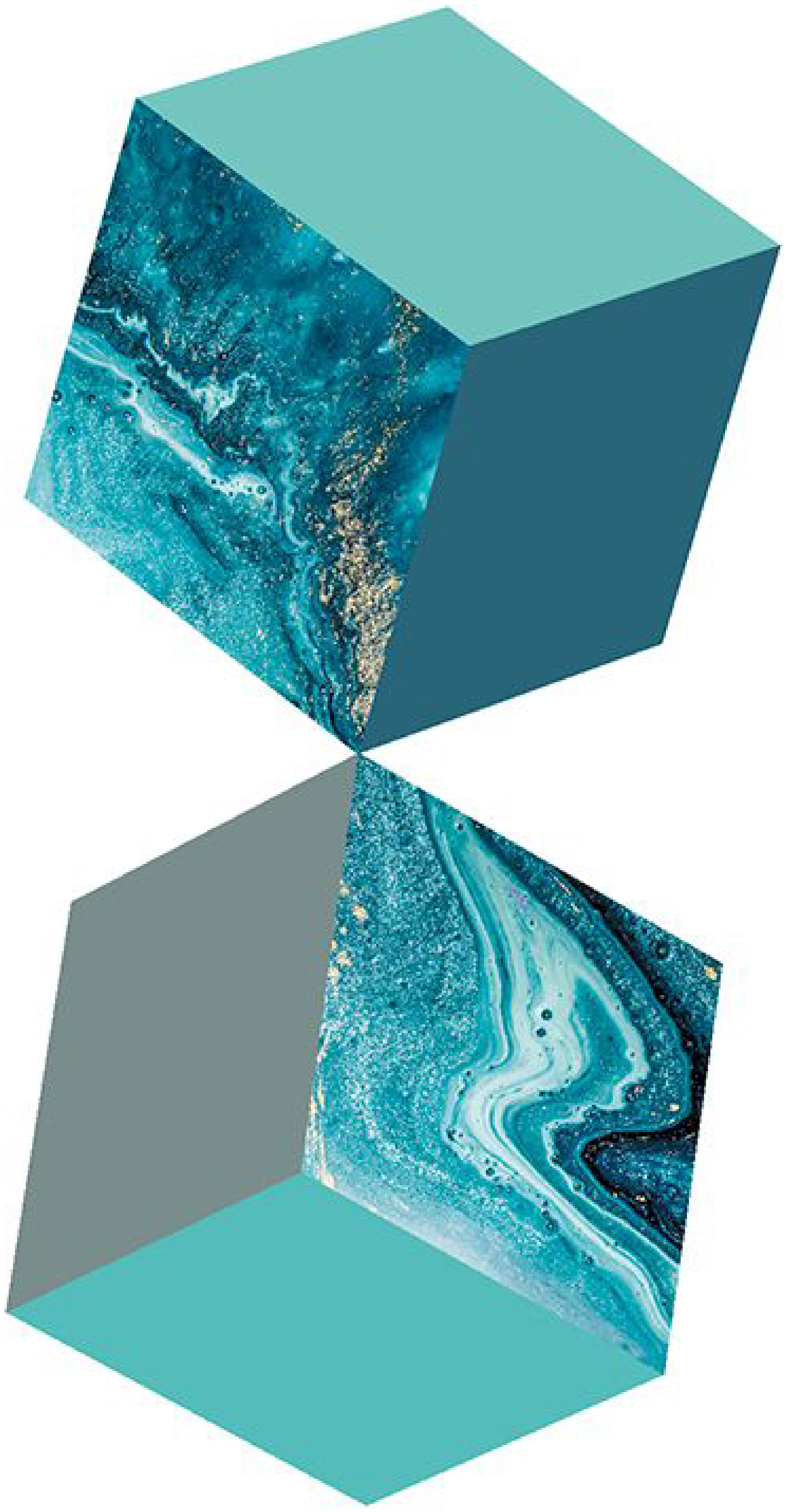
CHRISTOPH **LÜTGE** MATTHIAS **UHL**



BUSINESS ETHICS

AN ECONOMICALLY INFORMED PERSPECTIVE

OXFORD

Business Ethics

Business Ethics

An Economically Informed Perspective

Christoph Lütge

and

Matthias Uhl

OXFORD
UNIVERSITY PRESS

OXFORD
UNIVERSITY PRESS

Great Clarendon Street, Oxford, OX2 6DP,
United Kingdom

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
and education by publishing worldwide. Oxford is a registered trade mark of
Oxford University Press in the UK and in certain other countries

First Edition published in 2021

Published in the United States of America by Oxford University Press
198 Madison Avenue, New York, NY 10016, United States of America

British Library Cataloguing in Publication Data
Data available

Library of Congress Control Number: 2020951616

ISBN 978–0–19–886477–6

DOI: 10.1093/oso/9780198864776.001.0001

Printed and bound in the UK by
TJ Books Limited

Foreword

This textbook would not have been possible without the cooperation of many people. First and foremost, we would like to mention Johanna Jauernig, Jan Gogoll, and Julian Müller. Special thanks also go to Manuela Schönmann for her great help. We are indebted to Martin Berger, Benjamin Großmann-Hensel, Immanuel Klein, Sebastian Seisenberger, and Johannes Waldorf for research assistance. We would also like to thank Adam Swallow, commissioning editor at Oxford University Press, for the critical review of the manuscript, and OUP for the accepting this work. Last but not least, we also thank our families for their unwavering support during the time-consuming work on this book.

Christoph Lütge
Matthias Uhl

Munich
August 2020

Contents

List of figures

List of tables

List of boxes

An Economically Informed Approach to Business Ethics

Business ethics is now taught at many universities. In some places, it has become a compulsory subject in economics programs. This trend is expected to continue.

In the light of this development, there is a need for a new textbook on business ethics that summarizes the state of the discipline and gives an overview of its main topics.

For business ethics, there is an additional challenge, for it was involved in its early years in policy debates, especially in the German-speaking world. This is not surprising, though, for a new discipline trying to get its footing. Debates are productive, as long as they lead to progress in the subject in question and as long as new insights, perspectives, and points of contact arise, particularly for other disciplines. It is also the true that at a certain point, it is time to leave the policy debates behind. This textbook seeks as far as possible to distance itself from a specific business ethics approach in a favor of a comprehensive perspective.

With regard to its classification as a science, the question presents itself as to whether business ethics in the main is a philosophical discipline. Ultimately, that is more an issue of scientific organization than content. For the time being, this classification is maintained here, albeit with the caveat that the economic component is not merely an adjunct, but of great relevance for business ethics. In this book, not only are classical economic methods and results called upon in many places, but also experimental studies, their findings, and approaches. We believe that this results, in many ways, in a new conception of the phenomena of business ethics.

This textbook is intended for anyone interested in business ethics, in particular students of economics, the social sciences, and the humanities, as well as the computer sciences, engineering, and the natural sciences. Many of the questions discussed here extend far beyond narrowly conceived disciplinary boundaries.

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).
 DOI: 10.1093/oso/9780198864776.003.0001

This textbook is structured as follows:

Chapter 1 discusses the phenomenon of globalization and the challenges that it poses to traditional virtue ethics. An alternative view on globalization from the perspective of order ethics is proposed.

Chapter 2 defines basic concepts for business ethics such as ethics and economics and introduces fundamental theoretical and conceptual issues. These include the relationship between ethics and economics as well as the relationship between implementation and justification in business ethics.

Chapter 3 focuses on the development of business ethics thought in the historical context of the distinction between premodern and modern companies. Without this background, ethics in the globalized world would not be thinkable.

Chapter 4 addresses key models and tools of business ethics and corporate ethics. This occurs in three sections: The first section deals with philosophical theories and concepts that are used in business ethics, such as the different justifications for norms or the implications of the concept of consensus. The second concerns economic and social-science foundations and tools. Here, concepts are clarified such as the rational actor, dilemma structures, or the concept of utility. In order to avoid overwhelming the reader, a well-founded selection of methods and concepts has been made in both sections, some of which are competing against each other. The third section finally deals with the psychological foundations and tools. Major subjects here are the social intuitionist model of moral judgment and the concept of bounded ethicality.

In Chapters 5 and 6, the presented methods are used in the discussion of central business ethical or corporate ethical issues. The delineation of these two problem areas roughly corresponds to the distinction between economics and business administration.

Chapter 5 deals in turn with the business ethical issues of poverty and inequality, human dignity and human rights, and sustainability.

Chapter 6, the most book's comprehensive chapter, discusses corporate ethical issues. In doing so, it pays due attention to the fact that companies are key players in the globalized world. The problems here encompass corporate responsibility in the context of compliance, corporate social responsibility, corporate citizenship, and creating shared value.

We hope that this textbook will help people in their work on business ethical issues, whether it is academic or practical in nature.

1
Business ethics in the age of globalization

Selected learning objectives

After reading this chapter, you will be able to:
- describe the phenomenon of globalization from different dimensions
- understand the challenges that globalization poses for virtue ethics.

