisions. If the theory of ethical economy is applied to business and economic organizations it is the ethical economy of business and comes close to what is usually called business ethics. If it is applied to medical decision-making it becomes the ethical economy of medical practice and allocation ethics in medicine.[8]

Since any synthesis of theories can be approached from both sides and focus on each of the two terms of this synthesis, the theory of ethical economy is relevant for both of the synthesized theories, for economics and for ethics. Ethical economy can focus on either of the two parts of its synthesis.

If ethical economy focuses on the relevance of ethics for economics it is an ethical theory of economics. It analyses the ethical presuppositions of economic coordination, of the market, and of efficiency. I shall examine some aspects of the ethical theory of economics, the need for the third person in economic coordination and the problem of incomplete contracts.

If ethical economy focuses on ethical theory it forms an economic theory of ethics, of the efficiency and economy of ethics. It analyses the economic or efficiency conditions under which the ethical can be realized. The economy of ethics has two sides, a motivational and a systemic one.

8 Cf. KOSLOWSKI (1981 and 1983).

2. Ethical Economy as the Economy of Ethics

a) The Principle of the Aspired Compatibility of Morality and Advantage

The first question of the economics of ethics concerns the conditions under which efficient rule adherence can be expected. Under which conditions do individuals have incentives to follow the ethical norm? Ethical economy as the economy of ethics gives an answer to the question for which economic reasons individuals are motivated to follow ethical norms.

Approaches to business ethics, like Karl Homann's economic ethics or incentive ethics, cover this aspect of ethical economy that is an economy of ethics, and of it one part, namely how to formulate ethics in such a way that it is incentive-compatible or congruent with self-interest. The motivational part of the economy of ethics is concerned with the question how ethics can be made effective by harmonizing it with economic incentives. Economic ethics demands avoiding situations in which ethical demands are incentive-adverse and contradict the incentives individuals have. In contrast to situations in which ethical motivation and rule are contrary to self-interest and economic incentive, ethical economy as the economy of ethics proposes that the social and ethical order are instituted in such a way that, by following the ethical rule, the persons acting in the economy face no net loss of wealth, do not violate their self-interest.

The economy of ethics can also be interpreted as a traditional theme of philosophical ethics since Plato. As Plato stated in his works on political philosophy, in his *Republic* and in his *Laws*, society should be instituted in such a way that there is no conflict between what is moral and what is good for the individual. Plato was, however, aware of the fact that in its totality this goal can only be reached by a transcendent retribution, which induced him to have recourse to a myth. He relates the myth of Er, about the judgment of souls after their death. In the myth of Er, the complete harmony of moral motivation and happiness is assumed to be realized by the operation of the transcendent compensation of merits and moral failure. Only by this transcendent retribution of acting morally during the whole life span is an incentive-compatible ethics thought by Plato to be viable.

b) The Principle of Universal Weighing of Goods as Consequentialist Utilitarian Ethics

The second part of the economy of ethics concerns the question of which ethical rules are efficient in the sense of returning the highest yield or economic return or benefit. Extended cost-benefits analysis or the universal weighing of goods that include ethical arguments as well as utilitarian consequentialist theory belong both to the economy of ethics and form the part of ethical economy that could be called the consequentialist economy of ethics.

An example of the impact of ethical economy as the economy of ethics and a central issue at the interface of ethics and economics is the question of the degree to which the universalization of rules is economically efficient or what level of universalization should be aimed for.

An illustration for the case for an economic theory of ethics as a theory of the efficiency of different regimes of universalization is as follows. Parking a car in Amsterdam is difficult; there are just too many canals or *grachten* where you cannot park a car. Since it is not a good idea to fill up these *grachten* with sand to create more parking lots for other reasons, very strict rules for parking have been made and are enforced with great vigor. These rules for parking are now so strict and the price for parking meters so high that many parking lots are usually empty and unused. This is certainly not an efficient solution. The City of Amsterdam could do two things. It could lower the price for parking in the streets where the high price has the effect of creating an over-incentive not to park there and parking lots remain, therefore, unused. The municipal authority might not want to introduce different prices for parking since it does not wish to spoil the price in Amsterdam; however, on other occasions, the municipal authority may practice price differentials in parking fees by, for instance, making the parking fees very low in certain shopping quarters to attract consumers to these places.

Alternatively, the municipal authority could reduce the degree of universalization enforced and permit exceptions so that certain risk-loving drivers could park there and run a reduced risk of catching a ticket. This, in turn, might not be approved by the City Council since it creates exceptions and contradicts the principle of equality. The result is that, under strict universalization, the dilemma of unused parking lots and a certain inefficiency of the outcome persist and offer a good example of how complete universalization and the enforcement of universalization lead to a suboptimal outcome from the point of view of ethical economy as an economic theory of ethics.

Another example is the problem of universalization of new and very expensive therapies in medicine: Which degree of universal application of such a therapy is desirable, i.e. ethically required and economically efficient? Is it ethically admissible to postpone the universal use of a therapeutic means for economic reasons of efficiency until the costs of a therapy have come down?

3. Ethical Economy as the Theory of the Ethical Presuppositions of the Market Economy

The other part of ethical economy is the complement to the economic theory of ethics and forms the ethical theory of economics, the ethical economy of the ethical preconditions and presuppositions of the market economy.[9]

In the market economy, the price is not the only parameter for competition. The goods supplied in the market are not homogeneous for all suppliers when new goods or modifications of goods enter the market. New goods and services create unique offers for which there are no adequate substitutes yet and for which the price is not the only criterion in competition.

Perfect competition is the case of an ideal market following the criteria of microeconomic theory. It is an instantiation of actual markets or a market type that is more an ideal than a reflection of the actual shape of markets. Under perfect competition with a large number of suppliers and consumers, the goods offered by different suppliers become homogeneous. There is a uniform market price which is the same for all suppliers and consumers. Suppliers and consumers are price takers.