Chapter overview

1.1 The phenomenon of globalization

1.1.1 Definition and development

There are many definitions of the term "globalization." Some definitions focus on the economic perspective and, accordingly, understand globalization as the spread of Western market models across the globe (see e.g. Currie and Newson, 1998). Other definitions include not only economic but also political, technical, and cultural phenomena (Giddens, 1999, p. 10). Definitions of globalization often already contain normative criticism: Chomsky (2006), for example, considers globalization to be a doctrine for the promotion of neoliberalism. And Wallerstein (2000, p. 252) defines globalization as a scam perpetrated against everyone by powerful groups.

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).
 DOI: 10.1093/oso/9780198864776.003.0002

Matthias Fifka (2013) identifies four different dimensions of globalization that are mutually dependent:

1. Denationalization: The borders of nation states are becoming more permeable to goods and travel and financial transactions.
2. Deterritorialization: Culture (e.g. food, music, fashion) is less tied to geographical areas or nation states.
3. Reduction of spatial and temporal distances: New technical developments (Internet, mobile telephony, high-speed trains, air traffic) minimize spatial and temporal distances.
4. Interconnectedness: People interact across borders and are in increasingly intensive exchange.

On the basis of these four dimensions, Fifka understands globalization as the reasons, developments, and consequences of intensified economic, political, cultural, ecological, and technological relations across borders (Fifka, 2013).

The beginnings of globalization can already be identified, for example, in the colonial trade of the British East India Company (beginning in the seventeenth century). In the wake of the Industrial Revolution in the West, this trade intensified due to the high demand for raw materials and labor. On the eve of the First World War in 1914, the world economy was in many respects more closely intertwined than ever. This was undone, however, by the ruptures brought about by the two world wars.

After 1945, organizations like the United Nations (UN) created a framework for reviving international exchange. However, the start of modern globalization is not located until the end of the 1980s, after the end of the Cold War. With the end of bloc policy in the East and West, new markets emerged. The World Trade Organization (WTO) was founded in 1995 and began its work in Geneva one year later. In addition, new forms of mobility and communication have developed which will further boost globalization such as the Internet and social networks.

The following figures show the increasingly rapid development toward global interconnectedness: Trade accounted for 27.3 percent of the world GDP in 1970, rising to 59.4 percent in 2018 (World Bank, 2019b). Global freight traffic increased 29-fold between 1950 and 2007 (Fifka, 2013). Between 1980 and 2018, the volume of global exports of goods and services rose from USD 2.4 trillion to USD 25 trillion (UNCTAD, 2019, p. 86). It is estimated that the number of multinationals rose from 9,000 at the beginning of the 1990s to 65,000 at the turn of the millennium (Fifka, 2013).

In the gastronomy sector, chains spread across the globe: In 2019, sandwich-maker Subway was the largest company with 42,998 restaurants in 112 countries, followed by former frontrunner McDonald's with 36,900 restaurants in 119 countries and the Starbucks chain of cafes, ranked third, with 30,000 stores in 68 countries (Chepkemoi, 2019). As far as the international cross-linking of large companies is concerned, an estimated one-third of international trade is intra-company trade.

This development not only affects the Western world: Since the mid-1990s, the number of countries classified as "low-income countries" (i.e. countries with a GNI per capita of less than $1,025 as of July 1, 2019) by the World Bank (2019a) nearly halved, declining from 66 in 1995 to 31 in 2019. During the same period, the number of high-income countries rose from less than 50 to 80. Population shares have also shifted dramatically: While 6 in 10 people of the world's population lived in low-income countries in the 1990s, this number decreased to just about 1 in 10 today. The greatest growth has been in the middle group, with 75 percent of the world population currently living in the 107 lower- and upper-middle income countries (World Bank, 2019a). The number of people who live on less than USD 1.90 a day (2011 PPP) and are therefore defined as living in extreme poverty has fallen from 1.94 billion in 1981 to 736 million in 2015 (World Bank, 2018, p. 2). In 2015, the proportion of the world's population living in extreme poverty fell below 10 percent for the first time (World Bank, 2018, p. 2).

Globalization can also be quantified on the regulatory level: The worldwide average rate of customs duties dropped from 45 percent after the Second World War to 4 percent in 2010. In 2013, the number of international agreements was around 25,000, which are intended to regulate both environmental and safety issues in trade. Regarding mobility, the number of passenger kilometers in air transport increased 100-fold between 1950 and 2008. In 2000, the number of Internet users worldwide was over 400 million, the one billion barrier was crossed in 2005 and by the end of 2019, over 4 billion people used the Internet (see Figure 1.1).

Globalization is also reflected in the use of fossil fuels: From 1965 to 2014, CO_2 emissions rose from 11 to 36 gigatons (World Bank, 2016). During the same period, consumption of crude oil increased from 31 million barrels per day to 93 million barrels per day (BP, 2019). In 2019, the daily demand of crude oil exceeded the 100-million-barrel mark (International Energy Agency, 2020).

The numbers show that globalization is having positive effects on economic development. Nonetheless, there are numerous critics.

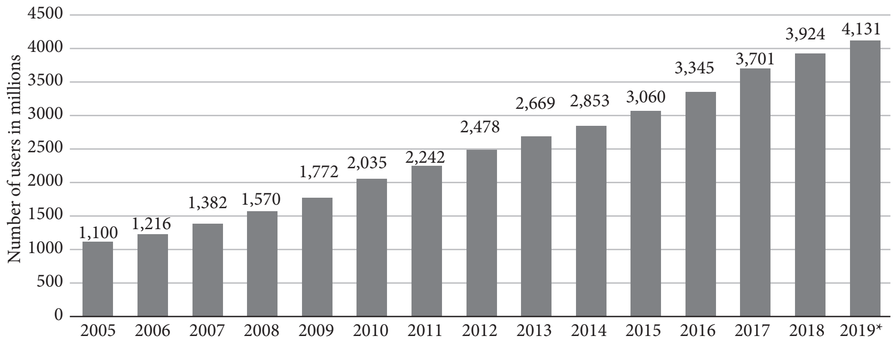


Figure 1.1 Number of Internet users worldwide
Source: https://www.statista.com/statistics/273018/number-of-internet-users-worldwide/

1.1.2 Critics of globalization

Despite the positive developments just described, the public debate on globalization is dominated by critical voices. This applies in particular to the presentation of globalization-related topics in the daily press. In this section, we would like to give two critics an opportunity to lay out their arguments and then analyze them.

Canadian economics professor Michel Chossudovsky has published several books on the subject of globalization criticism and stands out as a leading voice. In his book published in 1997 *The Globalisation of Poverty: Impacts of IMF and World Bank Reforms*, he presents theories about the negative effects of globalization, which are summarized here: On the one hand, Chossudovsky's criticism is directed against the International Monetary Fund (IMF) and World Bank and their structural adjustment programs in developing countries. As he sees it, new loans negotiated in rescheduling proceedings, which are intended for macroeconomic stabilization, actually led to the impoverishment of hundreds of millions of people. These programs were not aimed at economic reconstruction and stable exchange rates, but, on the contrary, were responsible for destabilizing national currencies and ruining the economy as a whole. According to Chossudovsky, something similar happened after the end of the Cold War in the former Eastern Bloc countries: Here, too, the macroeconomic restructuring is supposed to have only served the geopolitical interests of the West. Overall, the economic policies of the international financial organizations increasingly deprived developing countries of the opportunity to build up their own economies. On the contrary, these countries increasingly became reservoirs of natural resources and cheap labor. This led to the further contraction of commodity prices and thus to growing poverty.

In addition to the IMF and the World Bank, Chossudovsky is also very skeptical of the WTO: On the one hand, the policies of the WTO violate international law and legitimize almost criminal trade practices, such as the robbery of intellectual property by multinational companies. For example, the patentability of organisms would weaken the rights of plant breeders in favor of Western biotechnology companies. In addition, Chossudovsky sees the WTO agreements as being contrary to the 1948 Universal Declaration of Human Rights.

Chossudovsky argues that the credit policy of international institutions effectively makes developing countries insolvent. The loans are always linked to political provisos such as liberalization, exacerbating the balance of payments crisis. Project-related loans are rarely granted, thus preventing capital formation wherever the interests of the export industry are not directly impacted. Loans, conversely, are granted on a large scale for world-market imports benefiting industrialized nations. This has the effect of crowding out a wide range of domestic goods. According to Chossudovsky, developing countries are left only with exports to the industrial nations, which leads to fierce competition and, as a consequence, low prices and wage dumping.

Chossudovsky finds examples in the food crisis in Somalia in the 1980s, which had been made worse by the policies of the IMF and the World Bank. The economic reforms that the nomadic peasants were unable to cope with destroyed agricultural production, which led to a dependency on grain imports, which, in turn, prevented self-sufficiency. Chossudovsky contends that the "subsidized beef and dairy products imported (duty free) from the European Union have led to the demise of Africa's pastoral economy" (Chossudovsky, 2003, p. 99).

The Frenchman Thomas Piketty is another prominent economist who takes a critical view of globalization. While Piketty regards globalization as a benefit, he finds that the profit of global trade is not fairly distributed among the various actors. His book *Capital in the Twenty-First Century* published in 2014 addresses the critique of inequality. Piketty sees regulatory shortcomings as the main problem behind the unequal distribution of globalization's gains. Yet, institutions such as the IMF or the World Bank are not in a position to solve these problems. He also argues that the European Union has failed in its task of mitigating inequality (Piketty, 2014). Overall, Piketty advocates closer political and economic cooperation to effectively combat problems such as tax evasion.

In this context, Piketty also recognizes free trade agreements such as the Transatlantic Trade and Investment Partnership (TTIP, see also practice box 1.1: The TTIP Dispute) and Comprehensive Economic and Trade Agreement (CETA) as an opportunity: If free trade were complemented by fiscal-political cooperation between countries, which, for instance, could lead to a joint corporate tax, it would be an effective way of combating abuses. At present, Piketty points out, multinational companies in both the United States and Europe pay less tax than medium-sized companies. Piketty sees tax competition between countries that want to attract multinational companies into the country with the lowest possible corporate taxes as a central problem that can only be solved through political cooperation.

Overall, Piketty argues for a fundamental reorientation of globalization (Piketty, 2016). Only in this way can the greatest challenges of our time—inequality and global warming—be effectively combated. The instruments for this are international agreements, but they should no longer be geared exclusively toward trade liberalization. Rather, these agreements must ensure that global development is oriented in terms of the goals of fairness and sustainability. Specifically, this means that the reduction of trade tariffs must be combined with conditions to effectively tackle tax dumping and the exploitation of natural resources (Piketty, 2016).

Practice box 1.1 The TTIP Dispute—The fear of being flooded with "inedible food"

In the wrangling over the Transatlantic Trade and Investment Partnership (TTIP), the issue of food safety has dominated the reporting in the European and especially German press. As EU consumer protection, environmental and health standards are in most cases stricter than the corresponding US rules, many Europeans feared that harmonizing the regulations in the wake of TTIP implementation would drastically weaken current EU standards. This fear of a "race to the bottom" (Neslen, 2016) became particularly apparent through warnings of being forced to eat allegedly "inedible food," once TTIP opened the EU "floodgates" to American food products (Chan and Crawford, 2017). Europeans' fears of free trade with the United States crystallized in response to debates on "turbo pigs" (pigs treated with growth hormones), "chlorinated chicken" (poultry cleaned with chlorinated water to kill bacteria), and "gene food" (genetically modified food) (Hagelüken, 2014).

“Turbo-pigs”—feed additives and growth-promoting hormones

In the United States, the treatment of livestock with growth-promoting hormones and non-hormonal feed additives (e.g. ractopamine) to accelerate weight gain is a standard practice and the largest part of cattle and pigs produced in US feedlots is treated with either one (Diamand and Schimpf, 2016; Peter, 2015). Currently, this practice largely prevents the import of US beef and pork to EU member states: Most hormones used for cattle treatment have been banned in the EU for decades; ractopamine is prohibited in a total of 160 states, including the EU member states, due to potentially negative effects on the human heart and circulatory system (Diamand and Schimpf, 2016). In their last evaluation in 2009, the European Food Safety Authority (EFSA) concluded that no residue level of ractopamine was low enough to protect even the most vulnerable groups (EFSA, 2009). As a result, the sale of ractopamine-treated meat remains prohibited in the EU. Nonetheless, US lobby groups are calling for the ban on ractopamine to be lifted (National Pork Producers Council, 2016; Peter, 2015).

Pathogen reduction treatments

In meat, germs (especially Salmonella bacteria or Campylobacter) multiply very rapidly after slaughter. To prevent these germs from spreading, after being gutted, meat is subjected to so-called pathogen reduction treatments (PRT), i.e. meat-washing processes to kill bacteria. While the United States authorizes various processes for PRTs, the EU only allows washing with hot water or lactic acid. During TTIP debates, one such treatment in particular gained notoriety: The chemical washing of poultry in water baths containing antimicrobials (chlorine dioxide, acid sodium chlorite, trisodium phosphate, and peroxyacids) (EFSA, 2008) resulting in what the European press called “chlorinated chicken.” In the United States, meat handled in this way is labeled; in the EU the use of chlorine after slaughter and the import of chlorinated meat has been banned since 1997. In principle, after a thorough scientific evaluation (EFSA, 2008), the use of antimicrobials can be considered harmless and permissible. Yet, European consumer advocates still view the issue critically: They fear that the introduction of “chlorinated chickens” will gradually undermine hygienic standards in factory farming. By allowing chlorination after slaughter, standards of hygiene in breeding and husbandry could decline.

“Gene food”—genetically modified organisms (GMOs)

In the United States, genetically modified foods are already commonplace: almost the entire soybean harvest comes from genetically modified crops and more than

Continued

Practice box 1.1 Continued

two-thirds of the processed foods sold in US supermarkets contain genetically modified ingredients.

In contrast, there is strong opposition in the EU to the authorization of GMOs. Many Europeans fear that artificially engineered food or crops could harm human health or the finely balanced ecosystems in ways not known today. Since the EU Commission authorized the member states to block the cultivation and sale of GMOs for reasons beyond public health or environmental concerns, virtually no genetically modified crops, food, or animal feed may be sold in the EU. Currently only one GM plant, MON810 maize, is allowed to be cultivated in the EU. All products containing genetically modified ingredients must also be labeled accordingly. In the United States, however, there is no such obligation (Hagelüken, 2014; Peter, 2015).

Do the Americans also have their doubts?

While strong resistance had emerged among the European population and especially among consumer protection and environmental organizations, few critical voices against TTIP were heard from the United States. This may be due to the fact that the majority of the US-American population had little contact with the content of the negotiations. In a survey, for example, 46 percent of Americans surveyed said they knew too little about TTIP to be able to judge whether the agreement would be good or bad for the United States (compared to 30 percent of the Germans surveyed) (Bluth, 2016, p. 15). Nevertheless, there were also fears on the US side that TTIP would dilute their own quality and safety standards in the food sector or create new trade barriers for US food producers.

One reason for the US food industry to reject TTIP is, for instance, the EU insisting on protecting so-called "geographical indicators" (GIs) for food products. GIs identify an agricultural product that may only be produced in the traditionally associated region of origin. For instance, only sparkling wine produced in the French region of Champagne may be sold under the name "Champagne" in the EU and "Scotch beef" must not come from cattle bred outside of Scotland (Diamand and Schimpf, 2016; Serfati, 2015).

Yet, the United States does not legally recognize GIs and consequentially, American agro-food companies have been producing "feta," "parmesan," or "gorgonzola" for generations. During TTIP negotiations, the EU demand of a ban on sales of US manufactured products under these protected labels clashed with the US standpoint that these names designate "generic products" and thus the EU was only proposing new trade barriers for US food companies (Behsudi, 2015; Diamand and Schimpf, 2016; Serfati, 2015).

Concerning food safety, the regulations for milk products for human consumption have been much stricter in the United States than in the EU since the 1980s and were last tightened in 2014. In particular, products made from unpasteurized milk are considered to be hazardous to health and therefore may not be sold. For this reason, most French raw milk cheeses, such as Camembert, Roquefort, or Brie, are banned from import to the United States (Bonem, 2017; Bushak, 2014; US Food & Drug Administration (FDA), 1987).

Sources:

Behsudi, Adam (2015). U.S. to Europe: Don't Move My Cheese. *Politico*, updated July 21, 2015. Last accessed July 4, 2020 at: https://www.politico.com/story/2015/07/us-to-europe-dont-move-my-cheese-120387

Bluth, Christian (2016). *Attitudes to Global Trade and TTIP in Germany and the United States*. GED Study. Edited by Bertelsmann Stiftung, Gütersloh. Last accessed July 4, 2020 at: https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/NW_Attitudes_global_trade_and_TTIP.pdf

Bonem, Max (2017). Why Americans Don't Get to Eat Delicious Raw Milk Cheese, updated May 24, 2017. Last accessed July 4, 2020 at: https://www.foodandwine.com/lifestyle/why-americans-dont-get-eat-delicious-raw-milk-cheese

Bushak, Lecia (2014). FDA Bans Roquefort, Other French Cheeses Due To Bacteria Levels; Though They're Virtually Harmless. *Consumer News*, updated September 6, 2014. Last accessed July 4, 2020 at: https://www.medicaldaily.com/fda-bans-roquefort-other-french-cheeses-due-bacteria-levels-though-theyre-virtually-301638

Chan, Alexsia T. and Crawford, Beverly K. (2017). The Puzzle of Public Opposition to TTIP in Germany. *Business and Politics*, 19(4), 683–708.