Perfect competition has no need for ethics since the market price and the quality of the goods are perfectly transparent, the theory of perfect competition assumes. Furthermore, perfect competition tends to squeeze out non-remunerative incentives in the labor market since all suppliers have to provide the same working conditions to attract labor. It drives out non-remunerative incentives in the market for goods since consumers have no other incentive but the market price if the goods offered by suppliers are the same. Consumers can only differentiate in the quality of goods being sold on the market by moving to substitutes of the goods in question.

David Gauthier describes the ideal market of perfect competition as a "morals-free zone" (Gauthier 1985). There is no need for morals in a perfectly transparent market situation in which all goods are perfectly recognizable in their qualities, have no hidden qualities and are available in any part of the market at the same market price. In such a market, the price is the only decision parameter in the market interaction, and this price is determined by factors outside the control of the market participants. Monetary price incentives are the only incentives in a market of perfect competition. There are no

9 J. M. Buchanan subsumes parts of what is called here "ethical economy" under the concept of "the constitutional economics of ethics" (cf. BUCHANAN 1992).

buying incentives introduced by unique features of goods and services. Under perfect competition, there is no incentive for the buyer to buy above equilibrium price and no incentive for the seller to sell at a lower price.

It must be understood that the market of microeconomic theory describes an interaction of the market participants that is free of imposition and free of any distortion of the scarcity ratios. It reflects adequately the scarcity conditions and the suppliers' and consumers' preferences. In this respect, the perfect market is an ideal form of social coordination. The theory of the competitive market assumes that market participants are driven by self-interest and do not use force, power or collusion in their interactions. The price of the competitors is parametric in this model. The price is set beyond the control of a single supplier and therefore is not dependent on supplier discretion. The suppliers control only their own production and cost functions, the consumers only their budget. There is no coercion to enter into or maintain a contract. The market of perfect competition is a model of free interaction and satisfies conditions of freedom and optimality. These features render it far superior to any model of centrally planned and therefore coercive interaction.

a) The Principle of Self-Interest and its Ambiguity: *Homo Homini Deus* or *Homo Homini Lupus*?

The self-interest theorem as the driving motive of market interaction has been emphasized by Adam Smith in his famous dictum that it does not depend on the benevolence of the butcher but on his self-interest whether we shall have meat or not. Smith had, however, a Dutch predecessor who introduced the idea of the invisible hand of the market. More than one hundred years before the publication of Smith's *Wealth of Nations* in 1776, Pieter de la Court contended that self-interest is central and presented the concept of an invisible hand for a republic and market in his book of 1662 *The True Interest, and Political Maxims of the Republick of Holland and West-Friesland*.

Pieter de la Court writes that "the good government is not that where the well or ill-being of the subjects depends on the virtues or vices of the rulers; but (which is worthy of observation) where the well or ill-being of the rulers necessarily follows or depends on the well or ill-being of the subjects". (De la Court 2003, p. 10f.) According to de la Court, we have no other choice than to realize self-interest since the rulers or governments will always prefer and follow their own self-interest. "We must believe that in all societies or assemblies of men, self is always preferred." (De la Court 2003, p. 11) He concludes, quite in anticipation of the critical public choice perspective on government, about the self-interest of governments: "So all sovereigns or supreme powers will in the first place seek their own advantage in all things, tho' to the prejudice of the subject." (*ibid*.)

Fortunately enough, there is an invisible hand in politics and economics that turns the pursuit of the self-interest of the government into freeing the pursuit of the private good by the citizens. It also transforms the citizens' pursuit of their private good into the public good of the government.

> But seeing on the other hand true interest cannot be compassed by a government, unless the generality of the people partake thereof; therefore the publick welfare will ever be aimed at by good rulers. All which very aptly agrees with our Latin and Dutch proverb, that, *Tantum de publicis malis sentimus, quantum ad privatas res pertinet*; i.e. We are only sensible of publick afflictions, in so far as they touch our private affairs. (*ibid*.)

Pieter de la Court's gives a very early defense of a market in a republic that frees the self-interest of the citizens and thereby realizes the public interest since the pursuit of the citizens' self-interest will lead to the realization of the public interest and the pursuit of the government's self-interest will lead to furthering the private good of the citizens. This theory also links the republican form of government with the market form of the economy. Both are founded on the freeing of self-interest and on turning the pursuit of self-interest in the realization of the public interest, "so that *homo homini deus in statu politico*, one man being a god to another under a good government". (De la Court 2003, p. 23)

In the Dutch republic, it does not hold true what holds true for the kingdom of England, for the Leviathan of English absolutism: that *homo homini lupus*, that man is a wolf to man, as Hobbes stated it. In Holland, man is a God to man. In an impressive critique of Hobbes's absolutism eleven years after the publication of Hobbes's *Leviathan* of 1651, de la Court formulates the republican counter-principle to Hobbes in a country where the population is even more crowded and the citizens are closer to each other than in England.

> It is an unspeakable blessing for this land, that there are so many people in it, who according to the nature of the country are honestly maintain'd by such suitable or proportionable means, and especially that the welfare of all the inhabitants … from the least to the greatest, does so necessarily depend on one another. (De la Court 2003, p. 23)

De la Court (2003, p. 24) concludes: "*A furore monarcharum libera nos Domine* God preserve Holland from the fury of a monarch, prince, or one supreme head." As a radical republican, de la Court did not foresee that future generations of Hollanders would find a constitutional compromise that reconciled the status of the citizen and of the subject in the Dutch *onderdaan* (subject, in German *Untertan*).[10]

The comparison of Hobbes's, de la Court's and Adam Smith's understanding of the self-interest theorem shows that the self-interest theorem assumes quite different meanings and causes quite different conclusions about human nature. The interpretation of self-interest reaches from Hobbes's *homo homini lupus* to de la Court's *homo homini deus*. The self-interest theorem is not univocal. It embraces several possible interpretations of human nature that reach from an extreme pessimism to an extreme optimism about human nature and the effects of human self-interest.

b) The Principle of the Need for an Internalized or External Third in Contracts

There is a difficulty in the model of the market of perfect competition which concerns the workings of the invisible hand in the coordination of self-interested action. The business contracts might not be self-enforcing even under perfect competition. They seem to require a third party to enforce them.