Diamand, Emily and Schimpf, Mute (2016). *Schlechter Deal für EU—Bäuerinnen und Bauern. Gefahren für die Europäische Landwirtschafts durch TTIP*. Edited by Bund für Umwelt und Naturschutz Deutschland e.V.—Friends of the Earth Germany (BUND), Friends of the Earth Europe, Berlin. Last accessed July 4, 2020 at: https://web.archive.org/web/20160713105629/http:/www.bund.net/fileadmin/bundnet/pdfs/umweltschutz_international/160711_bund_ttip_studie_agrar.pdf

European Food Safety Authority (EFSA) (2008). EFSA Opinion on Four Substances Used to Decontaminate Poultry Carcasses: Assessment of Effects on Bacterial Tolerance and Antimicrobial Resistance. Last accessed July 4, 2020 at: https://www.efsa.europa.eu/en/press/news/080402

European Food Safety Authority (EFSA) (2009). Scientific Opinion: Safety Evaluation of Ractopamine. Scientific Opinion of the Panel on Additives and Products or Substances used in Animal Feed 1049, pp. 1–52. Last accessed July 4, 2020 at: https://ec.europa.eu/food/sites/food/files/safety/docs/codex_ccrdvf_18_agenda_item2-efsa_en.pdf

Hagelüken, Alexander (2014). Geplantes EU-Freihandelsabkommen mit den USA. Tempolimit für Turboschweine. *Süddeutsche Zeitung*, 29 April, 2014. Last accessed July 4, 2020 at: https://www.sueddeutsche.de/wirtschaft/geplantes-eu-freihandelsabkommen-mit-den-usa-tempolimit-fuer-turboschweine-1.1945592-0

National Pork Producers Council (2016). Comments on the "Transatlantic Trade and Investment Partnership." Last accessed July 4, 2020 at: https://nppc.org/wp-content/uploads/2016/03/Trans-Atlantic-Trade-Negotiations-Comments-to-USTR-on-TTIP-Negotiations.pdf

Continued

Practice box 1.1 Continued

Neslen, Arthur (2016). Leaked TTIP Documents Cast Doubt on EU–US Trade Deal, updated May 1, 2016. Last accessed July 4, 2020 at: https://www.theguardian.com/business/2016/may/01/leaked-ttip-documents-cast-doubt-on-eu-us-trade-deal

Peter, Laurence (2015). TTIP Talks: Food Fights Block EU–US Trade Deal. BBC News, updated June 10, 2015. Last accessed July 4, 2020 at: https://www.bbc.com/news/world-europe-33055665

Serfati, Claude (2015). The Transatlantic Trade and Investment Partnership (TTIP): A Controversial Agreement and Dangerous for Workers. European Trade Union Institute (ETUI), Brussels (ETUI Working Paper 2015.07).

US Food & Drug Administration (FDA) (1987). 21CFR1240.61 "Mandatory Pasteurization for all Milk and Milk Products in Final Package Form Intended for Direct Human Consumption," revised April 1, 2019. Last accessed July 4, 2020 at: https://www.accessdata.fda.gov/scripts/cdrh/cfdocs/cfcfr/CFRSearch.cfm?fr= 1240.61&SearchTerm=pasteurization

1.2 The implications of globalization for business ethics

1.2.1 Value pluralism and its challenge for virtue ethics

Marshall McLuhan coined the term "global village" as a result of technological interconnectedness. He assumed that cultural differences would inevitably lead to miscommunications: "The global village absolutely ensures maximal disagreement in all points. It never occurred to me that uniformity and tranquility were the properties of the global" (McLuhan cited in Stearn, 1968, p. 272). Geert Hofstede (1991) has emphasized the need for culture-sensitive communication and his research remains highly influential as it has been cited more than 10,000 times each year since 2012 (Google Scholar 2020). He considers cultural value differences along six dimensions measured in the form of indices. For instance, Hofstede's Power distance index captures the extent to which the less powerful members of society accept that power is distributed unequally. The scale reaches from 120 to 1. Higher degrees on this scale imply that the people accept hierarchies without questioning them, while lower degrees on the scale imply that people question authority and strive to distribute power equally. Malaysia (104), Guatemala and Panama (both 95) reach the highest values, whereas Denmark (18), Israel (13), and Austria (11) reach the lowest values (Clearly Cultural, 2009).

The substantial disagreement in ethical values across the globe has recently been impressively documented by a worldwide survey experiment on ethical dilemmas that arise from autonomous vehicles in cases of unavoidable accidents: the so-called Moral Machine experiment (Awad et al., 2018). The authors of the study find substantial cross-cultural ethical variations and uncover three major clusters of countries. They also show that these differences correlate with modern institutions and deep cultural traits. The distinction between individualistic and collectivistic cultures, another dimension used by Hofstede, reveals substantial differences in ethical values. Subjects from individualistic cultures, which put on emphasis on the distinctive value of each individual, tend to have a stronger preference for saving larger numbers of people in such ethical dilemmas. Subjects from collectivistic cultures, which emphasize respect for older community members, show a weaker preference for saving young over older people. The mean z-scores in Figure 1.2 indicate different preferences for certain attributes. For instance, higher mean z-scores for the attribute of "sparing higher status" express a preference for saving people with higher status over those with lower status in an unavoidable accident where not everyone can be saved. Higher z-scores for "sparing females" imply that people tend to prefer that women are saved over men. The figure reveals striking differences in ethical values. The Western cluster clearly has a strong preference for inaction, i.e. a preference to not intervene in the course of events. The Eastern cluster strongly prefers to spare the more vulnerable pedestrians over car occupants and to save the lawful at the expense of traffic rule violators. The Southern cluster strongly prefers to save higher status people and females. The substantial differences suggest that the respective countries would choose rather different laws to regulate autonomous cars in their jurisdictions.

The diversity of moral values exhibited around the globe poses substantial challenges for transnational actors like multinational companies. It is an enormous challenge to find some plausible common ground for a

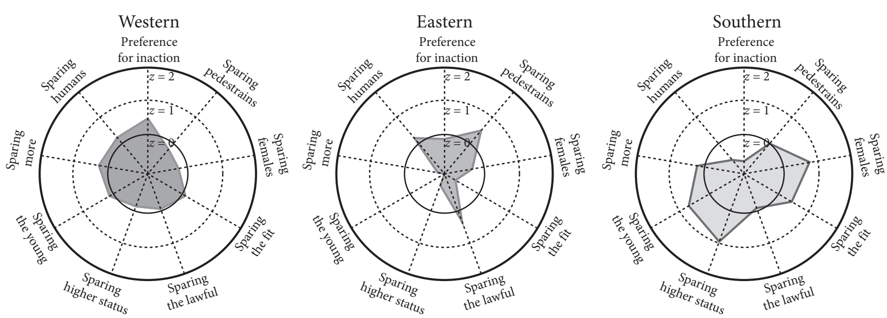


Figure 1.2 Ethical preferences for autonomous cars across three clusters of countries
Source: Awad et al. (2018, p. 62)

meaningful ethical dialog if a common denominator in terms of values does not exist. Joshua Greene (2014) has placed an emphasis on the ambiguous role of moral practices in a globalized world. While morals can serve as a social glue within certain cultural groups, they may induce substantial conflicts between groups that disagree about essential moral questions. The cultural borders need not necessarily be determined by the borders of geographical regions but can also run within countries. Catholics and non-Catholics, for instance, within the United States hold very different views on gay marriage and birth control. Greene notes that it is not surprising that cultural moral differences are strongest when sex and death at the margins of life are affected, because these are "the gas pedals and brakes of tribal growth" (Greene, 2014, p. 11). Appealing to virtues might be effective in culturally coherent groups but it is increasingly difficult in a secular and globalized world where people have diverging ideas of what defines a virtuous person. According to order ethics, the fundamental problem of a plurality of moral values in modern societies requires a normative criterion that relies on consensus seeking. The key idea of order ethics is to look out for strategies on the level of rules that enable win-win solutions for all affected parties.

1.2.2 Globalization from the point of view of order ethics

Order ethics understands the underlying problem of globalization as follows: In the course of opening new markets far beyond the borders of national jurisdictions, extra-legal spaces are created. The activities of global players, who have different locations around the world and trade in many countries, simply cannot be contained in a single legal area, especially since laws and regulations vary greatly from country to country. Further regulatory gaps exist in states where there are major deficits in the rule of law and where applicable law therefore also does not apply. Such states, however, are also involved in international trade, which further aggravates the situation. These major differences affect not only areas such as commercial law and tax policy, but also fundamental issues such as occupational safety, environmental regulations, or equality, where standards in the different countries often vary considerably.

These emerging legal loopholes give rise to numerous problems. To name just a few, it can give rise to tax avoidance by internationally operating companies, standards that are difficult to verify in the widely ramified supply chains, or wage levels perceived as "wage dumping" in countries with weak rule of law. The search for solutions to the aforementioned problems raises the question of whether a world government might be an appropriate means. In this context, Otfried Höffe (1999/2002) contemplates the creation of a world republic that establishes a democratic framework. It should be based, on the one hand, on state institutions legitimized by a consensus of the citizens, and, on the other hand, on the morals of all citizens, who must, among other things, have a sense of justice and a sense of community. According to Höffe, the tasks of a world republic would be to establish peace and law through a global jurisdiction, to guarantee the self-determination of peoples through humanitarian interventions, and to establish global trade law consistent with social and ecological standards through a global antitrust authority.

There is little doubt that institutions with such reach could solve many of the problems described above. But their creation is rather improbable: First of all, the concept entails many prerequisites, for it is not justified in terms of utility theory (a utility theory justification would be that all parties benefit in the long term from the creation of a world government), but rather as a moral imperative which depends on the morality of the citizens (Lütge, 2015). This therefore precludes a meaningful connection to the empirical sciences. At the same time, it is essential for successful institutions to be able to recognize and react to changes in constantly shifting circumstances. Such adaptability, however, requires analyses and findings from the different empirical sciences. Moreover, the creation of a world government in the foreseeable future is not very realistic for political reasons.

The question thus remains how—in view of the positive and negative effects of globalization—an institutional order (even if not a world government) can be established where the win-win potentials of global networking may be realized. Approaches to this kind of global governance already exist, namely, in the form of institutions that the above-mentioned authors strongly criticize: The WTO, the IMF, and the World Bank. The aim of global governance is to create institutional frameworks that promote collaborative solutions at all levels (Ehret et al., 2007). Contrary to widespread belief, the negative effects of globalization are not caused by too much market power, but too little. As an example, Ehret et al. cite a protectionist trade policy in those countries where world trade would make specific sectors of trade unprofitable. To avoid the closure of these sectors and the associated (temporary) job losses, these countries tried to sell their core commodities on the world market, while simultaneously isolating less profitable industries from the world market. This walling-off—often pursued by the industrialized nations—is happening at the expense of the emerging countries, which become globalization losers in the process.

Such inequalities caused by protectionism give rise to the problem of legitimacy for globalization, which ultimately depends on the consent of the people. Consent, however, can only be ensured here in the long term if the negative effects of globalization are combated through institutional intervention.

1.3 Case studies

The complexity and diversity of the aspects of globalization make it especially challenging to elucidate the proposed solutions. We will therefore take this opportunity to address two central problems, which are often regarded as consequences of globalization: The problem of child labor in developing countries and the sustainability problem in the global transport of foodstuffs. In doing so, it should become clear that problems posed or aggravated by globalization can only be tackled in structural terms.

1.3.1 The problem of child labor in developing countries

The International Labor Organization (ILO) defines child labor as the economic activity of children under 15 years of age. Child labor can be further divided into three categories, children in employment (1), child labor (2), and hazardous work and other worst forms of children labor (3). The first and broadest category is work in informal and formal markets within or outside the family, with or without pay. Child labor in the strict sense (2) excludes forms of light child labor. Finally, hazardous child labor (3) refers to work that endangers the welfare of the child physically or mentally, including serious forms such as physical or sexual exploitation, the use of child soldiers, or abuse for criminal activities.

According to the ILO, around 152 million children worked in 2016, almost half of them (73 million) in hazardous areas of activity. Africa has both the highest number and the highest proportion of working children (72 million, or 19.6 percent of all children). Together, the Africa region and the Asia and the Pacific regions account for almost 9 out of every 10 children in child labor. Worldwide, most children work in agriculture (108 million), 26 million in services, and 18 million in industry (International Labour Organization, 2017).

Not only is the ILO combating all exploitative forms of child labor under the umbrella of the UN, but there are also many non-governmental organizations such as Save the Children or Terre des hommes. The UN itself also takes the view that child labor should generally be banned, with the justification that child labor is dangerous and unnecessary. A total of 193 countries have committed themselves to the UN development goals, including the abolition of child labor worldwide by 2025 (United Nations, 2020).

In the meantime, the view that a complete abolition of child labor is desirable has changed in many scientific circles. In 2016, a group of international scientists criticized the UN's general ban on child labor in a letter to the British newspaper *The Observer* (McVeigh, 2016). They argue that the UN relies on outdated facts and ignores the positive effects of some forms of child labor. Child labor, for example, does not generally prevent children from attending school. Light forms of labor can even support it, for example, if it helps the child to afford his or her schoolbooks.

In their article "The Economics of Child Labor," the economists Kaushik Basu and Van Pham (1998) put forward two arguments against a general ban on child labor: Child labor is a phenomenon of the poorest of the poor, and even in the most deprived areas, parents send their children to work only if it is essential for the family's survival. There is therefore no better alternative here (for example: the child goes to school), which could be enforced by a ban on child labor. Even import bans on goods whose production involved child labor does not lead to the desired improvements for the affected children. On the contrary, a ban could drive children out of industrial work into even worse fields of activity such as prostitution. As an example, Basu and Van refer to the so-called "Harkin's Bill," named after US Senator Tom Harkin, who introduced the Child Labor Deterrence Act to the US Congress in 1992. The purpose of this law was to prohibit the import of products created by child labor into the United States. Even before the law came into effect, numerous clothing manufacturers in Bangladesh fired children in order not to jeopardize their trade agreements with the United States. UNICEF investigations, however, show that the children who were dismissed ended up in much more harmful activities, such as working in quarries or even in prostitution.

Other experts argue against a general ban on child labor, arguing that such bans ignore the reality of many countries and make working children even more vulnerable to exploitation (Liebel et al., 2012). An example of not generally prohibiting child labor, but regulating it in the interests of children, can be found in Bolivia (Liebel, 2014): In contrast to the usual prohibition on child labor as a whole, the law that came into force in 2014 (whose drafting incidentally involved children themselves) emphasizes the right of children to be protected at work. The law also takes into account the fact that among the indigenous peoples of Bolivia children are traditionally involved in the work. To protect children, however, the law provides for protective mechanisms and support measures on the part of the authorities, which would not be possible with a general ban. It is precisely through the inclusion of children in the drafting of the law that children are recognized as social subjects and not regarded as social cases.

1.3.2 The global transport of food

One of the most visible signs of globalization is the increased supply of food. While icons of the Western food industry such as Coca-Cola or McDonald's or Burger King hamburgers are spreading all over the globe, exotic foods are becoming more and more a fixed part of the goods offered in Western supermarkets. Overall, world trade in agricultural products and food grew significantly from the early 1980s to the late 2010s: World trade in cereals more than doubled from roughly 200 million tons in 1980 to over 400 million tons in 2019. OECD and FAO forecasts project another increase to 517 million tons by 2029 (FAO, 1981; OECD/FAO, 2020).

But the flow of foodstuffs worldwide not only led to falling costs for food and more variety on people's plates, but also to fundamental criticism of global food transport. This gave way to a regionalism movement. For example, locally grown products[1] have become increasingly popular in the United Kingdom: In 2017, 33 percent of the people surveyed said they buy locally produced food "always" or "very frequently," while only 2 percent reported never purchasing local food Statista, 2017). Labels like "Our land" ("Unser Land")—which has been selling regional products within various districts in Bavaria since 1994—and identifiers like the "Regional window" ("Regionalfenster") introduced in Germany in 2014 make it easier for consumers to orient themselves.

Consumers cite freshness, the desire to support the local economy, and taste as the three most important criteria for consuming locally grown food (Food Marketing Institute, 2011). The products at weekly markets and from organic farmers enjoy the most trust. The increasing popularity of regional products can be interpreted as the result of growing uncertainty caused by the non-transparent food trade worldwide. By contrast, short, regionally anchored value chains create a subjective level of security (Penker and Schlich, 2015).

In public opinion, the consumption of regional products is often seen at the same time as a decision for more sustainability. Products from the region appear to be less harmful to the environment than products imported from overseas, for example. This belief is fueled by the avoidance of long transport routes, which are not part of regional sales. Nevertheless, research has shown that the general formula “regional = sustainable” does not apply to agricultural products and foodstuffs. The theory of ecology of scale by Elmar Schlich (Schlich and Fleissner, 2005) plays a major role here. This states that, besides distance to market, many other factors determine the environmental friendliness of a product. According to Schlich, the greatest influence is the efficiency of the means of production and transport, and here the size of the company is decisive.

This also applies to the production and transport of meat: Schlich and his colleagues have calculated the energy consumption of lamb produced in New Zealand and imported into Europe (Schlich and Fleissner, 2005). About 60 percent of the lamb consumed in Germany comes from New Zealand. The results of the study show that due to extensive grazing in large farms, New Zealand lamb can be produced with very low energy consumption. In comparison, lamb breeding in Germany takes place in much smaller companies and is much more energy-intensive: Sheep are housed for half the year in a barn due to weather conditions and have to be fed, resulting in more intensive husbandry. These differences in the energy balance are also not offset by transport emissions: New Zealand lamb is shipped frozen to Hamburg within 30 days. The ship examined at that time (the *New Zealand Pacific*[2]) transports a total of 1,403 containers containing various goods from New Zealand, including 2,066,100 kilograms of lamb for the German market (Schlich and Fleissner, 2005). Overall, Schlich and Fleissner conclude that the energy balance of lamb depends, on the one hand, on the size of the farm (whereby larger farms produce more energy-efficiently) and that, secondly, transport by sea consumes less energy than local transport and distribution. Schlich draws a similar conclusion for the import of Argentine beef to Europe (Schlich et al., 2009) and for the import of orange juice concentrate from Brazil (Schlich and Fleissner, 2005).

Schlich refers to another striking result: 40 percent of the climate impact of a process chain is incurred in the last few kilometers of trade to the end user (Schlich, 2012). The energy balance is particularly negative if the consumer takes special routes to get to a retailer for small quantities of food—for example, if the consumer drives her car to the farmstead or the butcher shop in order to buy as locally as possible.

These findings show that the purchase of regional products does not necessarily support the lowest energy production method. They also show that, contrary to what many consumers think, global food markets as a whole also allow for new ways of energy-efficient production.

Notes

1. What “regionally” or “locally” exactly means is not clearly defined. In the narrow sense, regional or local can mean that food is distributed within a certain geographic distance from the producer. But products from the same federal state or cultural region can also be considered regional.
2. Built in 1978, in operation until 2012 (http://www.shipspotting.com/gallery/photo.ph-p?lid=1498992).

References to Chapter 1

Awad, Edmond, Dsouza, Sohan, Kim, Richard, Schulz, Jonathan, Henrich, Joseph, Shariff, Azim, Bonnefon, Jean-François, and Rahwan, Iyad (2018). The Moral Machine Experiment. *Nature*, 563, 59–64.