In his *Leviathan*, Hobbes writes about the nature of humankind's desires:

> So that in the nature of man, we find three principall causes of quarrell. First, Competition; Secondly, Diffidence; Thirdly, Glory. The first, maketh men invade for Gain; the second, for Safety; and the third, for Reputation …. Hereby it is manifest, that during the time men live without a common Power to keep them all in awe, they are in that condition which is called Warre; and such a warre, as is of every man, against every man. (Hobbes 1909, p. 43).

Human beings need a third party to control their desire to invade each other for gain, greater safety, or more glory. Human beings understand that they can improve their lot by entering into agreements not to invade for greater gain, safety, or reputation, but their rational self-interest to come to mutual

10 This constitutional compromise turns even the EU citizen living in the Netherlands into an "*EU Onderdaan*". Since the author's Dutch permit of residence (Dutch *Verblijfsdocument*) describes his status as *EU Onderdaan* or EU subject the term raises the question whom the *EU Onderdaan* is *onderdaan* or subject to.

agreements might be not as strong as their reluctance to keep these agreements. Their readiness to observe contracts is unstable as long as there is not a third party to control their permanent temptation to break agreements or contracts. This is why a social contract of association, a contract between two parties, Ego and Alter, is not sufficient for a civil state of contract compliance. Anyone living in a civil state cannot be prevented from leaving it any time he or she considers it expedient. Without a third party who enforces compliance, human beings are always tempted to breach their contracts. The war Hobbes talks about does not consist in actual hostility but in an assured insecurity, in the knowledge of the fact that all contracts can be breached at any time.

> So the nature of War, consisteth not in actuall fighting; but in the known disposition thereto, during all the time there is no assurance to the contrary. … And the life of man, solitary, poore, nasty, brutish, and short. (*ibid*.)

The assured insecurity surrounding contracts is the reason why a social contract of association is not only unstable for the civil state or commonwealth but is also unstable for the contract of civil law between two parties, Ego and Alter, in the realm of business. Everyone living under civil or public law in a civil state cannot be prevented from leaving the social contract or the private contract at any time that he or she considers this useful.

Any contract of association must be supplemented by a contract of subjection to a third party whom the power is granted to enforce the contract of association. This third party can either be the law and its courts or an internalized ethics. Without a contract of subjection under the authority of legal or ethical enforcement, any contract of association is weak if not useless. The contract of two always implies a third, the third party of contract enforcement or of self-commitment to the general rule of keeping contracts. When you are two, you are actually three.

With Hobbes, ethical economy shares the skepticism about the idea that the will to associate and to enter an agreement already guarantees the will to fulfill the agreement. In contrast, both Hobbes and ethical economy assume that agreements need the enforcing third party. Franz von Baader remarked that not only the social contract but also any contract, even the business contract, presupposes the enforcing third party, either of law and religion or of ethics and religion. Therefore, ethics and the law are present in all contracts and stabilize every contract.

Hobbes believed that human beings find their way out of the state of nature because they are rational beings. Each human being should be willing to honor contracts and to pursue peace when others are willing to do the same, while retaining the right to continue to breach a contract or pursue war when others fail to observe contracts or pursue peace. By being reasonable and by recognizing the rationality of this basic precept of reason, human beings can be expected to construct a social contract consisting of a contract of association between the first and the second person, and of a contract of submission between the two or the many and the third that consists in the submission of the first and second person to the authority of the third person. Thus, according to Hobbes, when different interests are at stake, and that means in every agreement, it is rational to sign away your right to the self-enforcement of contracts to a third party or power, be it a juridical court or a sovereign power or an ethical rule of observing contracts regardless of one's desire to breach them. Since we are never able to judge our own interests objectively and will always be tempted to interpret the contract in our favor, we are always in need of a third party, as the third impartial judge of our agreements. In most cases, this third party will be the ethical principle of the duty to observe contracts.

In the instability of our interest to keep a contract, there is no self-enforcing contract and no difference between civil and public law. This is one of the consequences of Hobbes's theory. If we need the third party in public law, we also need the third party in civil or common law. All agreements, be they civil or public, need the third party to guarantee their fulfilment and to ensure certainty of expectation, which is the core of legal safety. Without the third party, Ego and Alter have no certainty that their agreements will be observed and that their expectations about the future will be fulfilled. They cannot plan for the future without an external or internalized third party guaranteeing observance of the contracts.

The civil state or the state of law is the state in which agreements between the first and the second party always imply a third. The ethical rule of the duty to observe contractual agreements is the preparation of the law.

Adam Smith has assumed that, by the invisible hand of the market, self-interested actions are transformed into the common good: into an efficient general economic outcome that does not involve the interference of a third party. Adam Smith's business contracts need no contract of submission to a third party, although Smith assumes that the judiciary will enforce contracts. His theory uses the invisible hand of self-interested market transactions and the visible hand of the legal enforcement of contracts. There remains a residue of skepticism about the working of the invisible hand of the market in Adam Smith in that he assumes that, even under conditions of an invisible hand at work, the visible hand of the law and of contract enforcement remains necessary. Smith's theory of the market relies on courts and on the invisible hand, not on the invisible hand only. It relies on double control measures. As American lawyers say: any contract must use double measures – must use, metaphorically speaking, a belt and suspenders to make sure that the trousers hold.

c) The Principle of the Ethical Assurance of Loyalty to Contracts

The competitive market works perfectly well if there is transparency in interactions and the interactions are carried out simultaneously, under the condition that compliance with the contract can be monitored easily by the contracting partners. As soon as there is a time lag between contracting and serving the contract, uncertainty enters as to whether the contract will be observed as agreed upon. This uncertainty is reduced by a third party, be it the legal guarantor of contracts, long-term business relationships and repeat business, or an effective business ethics code. The legal monitoring and enforcement of contracts is costly. Legal costs occur, and the contract enforcement is only realized later when the damage caused by the delay in honoring the contract and by the non-realization of the contract-based expectations about the future have already occurred. Even if the law enforces a contract, the plans of the contracting partner for the future made on the basis of the contract have already been disrupted.