Basu, Caushik and Van, Pham Hoang (1998). The Economics of Child Labor. *American Economic Review*, 88(3), 412–27.

BP (2019). Oil Consumption—Barrels [Data file]. *BP Statistical Review of World Energy—all data, 1965–2018*. London: BP plc. Last accessed May 4, 2020 at: http://www.bp.com/statisticalreview

Chepkemoi, Joyce (2019). The World’s Largest Fast Food Restaurant Chains. *WorldAtlas*. Last accessed April 30, 2020 at: https://www.worldatlas.com/articles/the-world-s-largest-fast-food-restaurant-chains.html/

Chomsky, Noam (2006). Globalization. Noam Chomsky interviewed by Maria Ahmed. Last accessed February 28, 2017 at: https://chomsky.info/2006/

Chossudovsky, Michel (1997). *The Globalisation of Poverty: Impacts of IMF and World Bank Reforms*. London: Zed Books.

Chossudovsky, Michel (2003). *The Globalization of Poverty and the New World Order*, 2nd edition. Pincourt, Quebec: Global Research.

Clearly Cultural (2009). Power Distance Index. Last accessed July 21, 2020 at: https://clearlycultural.com/geert-hofstede-cultural-dimensions/power-distance-index/

Currie, Janice K. and Newson, Janice (Eds.) (1998). *Universities and Globalization: Critical Perspectives*. Thousand Oaks, CA: Sage.

Ehret, Michael, Haase, Michaela, and Kaluza, Martin (2007). Concepts of Globalisation: The Institutional Prerequisites for the Integration of World Markets. In: K. Homann, P. Koslowski, and C. Lütge (Eds.), *Globalisation and Business Ethics*. Aldershot: Ashgate.

Fifka, Matthias (2013). Globalization. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Food and Agriculture Organization of the United Nations (FAO) (1981). *The State of Food and Agricultural 1980. World review. Marine fisheries in the new era of national jurisdiction*. Rome: FAO (FAO agriculture series, 12). Last accessed August 6, 2020 at: http://www.fao.org/3/a-ap660e.pdf

Food Marketing Institute (2011). *U.S. Grocery Shopper Trends*. Arlington, VA: Food Marketing Institute.

Giddens, Anthony (1999). *Runaway World: How Globalization Is Reshaping Our Lives*. New York: Routledge.

Greene, Joshua (2014). *Moral Tribes: Emotion, Reason, and the Gap Between Us and Them*. London: Penguin.

Höffe, Otfried (1999/2002). *Demokratie im Zeitalter der Globalisierung*. Munich: Beck.

Hofstede, Geert (1991). *Cultures and Organizations: Software of the Mind*. London: McGraw-Hill.

International Energy Agency (2020). Daily Demand for Crude Oil Worldwide from 2006 to 2020 (in million barrels)* [Data file]. *Statista*. Last accessed May 4, 2020 at: https://www-statista-com.eaccess.ub.tum.de/statistics/271823/daily-global-crude-oil-demand-since-2006/

International Labour Organization (2017). Global Estimates of Child Labour. Results and Trends, 2012–2016. Last accessed April 17, 2020 at: https://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/documents/publication/wcms_575499.pdf

Liebel, Manfred (2014). Protecting the Rights of Working Children Instead of Banning Child Labour: Bolivia Tries a New Legislative Approach. Last accessed April 22, 2020 at: https://www.europarl.europa.eu/meetdocs/2014_2019/documents/deve/dv/liebel_policy_paper_bolivia_/liebel_policy_paper_bolivia_en.pdf

Liebel, Manfred, Meade, Philip, and Saadi, Iven (2012). Brauchen Kinder ein Recht zu arbeiten? *Kindheitskonzepte und Kinderarbeit. Aus Politik und Zeitgeschichte*, 62(43), 35–41.

Lütge, Christoph (2015). *Order Ethics or Moral Surplus: What Holds a Society Together?* Lanham, MD: Lexington Books.

McVeigh, Tracy (2016). UN's Ban on Child Labour Is a 'Damaging Mistake'. *The Observer*, December 18, 2016. Last accessed April 17, 2020 at: https://www.theguardian.com/world/2016/dec/18/child-labour-un-ban-damaging-mistake

Organisation for Economic Co-operation and Development/Food and Agriculture Organization of the United Nations (OECD/FAO) (2020). *OECD-FAO Agricultural Outlook 2020–2029*. Paris: OECD Publishing. Last accessed August 6, 2020 at: https://doi.org/10.1787/1112c23b-en

Penker, Marianne and Schlich, Elmar (2015). Nachhaltigkeit durch Kauf regionaler Lebensmittel. *Forum Wirtschaftsethik*, April 20, 2015. Last accessed April 22, 2020 at: https://www.forum-wirtschaftsethik.de/nachhaltigkeit-durch-regionalitaet-pro-und-contra/

Piketty, Thomas (2014). *Capital in the Twenty-First Century*. Cambridge, MA: Harvard University Press.

Piketty, Thomas (2016). We Must Rethink Globalization, or Trumpism Will Prevail. *The Guardian*, November 16, 2016. Last accessed April 22, 2020 at: https://www.theguardian.com/commentisfree/2016/nov/16/globalization-trump-inequality-thomas-piketty

Schlich, Elmar (2012). Regionalität—beliebt oder beliebig? Zwischenruf. *Ernährung im Fokus*, 07–08 (2012) S. 237. Last accessed April 30, 2020 at: https://www.forum-wirtschaftsethik.de/nachhaltigkeit-durch-regionalitaet-pro-und-contra/

Schlich, Elmar and Fleissner, Ulla (2005). The Ecology of Scale: Assessment of Regional Energy Turnover and Comparison with Global Food. *The International Journal of Life Cycle Assessment*, 10(3), 219–23.

Schlich, Elmar, Hardtert, Bettina, and Krause, Frank (2009). Beef from the Ecology of Scale Perspective. Regional Beef Compared to Global Provenance: From Stable to Point of Sale!—Energy Use and Carbon Dioxide Release of Entire Supply Chains. Last accessed April 30, 2020 at: https://www.fleischwirtschaft.de/service/fleischwirtschaft/abstracts/Fleischwirtschaft+89/Rindfleisch+aus+Sicht+der+Ecology+of+Scale

Statista (2017). How Often Do You Buy Locally Produced Food When Buying Groceries? [Graph]. *Statista*. Last accessed May 4, 2020 at: https://www.statista.com/statistics/681104/frequency-of-buying-local-food-united-kingdom-uk/

Stearn, Gerald E. (Ed.) (1968). *McLuhan Hot & Cool: A Primer for the Understanding of McLuhan & a Critical Symposium with a Rebuttal by McLuhan*. London: Penguin.

United Nations (2020). Promote Inclusive and Sustainable Economic Growth, Employment and Decent Work for All. Last accessed August 6, 2020 at: http://www.un.org/sustainable development/economic-growth/

United Nations Conference on Trade and Development (UNCTAD) (2019). *Handbook of Statistics 2019*. New York: United Nations Publications.

Wallerstein, Immanuel (2000). Globalization or the Age of Transition? A Long-Term View of the Trajectory of the World System. *International Sociology*, 15(2), 251–67.

World Bank (2016). CO_2 Emissions (kt) [Data file]. *World Development Indicators*. Washington, DC: The World Bank Group. Last accessed May 4, 2020 at: https://data.worldbank.org/indicator/EN.ATM.CO2E.KT

World Bank (2018). *Poverty and Shared Prosperity 2018: Piecing Together the Poverty Puzzle*. Washington, DC: World Bank. Last accessed April 22, 2020 at: https://openknowledge.worldbank.org/bitstream/handle/10986/30418/9781464813306.pdf

World Bank (2019a). Classifying Countries by Income. Last accessed August 5, 2020 at: https://datatopics.worldbank.org/world-development-indicators/stories/the-classification-of-countries-by-income.html

World Bank (2019b). Trade (% of GDP) [Data file]. *World Development Indicators*. Washington, DC: The World Bank Group. Last accessed May 4, 2020 at: https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS

2
Basic concepts

Selected learning objectives

After reading this chapter, you will be able to:

- understand the importance of human interactions for business ethics
- distinguish ethics and morality and to interpret business ethics as ethics with an economic method
- differentiate the two basic conceptions of business ethics, dualism and monism.

Chapter overview

2.1 Business ethics problems as interaction problems

Try to picture Robinson Crusoe on his island. In his daily struggle for survival, procuring resources has priority. At the same time, Robinson is restricted to what the island can offer and to what he can acquire through his own labor. His biggest problem is therefore scarcity: Where will he get his next meal from? Or how will he store rainwater for arid spells or secure a shelter? The object of observation here is the specific activity of Robinson. He is both producer and consumer. One question about this "Robinson economics," for example, might concern the effectiveness of his procurement measures. However, scarcity does not become an interaction problem and thus an economic problem in the true sense of the word until Friday comes

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).

DOI: 10.1093/oso/9780198864776.003.0003

into play. With the arrival of a second person, scarcity becomes a social problem, because now two individuals are competing for limited resources, such as food, drinking water, or shelter (Homann and Suchanek, 2005).

This situation already contains the two basic elements of business ethical problems: Here, at least two actors find themselves in an environment characterized by scarcity—and that leads to conflicts. Thus, the focus of consideration of ethical questions in business is not only on the action of an individual, but also on the *interaction*. Only when at least two actors are involved do individual problems become social, that is, societally relevant, problems. In other words, business ethics becomes important once Friday appears on the island.

What is Robinson to do? He has several options: He can fight for scarce resources like the available fruits or the collected rainwater and defend them against Friday. This undertaking is risky, however, for Robinson would run the risk of losing the battle over resources or losing his capacity to procure them by taking defensive measures. He would be worse off either way. According to the commandment of charity, he could also share his stocks. In this case, however, it is unlikely that either he or Friday would be satiated. There is another, third way: He can decide to cooperate. Of course, that is no easy task. Robinson and Friday not only have common interests, but also those that are in conflict with each other. This problem and the associated exploitability of services in interdependent relationships will be discussed in detail in Chapter 3.

2.1.1 Share or multiply?

If we assume for the moment that Robinson and Friday succeed in working together, then the now social *problem of scarcity* can be solved. Now cooperation gains can be achieved, for example with the increasing yields that come from fishing together. The available resources (e.g. the catch of a day) still have to be shared, but since the cooperation enables an increase in the total quantity, both can be satiated and are probably even able to develop new sources of food together which Robinson could not have achieved on his own. As a result, Robinson ends up being materially better off than he was before in his loneliness.

This fictional realization of cooperation gains provides an indication of how to outline the subject of business ethics: If you have a resource in which demand exceeds supply, you can approach the problem in two ways: You can view the existing quantity of goods as given and then think about how best to divide up this cake. If the decisive criterion is distribution based on rules that aim at the most equitable result possible (whatever one wants to understand by this), then one speaks of distributive justice. It concerns results, not rules. The view that distributional issues are treated independently of questions of production is often found in ethical discourses. Scarcity itself is not considered and persists, since the situation is structurally characterized by the fact that the demand for the good exceeds the respective supply.

There is a second way to deal with the problem of scarcity. You can try to improve the goods quantitatively or qualitatively in order to satisfy more demand than before. If the sought-after commodity is a raw material, for example, this can be achieved through improved mining possibilities or new technologies that enable more an efficient and thus more economical use of the raw material. Even the workforce in a specific field may be in short supply: Here, for example, educational offerings and retraining programs can be increased. So now it is no longer a matter of distribution, but of allocation, that is how the scarce resource (labor, raw materials, capital, etc.) needed to produce a good can be used in the best possible way. At the same time, the question arises as to what scarce production factors should be distributed and used to satisfy which needs. One speaks here of the allocation problem. The point of view, which concentrates primarily on allocation issues, is often found in economics.

From the point of view of business ethics, production and distribution should be recognized as interdependent and therefore only discussed simultaneously. This is because when the "cake," i.e. the product to be produced, is distributed differently, its size also changes. This interdependence is created by the incentives that every redistribution emanates: The actors in a market economy play their part in production in anticipation of a certain share of the total product. The motivation and thus the production performance can be maintained only if these expectations are not continuously disappointed. On the one hand, it is therefore necessary to try to make the allocation of the production factors required to produce a desired good as efficient as possible so that the total quantity of the good increases. On the other hand, it is important to uphold the incentive mechanisms for production. This happens through correctly calibrated redistribution, since both too little and too much distribution leads to productivity losses, causing the cake to shrink again.

This is also evident at the aggregated level: In a market economy with social welfare characteristics, redistributions are made through the levying of taxes and social security contributions and the payment of social benefits.

One of the core questions of economic policy has always related to what criteria (performance criteria, etc.) these redistributions should be based on: Which combination of produced goods and their distribution leading to maximum productivity must be balanced in a political process by trial and error. Here, too, (experimental) economic research can provide insights into how unwanted effects, such as free riding, can be prevented by way of institutional design. And what applies to the production of goods in demand also applies to the redistribution at the state level: If you want to distribute a cake to as many people as possible and in the largest possible pieces, you also have to think about how to make the cake so that it is as big as possible.

2.1.2 Individual virtues and counterproductive results

Let us return to the lonely island: Let us assume that Robinson, as an ethically educated humanist or a good Christian, asked himself the question "What should I do?," and he then answered himself by choosing the option of simply giving up half of his stocks to Friday. No doubt, this would be an act of the highest virtue, but it would lead to a counterproductive outcome: Neither one would be satiated. This clearly demonstrates the limits of individual-moral action. The moral philosopher and founder of the political economy, Adam Smith (1723–1790), recognized this in 1776 in his work *Wealth of Nations*. In the following famous quote, Smith declares his support for a renunciation of individual moral postulates of action: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages" (Smith, 2007, pp. 9–10). Thus, there is a decoupling of motive and result, according to which morality is interpreted as an unintended result of intentional action. Consequently, the solution of ethical economic problems must not be based on actions and their motives, but rather on the conditions under which they are carried out.

In keeping with Smith's theory, business ethics starts where individual virtuous behavior cannot solve the problem. Business ethics recognizes the structures and interdependencies underlying these social issues. In addition, in an increasingly globalized world, the degree of complexity of economic relations is constantly increasing. The problems are thus also marked by the interdependence of many actors. Economic ethical problems are therefore, in their nature, systematically interaction problems and interdependence problems.

2.2 Ethics and economics—definitions and methodological deductions

Before the theoretical concepts underlying twenty-first century business ethics are dealt with, it is necessary to analyze the conceptual foundations.

2.2.1 Definition of ethics

In common speech, the terms "ethics" and "morality," or the adjectives "ethical" and "moral" are used synonymously. Strictly speaking, however, morality refers to the complex of rules and norms that determine or are supposed to determine people's actions, i.e. the very subject itself, whereas *ethics* refers to the scientific theory of morality (Homann and Lütge, 2013). Etymologically, the word ethics goes back to the ancient Greek "ἔθος" (ethos). This originally referred to the place of dwelling, location, horse stable, but then also habit, custom, convention ("ἔθος" = character, sense, convention, custom, habit). Cicero translated the Greek term into Latin with "mores" (ethos, customs), from which our modern concept of morality is derived. Ethics is the subject matter of philosophy, which was classically delineated by Immanuel Kant (1724–1804) with the question "What should I do?"

Basically, ethics can be defined as the analysis of human actions from the perspective of "good" and "evil," or more precisely of "morally correct" and "morally wrong." If ethics concerns which actions and norms are morally correct or wrong, one then speaks of normative or prescriptive ethics. Normative ethics always demands consent and compliance. Different types of normative ethics make judgments about actions on the basis of different considerations: When actions as such are judged, one speaks of behavioral ethics. If the realization of a goal considered morally right is paramount, one speaks of a teleological ethics (τέλος = the goal). In ethics of ultimate ends, the individual action is evaluated on the basis of the intentions and motives of the actor. If the effects of an action are decisive, it is called consequentialist ethics. A special form of consequentialist ethics is utilitarian ethics, whose criterion is the greatest possible benefit for the greatest possible number of individuals (see Section 4.1).

Ethics does not necessarily have to be normative: Like ethnology or moral psychology, it deals with the description and explanation of regulatory systems and is therefore descriptive. At the same time, descriptive ethics is always an essential part of normative ethics, since the evaluation of actions is impossible without descriptive elements.

However, if you take a step back to look at ethics from a higher point of view, you are conducting metaethics. Metaethics as second-order theory deals with the metaphysical, epistemological, semantic, and psychological presuppositions of ethics and the different forms of moral justification (Sayre-McCord, 2012). For example, it deals with the question of what the attribute "morally good" means or whether ethical judgments are culturally relative. In contrast to normative ethics, however, metaethics does not make any substantive statements about the moral quality of actions.

2.2.2 Definition of economics

Analogous to the conceptual pair of morality and ethics, economy in turn refers to the object of observation and economics refers to the theoretical study of the economy. The English word "economy" derives from the ancient Greek word *οἰκονόμος*, which means "head of the household" or "landlord." According to Lionel Robbins (1898–1984), economy can be defined as the sum of human behavior, a relationship between goals and scarce resources that can be used in different ways.

Today, economics is the theory or science of the economy. The subject matter, however, has expanded considerably in recent decades. The focus of economic deliberations is no longer merely the traditional (money) economy but has been extended to include numerous human activities which also have economic dimensions. Examples include phenomena such as culture, education, health, family, political office, elections, or addictive behavior. This extension takes account of definitions that do not focus on the subject itself, but rather on specific problems or questions. Gary S. Becker (1930–2014) is central to such an understanding of economics. One could then formulate the following definition of economics:

Economics deals with the explanation and design of the conditions and consequences of interactions on the basis of individual benefit/disadvantage calculations.

2.2.3 Definition of business ethics: ethics from an economic perspective

How is business ethics defined? On the one hand, it can be understood to a certain extent as a kind of hyphenated ethics in a combination with the above-mentioned terms, ethics and economics. According to this understanding, business ethics is an ethics *for* the business, just as medical ethics, bioethics, or media ethics investigate area-specific problems and give recommendations for action. This definition is based on a traditional understanding of economics.