Long-term business relationships and repeat business do not rely on ethical considerations, but on the formation of habits and the expectation of lower transaction costs by replicating the same business. The same process that creates economic advantages and the formation of trust, however, is also subject to the possibility of being exploited by both sides. The more often a business transaction is repeated and a habit of doing business is established, the more both sides are locked into the business relationship. They cannot circumvent it except at high cost. They become quasi-monopolists for each other, with the consequence that both sides can extract a monopoly profit from each other due to the fact that their partner is locked into the business relationship. Repeat business is economically and ethically ambivalent. Not only does it create cost-saving opportunities but also the possibility of losses from being locked into a relationship and being exploited in it.[11]

Contractual relationships in the market can be monitored by more than fear of legal punishment or the establishing of long-term business relationships. Ethical codes and ethical convictions serve as a substitute for legal enforcement and monitoring, and as a way to reduce the exploitation potential in long-term business relationships. An ethos of observing contracts leads to a market environment that is superior to an environment where only lawyers or mere habits ensure that contracts are served.

Pacta sunt servanda is a central norm of the economy that is not secured by self-interest alone. Every time business partners can get away with opportunistic behavior, they will engage in it unless they are restrained by respect for the principle of observing contracts. Even in a market with well-functioning legal enforcement of contracts, there are many contracts that are incomplete, ill defined, or indeterminate with regard to the contractual obligations. Ethics and religion are a means to give substance to the expectation that the contracting partner will observe the contract and keep the promises made in the contract.

Reliability and mutual trust on the part of business partners result in reducing the costs of economic exchange. Trust reduces transaction costs, since the contracting partners can come to an agreement more rapidly. They face fewer monitoring costs.

Individuals may react in three ways to this relationship between trust and freedom of contract:

First, individuals can behave unconditionally morally. They understand the common economic need in ethical behavior as the *motive* for their *own* behavior. The persons turn common interest into their own interest, i.e. the persons behave morally irrespectively of the behavior of the others (*Case 1*). For example, firm employees try to do their best irrespective of what the others achieve, or businesspersons try to remain fair even if widespread forms of unfair behavior are to be found in the industry.

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11 In a famous business case, the so-called "Schneider bankruptcy" in Germany, the owner of a building firm, Jürgen Schneider, had been able to attract large sums of credit through his position of trustworthiness acquired through long-term business relationships with large banks, which at some point in time had simply stopped controlling whether the real estate existed that he had given as security for loans.

Second, a person can behave conditionally morally. Individuals are ready to follow ethical rules if the others or the majority also follow them, but violate the rules if they feel that they alone "will be the fool" (*Case 2*). The contracting partner fulfils the contractual obligations only if everybody else does so as well.

Third, persons may appreciate that the better situation for everybody is achieved if everybody follows the rules, but consider the best situation a situation in which everybody but them follows the rules (*Case 3*). This is the pattern of behavior assumed by the famous prisoners' dilemma in game theory. A firm knows that it is best for the industry if every firm sticks to the rules and no bribing of business partners or other form of corruption takes place, but it prefers to make an exception for itself and to support contracting by doing favors for business associates.

Case 3 of the behavioral options presents a typical dilemma situation in which one cannot remain. The dilemma describes a situation in which everybody benefits if *everybody* follows the rules and in which each person is interested in being the only one who can violate the rules in the hide. As a consequence, the rule will be violated if it is not enforced by external control and sanctions, or if it is not affirmed by the individuals on ethical grounds. Case 3 will be transformed either into the ethical options of case 1 or 2, or into a system of external monitoring and enforcement.

Case 2 that one acts morally if everyone else does so, too, is a typical intermediate situation that seems to be acceptable to most people. One behaves morally if others do the same; one stops behaving morally if one feels oneself to be the only person behaving morally. Ethics is a means to transform the situation of a prisoners' dilemma into a situation of trust or assurance. The general acceptance of and compliance with ethical rules would transform the isolation paradox, named so by Amartya Sen (1967, p. 112), of case 2 into a situation of relative certainty. The isolation paradox implies that individuals will not follow the rules under conditions of isolation and uncertainty about the others' behavior since they are afraid of being deceived, although they are actually ready to follow the general rule in other circumstances.

However, case 2 is not stable, as the certainty that all the others or at least most of them follow the rules is always vague and limited. Sen, though, assumes that generally acknowledged moral values transform case 3, the situation of the prisoners' dilemma, into case 2, the situation of certainty or assurance, into an "assurance game". When moral values are generally acknowledged, the individual is no longer uncertain about the moral preferences of the others. But Sen's position is begging the question – a *petitio principii* remains. If one says that individuals have further motivation to behave morally if ethical behavior is general, i.e. that "values" are recognized, this begs the question of whether the values are indeed generally acknowledged. How is it possible to make sure that moral "values" are generally acknowledged, that the others also behave morally and that the individuals make the rule their motive? The element of uncertainty remains here; assurance is only relative. Case 2 is more stable than case 3, as in case 2 the individuals are at least partially moral and cooperating, but case 2 cannot ensure absolute certainty about the moral behavior of the others and provide secure grounds for trust.

In case 2, in the situation of the isolation paradox, two questions arise: "How long will the individuals be ready to follow the moral rules if most of the others violate them or if they are not certain about the others' actual behavior?" and "How may the uncertainty about the behavior of the others be reduced?" Both questions cannot be solved by ethics alone. Answering the questions by pointing to the need for a general ethics leads again and again to the *petitio principii* that the ethics will be accepted by the individuals and find general recognition if this already enjoys general recognition and that the isolation paradox of the acceptance of ethics may be overcome if the ethics is already generally effective.

Case 2 shows that the prisoner's dilemma and isolation paradox may be solved by ethics only if individuals recognize the moral rule naturally and irrespectively of the behavior of the others – if they make the moral rule their individual motive also. As uncertainty about the others' behavior cannot be eliminated, the moral rule can win recognition only if it is recognized despite the others' behavior.

The failure of ethics requires a corrective. Kant, in his *Critique of Practical Reason*, sheds light on this problem of ethics failure. If a moral individual follows the categorical imperative while all the others follow the rule of personal happiness, the harmony between one's own morality and pursuit of happiness is destroyed. Kant thought that this problem could be solved by the "postulates of practical reason". The postulates of practical reason – God, liberty and the immortality of the soul – restore trust in the meaningfulness of moral behavior, and in the harmony between morality and advantage. Religion here is a postulate guaranteeing the exigency of being moral. It helps build up a social capital on which trust can be founded.

The religious belief can transform ethics failure into trust in the effectiveness of ethics. It transforms the empirical uncertainty of the isolation paradox into the belief that morality is a common phenomenon and that it is useful to be moral. Religion accomplishes what Sen ascribes to ethics: the transformation of situations of prisoners' dilemma and of the isolation paradox into situations of assurance (in game-theoretic terms: into an *assurance game*). Assurance and trust in the advantage of being moral are not fully attained on the basis of ethics, but on the basis of religion. There is a sequence of compensations for failure. When self-interest fails, there is ethics; when ethics fails, religion. This structure of failure compensation has been analyzed in greater detail in the author's *Principles of Ethical Economy* (Koslowski 2002).

The ethical economy of the relationship between the individual's utility calculus and the individual's readiness to act morally has been discussed in different epochs of the history of philosophy. In Kant, religion gives reason to the belief in the final harmony between moral behavior and happiness in the form of the postulates of practical reason. In Plato, it is "the idea of the good" and of the myth of the trial of the soul after death that assures the human being that morality and happiness converge. It guarantees trust even in situations in which the individual is unsure of the behavior of the others, such as in the situations of isolation and the prisoner's dilemma.

The theory of the link between economics, ethics, and religion seems to violate the rule that the scholar has to renounce the use of God in scientific discourse. The theory developed here is, however, first a positive, non-normative theory of the link between ethics and religion. The response against the objection that religion should not be used in scientific discourse is quite simple: Social science has to include religion if religion is a motivational factor in the actual human behavior and is shared by many individuals in a society. Religion is than a socially effective force even if its truth value in the scientific sense remains open. Religion is real in its consequences if it has consequences for the individuals' behavior.

The result of the analysis of the relationship between economics, ethics, and religion can be interpreted in a threefold way. First, it can be interpreted as an empirical nexus between religious and ethical motivation that exists in many humans but not in all. Secondly, it can be interpreted as an argument for the economic and ethical usefulness of religion.[12] Thirdly, it can be inter-

12 RATZINGER (1985) also emphasizes the conditionedness of economics by ethics and of ethics by religion. – Pope BENEDICT XVI refers in his paper to KOSLOWSKI

preted as an argument for the existence of God. In the last sense, it demonstrates that if God is the condition for the congruence of ethical and rational self-interested behavior and if this congruence cannot be proven by rational calculus alone there is an ethical-economic argument for the existence of God or an argument from ethical economy for religion as the compensation for the failure of ethical motivation.[13]

The aim of the argument developed in the present paper is not metaphysical but ethical and economic. It is satisfied by proving that economics is conditioned and "improved" in its efficiency by the validity of ethics and that ethics is conditioned and "improved" in its effectiveness by the validity of religion.

d) The Principle of Double Effect: Handling Externalities of Economic Action

The assumption of market theory is that the market price includes or internalizes all benefits and costs caused by the exchange to both sides. Both sides confirm that all benefits and costs are internalized by their consent to the exchange. Third parties that are not part of the exchange are not concerned. There are, however, exchanges that have side-effects or externalities on others that are not internalized in the exchange like environmental pollution. When pollution on third parties originates from a contract of two parties the principle of internalization is violated.[14]

Side-effects are a classical problem of moral philosophy and of economics. Moral philosophy and moral theology, particularly in the Catholic tradition, developed the theory of the principle of double effect which can be con-

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(1985b), an earlier version of the argument developed here. The argument about the usefulness of religion as a guarantee for that being ethical is also useful for the individual is expanded further in KOSLOWSKI (2007).

13 Cf. for this ethical-economic argument for the existence of God KOSLOWSKI (2008).

14 A tragic example for an action with double effect is the "three-strikes laws" in the United States, under which a third felony conviction yields life imprisonment. These laws are intended to deter repeat offenders. However, they may encourage repeat criminals to kill witnesses – since the sentence for murder is no worse than the sentence for a lesser third offense. Cf. JOHN SLOAN III, TOMISLAV V. KOVANDZIC, LYNEE M. VIERAITIS: "Unintended Consequences of Politically Popular Sentencing Policy: The Homicide-Promoting Effects of 'Three Strikes' in U.S. Cities (1980-1999)", in: *Criminology & Public Policy*, 1 (2002).

sidered to be a transcendental principle of handling side-effects. As a transcendental principle of handling side-effects it is also a central principle of ethical economy and of business ethics.

The principle makes it possible to analyze and assess decision situations under uncertainty and expected (negative) side effects. It is a decision principle for ill-structured and ambiguous decisions. Most ethically relevant decisions in business do in fact have side effects and, therefore, are ill-structured decision problems under uncertainty. They cannot be converted into well-structured decision situations by calculi unless with unrealistic, scientistic premises, such as premises that the results of actions can be known with certainty or that the probability distribution of the possible effects of actions and outcomes is known. The probabilistic principle of action with side effects or double effect[15] is therefore especially applicable in economic ethics and decision theory, and is able to penetrate the ill-structured economic-ethical decision situation and to reduce it to a better defined structure. The principle of double effect is, in contrast to the principle of the categorical imperative, concrete and makes it possible to perform comparisons of goods. It is, therefore, an important complement to the universalization principle, which is weak in judging the concrete case.

The principle reads: An action with negative side effects is sensible and permitted, if the following four conditions are met:

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15 On the problem of actions with double effects, see PETER KNAUER: “The Hermeneutic Function of the Principle of Double Effect”, in: *Natural Law Forum*, 12 (1967), pp. 132-162; RICHARD MCCORMICK: “Das Prinzip der Doppelwirkung einer Handlung”, in: *Concilium*, 12 (1976), pp. 662-670; R. A. DUFF: “Absolute Principles and Double Effect”, in: *Analysis*, 6 (1976), pp. 68-80; JOSEPH M. BOYLE, JR., GERMAIN GRISEZ, OLAF TOLLEFSON: *Free Choice*, Notre Dame (Notre Dame University Press) 1976; ROBERT SPAEMANN (1977, pp. 167-182); JOSEPH M. BOYLE JR.: “Toward Understanding the Principle of Double Effect”, in: *Ethics*, 90 (1980), pp. 527-538; L. J. MCNAMARA: *Direct and Indirect*, Ph.D. Thesis, University of Oxford 1980; J. L. MACKIE: *Ethics*, London (Penguin) 1977, pp. 160-168; S. S. LEVY: *The Doctrine of the Double Effect*, Ph.D. Thesis, University of Michigan 1982; G. E. M. ANSCOMBE: “Action, Intention, and ‘Double Effect’”, in: *Proceedings of the American Catholic Philosophical Association*, 57 (1983), pp. 12-25. On judgment of consequences, cf. RAINER SPECHT: *Innovation und Folgelast*, Stuttgart (Frommann Holzboog) 1972.

1) The goal of the action must be good and sincere (i.e. the acting person may not intend a bad and impermissible effect). The side effects must be unintended, must be *praeter intentionem*.[16]

2) The type or form of the action must be intrinsically good.

3) The negative side effects must be true *side* effects. They must objectively have the character of accidental effects arising in the pursuit of other goals, and may not serve as means to the good effect.

4) There must be a proportionately grave reason to perform the action. The acting person may not be obligated by other duties to refrain from it completely.

This list of conditions summarizes the formulations of the principle by John of Saint Thomas,[17] from whom the first complete version of the principle is derived, and by Jean Pierre Gury.[18] Conditions 1), 3) and 4) are the same for both authors. Condition 2) has been expanded by Gury, in order to ensure that the principle is not applied in the sense of a universal comparison of goods that does not differentiate effects and side-effects. The principle of double effect is not identical to an uncritical, universal comparison of goods, with which the good and bad effects of *all* actions, including actions of an unambiguously unethical character, are taken into account, and the least evil of several evil actions is chosen. With condition 2), Gury attempts to guarantee that intrinsically-evil actions are excluded from the comparison of goods.

The question is discussed within general ethical theory whether the principle of double effect can be united with various normative, basic convictions, or whether it is a prerequisite of a normative ethical theory that judges certain actions as intrinsically evil and excludes them from comparing main effect and side effects according to the principle of double effect. Joseph Boyle holds the view that the principle of double effect can be united with any normative theory that assumes that there are types of actions that are good and types that are evil. Every ethical theory that makes such a distinction can make use of the principle of double effect.[19]

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16 On *praeter intentionem*, see JOSEPH M. BOYLE JR.: „Aquinas on Praeter Intentionem“, in: *Thomist*, 42 (1978), pp. 649-665; and M. MÜLLER: *Ethik und Recht in der Lehre von der Verantwortlichkeit*, Regensburg (J. Habbe) 1932.

17 JOHN OF SAINT THOMAS: *Cursus Theologicus*, Madrid 1645-56, tom. VI, disp. XI, a. 6, cap. 39 &. 42.

18 JEAN PIERRE GURY: *Compendium theologiae moralis*, Regensburg 1857, 2nd edition, tr. I, cap. II, n. 9.

19 BOYLE: “Toward Understanding the Principle of Double Effect”, p. 537.

This position, of course, shifts the debate, from the question whether there are actions that are intrinsically good and evil and whether the answer to this question is a prerequisite for being able to apply the principle of double effect, to the question, *which* actions are intrinsically good or evil.

Elizabeth Anscombe is of the opinion that the principle does not say what one can or should do, but instead what one may not do, and thus that its applicability is restricted. The principle does not read that the predominance of good over bad/evil makes an action permissible and recommends it, but instead requires that the side effects stand in a reasonable relation to the good. It permits only *good* actions with negative side effects, and only actions with which the negative side effects stand in an appropriate relationship to the (good) primary effect.[20]

The principle has been further explicated as follows: The necessity of tolerating negative side effects must be proportional larger, if:

1) the primary goal is by nature closer to the negative effect,

2) it is certain that the evil effect will follow, and

3) there are fewer ways to avoid the evil than there would be if the goal or primary effect were first to occur.[21]

Additional support for decision-making that can be derived from the principle of double effect, is:

1) How closely is the bad result or side effect dependent upon the action?

2) Is the damage that would result from the omission of the intrinsically-good action greater than the evil side effect that would result from performing the action?[22]

The principle and its explications do not remove the burden of judgment and of evaluating the internally assumed probability, the *probabilitas interna,* from the decision-maker, but they help to penetrate the decision to be made.[23] The analysis of side effects and the principle of double effect form a

20 ANSCOMBE: “Action, Intention, and ‘Double Effect’”.

21 COLLEGIUM SALMANTICENSIS: *Cursus Theologicus* (*Comm. in S. Thomae s. th.* II-II, q. 64, a. 7), (= *Tractatus de bonitate et malitia actuum humanorum*), edited by Domingo de Santa Teresa, Paris 1878, tom. 7, tract. XIII, disp. 10, dub. 6, n. 214-47. See also J. T. MANGAN: “A Historical Analysis of the Principle of Double Effect”, in: *Theological Studies*, 10 (1949), pp. 41-61.

22 NIKOLAUS SEELHAMMER: “Doppelwirkung einer Handlung“, in: *Lexikon für Theologie und Kirche*, Freiburg im Breisgau (Herder) 1959, Vol. III, pp. 516-517.

23 See for an application of the principle of double effect to a business ethics case P. KOSLOWSKI: “Hoe om te gaan met de neveneffecten van bierleveranties?”, in:

bridge between ethics and economics. The principle is a crucial instrument of the analysis and judgment of ethical economy.

e) The Principle of Hyper-Motivation: Incentives of Self-Justification as Economic Incentives

The idea of the right structure of incentives and contributions is a central concept of economic and management theory.[24] There exist, however, not only incentives but there exist right and wrong incentives in business, science and technology. A remuneration of managers according to the rise or fall of the share price of the firms they manage creates incentives to arrange their performance primarily on this goal and to neglect other duties of their work. A remuneration of scientists only according to their ability to attract funds from third sources has the effect that they pay attention particularly to the third party's interests and neglect independent, long-term, original, creative research.

Motivation structures and contributions can be intensified in their effect through motivation boosters as the history of entrepreneurship, of technological invention and of scholarship demonstrate. German Idealism turned the scholar into the agent or fiduciary of the absolute spirit. J. G. Fichte believed that the scholar is the vessel of the absolute. The scholars of historism and of the historical school of the humanities as the successor of idealism followed a similar path of enforcing motivation. They were confirmed in their urge to creative research by the conviction that the absolute realizes itself in history, in the historical spirit of cultures and nations, and that they illuminate this self-realization of the absolute. The illumination of the historical phenomena became by this conviction a work on the realization of the absolute, *Arbeit am Absoluten*. For the phase of the blossom of the German humanities in the 19th century, these aggrandizement of the scholar's own work by a pantheistic metaphysics had a motivation- and creativity-amplifying effect. This effect was at the same time boosting research and its results and problematic since it caused a self-aggrandizement of the scholar with the dangers of forming the ideal-type of the mandarin-scholar.

Business competition increases motivation and creativity as does the competition between nations. Japan was stimulated to high performance since

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WIM DUBBINK, HENK VAN LUIJK (Eds.): *Bedrijfsgevallen. Morele beslissingen van ondernemingen,* Assen (Koninklijke Van Gorcum) 2006, pp. 126-132.

24 Cf. COLEMAN (1993).

the end of the 19th century by the incentive of catching up, by the motto „make up, catch up, overtake." (*Einholen, Aufholen, Überholen*).

Max Weber's Calvinist entrepreneur becomes creative and is motivated for high performance through religious incentives. Because he understands his economical success as a proof of being in the state of grace he experiences additional religious incentives to be successful in business. Max Weber's *The Protestant Ethic and the Spirit of Capitalism* (1905) shows that cultural and economic incentives and motives overlap and that culturally defined incentives enhance economic creativity and business performance. The Calvinist teaching on justification undergoes a revision. Justification is finally in part redefined as economic success.

The insecurity in Protestantism whether the Protestant believer can be certain to be in the grace of God is eased by economic success interpreted as a sign of grace. Justification becomes only visible through economic success since in Calvinism even faith is no guarantee of being chosen. According to the Westminster Confession of 1646, God chooses those predestined to eternal life "out of His mere free grace and love, *without any foresight of faith or good works* (italics by PK), or perseverance in either of them, or any other thing in the creature as conditions or causes moving Him thereunto".[25] Neither faith nor good works make a human being deserving the state of grace. The only proof of being predestined to the state of grace can be given, as Weber (1905) showed in his analysis of Calvinism, through being economically successful. This re-interpretation of economic into religious success is presumably one of the most powerful and subtle incentives and amplifiers of motivation and creativity that humankind ever experienced.

The difference in the effect of the Calvinist and the Lutheran teaching on justification cannot be overestimated. Whereas the Lutheran is justified *sola*

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25 *Westminster Confession,* Chapter III. Of God's Eternal Decree, § 5: "Those of mankind that are predestinated unto life, God, before the foundation of the world was laid, according to his eternal and immutable purpose, and the secret counsel and good pleasure of his will, hath chosen in Christ, unto everlasting glory, out of his free grace and love alone, without any foresight of faith or good works, or perseverance in either of them, or any other thing in the creature, as conditions, or causes moving him thereunto; and all to the praise of his glorious grace." Online edition: http://www.reformed.org/documents/index.html?mainframe= http://www.reformed.org/documents/westminster_conf_of_faith.htm
Weber (1905, p. 57) quotes the Westminster Confession extensively as one of the central historical and theological documents for his thesis.

fide, only by faith,[26] the Calvinist is even unsure about his or her justification by faith.

The German Lutheran contempt for "good works", for religious good works, affects also the economic good works and economic success. The weakness of economic thinking in the German intellectual tradition is influenced, if not caused, by the Lutheran teaching on justification and good works. This teaching renders the success of actions irrelevant for the justification of the human being as compared to mere faith. It also justifies a right of every one to every kind of social benefit since no good or success is "deserved" – a position which opens somehow a right to everything. The attitude toward economic success and good works is different in Calvinism where the radicalization of predestination made the recourse to justification *sola fide*, only by faith, impossible. Success in the world becomes the only assurance of being chosen in Calvinism which, theologically speaking, remains a doubtful assurance.

Re-interpretation and aggrandizement of meaning are central phenomena of cultural and economic enforcement of motivation. One can call this meaning enforcement a „hyper-motivation" by cultural incentives. Since the external world as such does not have enough meaning for the human being, humans are in need of cultural-religious boosters of motivation in their economy of creativity.

f) The Size of the Market and the Need for an Ethics of Market Exchange

It is a frequently heard thesis that ethics is a phenomenon of small groups who, through their face-to-face control, can assure the effectiveness of ethics, which is by nature not legally enforced. Friedrich von Hayek, James Buchanan, and in the German discussion on business ethics Karl Homann defend the thesis that the ethics of small groups has been replaced in the modern market society by the formal coordination of the market process, which does not rely on goodwill but on market forces to make sure that individuals deliver for the good of all. Homann in particular goes so far as to say that only modernity has established and understood markets and that it has re-

26 Cf. *Augsburg Confession* (1530), Article IV. Of Justification: "…men cannot be justified before God by their own strength, merits, or works, but are freely justified for Christ's sake, through faith." Online: http://www.ctsfw.edu/etext/boc/ac/augustana04.asc

moved all ethics from actual market interactions to the frame order of the market, i.e. to the institutional rules of the market.

First, one must reply to this position that it is not necessary for the existence of a market and for acting in a market that market participants understand all aspects of what a market is. Rather, it is central that they do act in it. Particularly for the market, the Vico principle *Non intelligendo omnia facimus* (Not by understanding everything do we do everything) holds true. Even if we do not find an elaborate market theory in the history of ideas before Adam Smith, it is inconceivable hat the Roman Empire with its sea and land trade and with its civil law had no markets and that its citizens did not engage in far-reaching market exchange. One limitation on the development of a market society in the Roman Empire, though, was slavery and the non-market organization of labor. Slavery is a commodification of labor without the free marketability of it. Forced labor limited the development of a market economy in antiquity. In this sense, modernity brought a radical change.

Secondly, it must be emphasized that ethics as deliberation over the goodness of an action on a personal level developed precisely in a setting in which the small-group society grew to become the large-group society. As a theory of right action, ethics did not develop in traditional small-group societies but in societies in transition to a large-scale society. Plato's and Aristotle's ethics are not the ethics of small groups with face-to-face control but the ethics for human beings living in extended large groups. Plato emphasized in his *Gorgias* that ethics intervenes precisely at that point at which group control ceases. His example is the ring of Gyges, a ring that renders its wearer invisible. Plato asks the ultimate question of ethics: What could convince a human who can do everything invisibly to act ethically?

Finally, the development of the universalistic Christian ethics in the Roman Empire that transformed the particularistic ethics of nations and groups to an ethical universalism proves that ethics in not a small-group phenomenon. As Paul's letter to the Galatians 3.28 says: "There is neither Jew nor Greek … for ye are all one in Christ Jesus." Friedrich Schelling called this letter "the Magna Carta of Protestantism". Christian ethics belongs to a society in which the habitual morality of local habits and customs is superseded by a universalistic ethics.

Hayek introduced the argument that the market society replaces the society of small groups by an abstract order that renders ethics obsolete. This Hayekian argument is flawed and must be turned round. The market society requires personal ethics since it does *not* rely on the face-to-face control of small groups but on the formal rules of market coordination *and* on the ethics of observing contracts and of realizing mutual value creation. The ethos of *pacta sunt servanda* cannot be guaranteed by the legal system and mutual monitoring devices only.

It may be true that the market erodes certain features of ethics, but it is also true that the market accumulates features of a new ethos of contractual obligations. The constitutional state and the market economy do not only live on values that are prior to the state and the market. Nor do the constitutional state and the market only use up moral resources or moral capital. Rather, they also build up ethical resources since the individuals involved understand that ethics secures the working of the constitutional state and the market and that it must therefore be fostered in their individual motivation and action.

A good example of the anticipation of generalization in individual motivation is electoral participation. For years, public choice theory argued that, from the point of view of self-interest, a rational voter should not take the trouble of casting his or her vote since it is not worth the effort, as the voter's single vote has no influence on the outcome of the vote. Now, history reveals that voters do cast their vote. They act under anticipation of universalization. They seem to tell themselves: "The election works only if everyone votes; therefore, I shall vote."

The workings of the market also support the formation of an economic ethos by remunerating loyalty to contracts, reliability and the like, by furthering and putting a value on trust, reputation, and other non-monetary but valuable ethical assets.

Ethical economy interprets the ethical presuppositions of market interaction and exchange as second-order optimality conditions that must be added to the first-order economic optimality conditions of market interaction. Although market interaction needs to work – and actually does work – without strong ethical commitments and under the condition that individuals follow their narrow self-interest, it is improved by the ethics of contractual relationships. The need to economize on love in the market requires institutions that work without the resource of love. But this does not imply that institutions are required that work without the ethics of contractual relationships. Such institutions work even better if the resource of ethics is present.

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I conclude with a short ironical biographical remark taken partly from Edmund Clerihew Bentley (1875-1956), *Biography for Beginners* (1905), and its entry on 'John Stuart Mill':

John Stuart Mill
By a mighty effort of will,
Overcame his natural bonhomie
And wrote 'Principles of Political
Economy'.

Peter Koslowski
By rehabilitating natural bonhomie
Wrote 'Principles of Ethical
Economy'.

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