However, one can also understand business ethics—in recourse to a more Becker-like definition—as ethics with an economic method. This viewpoint opens up the possibility of reconstructing the object of morality itself in economic terms. Business ethics is then general ethics, however, that deals with the question of implementing standards, i.e. implementing rules in the social context.

In our everyday lives, though, ethical arguments are usually very different from economic ones. As an example, arguments in favor of obligatory health insurance companies are presented here—on the one hand, from an ethical point of view and, on the other, from an economic point of view. From an ethical point of view, it could be argued that the offer of care requires that the appropriate therapies should be available to anyone who has a health emergency. A system based on solidarity, where each individual contributes according to his or her income and the resources are accessed in accordance with their health needs, would thus be an appropriate means of ensuring broad-based health care. From an economic point of view, however, compulsory membership in a health insurance fund or health plan would be advocated for quite different reasons: In short, it is a risk to the larger economy when working people do not have access to health care. On the one hand, a lack of health care could lead to massive losses of manpower, and, on the other hand, riskier work can only be undertaken in the first place when there is insurance in the case of illness or injury. In many instances, such work is necessary. Therefore, the introduction of a solidarity-based system, which provides for (minimum) care, is a safety net the economy cannot do without.

However divergent these two lines of argument may appear, if you practice ethics with an economic method, then you must always be mindful of economic argumentation, even as an ethicist. It is essential to conduct an economic analysis of an ethical problem in business—in which both actual state of affairs, incentive systems and forecasts are highlighted—if you do not want to founder on the implementation question. On the basis of this understanding, business ethics may be defined as follows:

> *Business ethics is a discipline of practical philosophy that examines which norms can be established and brought to bear under the conditions of modern society.*

With this point of departure, more and more ethicists are dealing with empirical analyses of specific problems and are increasingly resorting to economic methods. In the fields of experimental business ethics or behavioral business ethics, ethical analyses are being created empirically from the bottom up. This interdisciplinary ethics draws on methods of experimental economic research, which are explained in Section 3.2.

But even economics itself, according to this view, has a normative dimension. For it provides the business ethicist, who deals with the designing of institutions or rules for cohabitation, essential assistance in their implementation. Just as the architect asks about the function and purpose of a building but requires the knowledge of an engineer to implement the plan, so too is the ethicist at times dependent on the economist. In order for a building design to serve its purpose, such as a harmonious and comfortable communal life, the building must be adapted to the circumstances, the laws of statics, and the costs. When planning an institution or rule, ethics first asks about the values or norms that should be promoted by the institution and how these ideas can be substantiated. For the implementation, calculations have to be made as to how the incentive structures of the institution are to be defined so that the institution's goal is also finally achieved.

If a goal proves not to be feasible from the outset, it is untenable (as per the old dictum "ought implies can"). However, the economist's work can also take on a moral component beyond mere implementation itself, specifically if new problems are only first discovered during the structuring phase. These can be loopholes and possible misuse, for example, which the economist identifies with the help of his models, analyzes the reasons for them, and suggests solutions. In this way, it is only in the interplay of ethical reflection and economically informed implementation that rules and institutions can be created that are resistant to exploitation and mutually beneficial.

2.3 Situating business ethics in philosophy

2.3.1 Two basic approaches: dualistic and monistic business ethics

In general, the different approaches of business ethics can be attributed to two fundamentally different theoretical concepts: dualism and monism.

Dualism is based on the assumption of two opposing poles: on the one hand, the economy with its maximization claims, profit maximization and efficiency and, on the other hand, morality, which demands at the same time that human beings should not be neglected. In theoretical terms, economics and ethics are antithetical.

This dualistic thought structure is initially reflected in the everyday intuitions of a lot of people: It is said that the writer and satirist Karl Kraus (1874–1936) told a student of business ethics: "You want to study business ethics? You have to decide for one or the other!" In general, morality is given precedence. Social psychologist Erich Fromm (1900–1980), for instance, set out this traditional position in his book *To Have or to Be?* (1976), where he advocates the primacy of the "true" needs of man (being) over the "needs of the economy" (having). Fromm tries to clearly delineate these contrary poles on the basis of four moments (Fromm, 2013).

But also, in business administration, dualistic approaches were predominant for a long time, although in some cases the signification was inverted: For example, Ulrich Döring describes morality in the economy as fundamentally dysfunctional. In his view, the stakeholder approach (which he attributed to morality), according to which a company is to take into account the interests of all stakeholder groups, is doomed to failure because of the completely conflicting interests of these different groups and throws nothing but "sand into the machinery" of the economy (Döring, 2010).

Basically, dualistic thought structures lead to conflicting goals. The business ethicist's weighing of the issues usually consists of deciding in individual cases for one of the two poles. In principle, he or she has the opportunity to either work toward reining in the economy in favor of morality or to favor economic goals at the expense of morality. Even a desired mediation of both positions will not be able to completely resolve this conflict of aims. Business ethical demands that make an appeal to the conscience or postulate certain values and thus push for a voluntary change in actors' behavior do so from a dualistic perspective—such as when a company forgoes part of its profits in favor of an environmental protection measure.

The demands of business ethicists with a dualistic approach, however well intended they may be, often fall apart when it comes to the question of implementation: Even if the actors involved agree that the postulated goal (such as implementing the environmental protection measure) is desirable, that does not mean it is possible for those who stand in competition to comply with the moral requirement without suffering disadvantages. In other words, if they follow the moral appeal, they are vulnerable to exploitation and should expect to suffer competitive disadvantages or be completely left behind. This dilemmatic situation of the exploitability of competitors and the resulting postulate of incentive-compatible implementability is discussed in detail in Section 4.2.

According to the monistic concept of business ethics, this conflict is avoided from the outset to the extent that morality and economics are considered two sides of the same coin. The question of implementation is not a final step here, which takes place after a solution has been recognized as morally correct. Instead, the question of implementation is considered from the very beginning, with reference to the ethical principle "ought implies can": This formula states that an actor is only morally obliged to carry out a certain action if he or she is also capable of doing it (logically, technically, etc.). With regard to ethical problems in business, one could interpret the sentence to mean that the individual is not required to continuously act against his or her own interests.

This means that a certain rule can only be advocated for monism in ethical terms if all involved actors are at least better off over the long term than by means of alternative candidates for rules. In individual cases, this may well result in the short-term disadvantage of certain actors, but this cannot outweigh the overall benefits for all those involved, especially those who are initially in worse off. One example is the prohibition of price fixing. This competition policy measure de facto puts the providers, who have agreed on an artificially high price, at a disadvantage, for they now miss out on the higher profits. All in all, however, this measure prevents the price exploitation of consumers and thus contributes to the creation of a better competitive climate, which ultimately benefits everyone (even suppliers, who of course are also consumers themselves): Even if the individual would benefit from circumventing the rule, the rule's existence is still an advantage for everyone overall (Lütge, 2019).

One can thus only expect a certain moral commandment to be observed when there are (mutual) advantages. The normative criterion of (mutual) consent is only fulfilled if a moral rule generally leads to mutual betterment. In other words, no one will agree to a rule that makes him or her worse off in the long run. The criterion of consent as a norm justification, which plays an important role in social contract theory in particular, is described in detail in Section 4.1.

2.3.2 Dualistic and monistic corporate ethics

Whereas (monistic) business ethics deals with the normative design of the framework, i.e. the conditions, corporate ethics deals with normative recommendations for actions *under* given conditions. The dominant players in the market economy are companies, hence the common term "corporate ethics."

Ideally, which is to say in a perfect economic order, corporate ethics would be redundant. This is because under perfect framework conditions the actors would only have to follow their own interests while, at the same time (albeit unintentionally), promoting the common good (Adam Smith's invisible hand). For practical as well as systematic reasons, though, these ideal conditions can never be completely present.

A "perfect" framework, where all the actions that take place in competition are regulated in the most minute detail, is practically impossible given (for instance) the complex properties of the goods, different frameworks, and difficulties in enforcing the law. What is more, a complete spelling out of the rules is not even desirable given the dynamic nature of global markets. Incomplete rules offer room to maneuver and are necessary for being able to react flexibly, for example to new technical developments or conditions which are not within the sphere of the legislature. For example, rapidly advancing techniques for collecting and storing data are creating legal vacuums. Here, corporate ethics can sketch guidelines for action long before the legislator, whose processes are necessarily impeded by the supervisory authorities, can react to new problems in a regulatory manner. Even moral issues that arise in the course of increasingly globalized business relationships and which exceed the authority of national courts and legislators, are the subject of corporate ethical analysis.

This need for ethics at the level of action, which is complementary to business ethics, can be clarified by means of the theory of incomplete contracts (Hart, 1995; Hart and Holmström, 1987). It assumes that human interactions are governed by contracts, formal (e.g. codified laws) and informal (e.g. promises). These contracts are incomplete in a number of ways, however: Services and return services are not precisely defined, and as fulfillment often cannot be ascertained externally, it is therefore not justiciable. Beyond this, enforcement in court is often too expensive. Incomplete contracts thus lead to more uncertainty, the danger of greater dependencies, and opportunities for exploitation. These problems, which arise from the incompleteness of contracts and require ongoing interpretation and exposition, also have advantages: Greater flexibility and thus higher productivity are two benefits that are difficult to do without in an increasingly globalized world.

Here, corporate ethics fulfills the role of staving off the negative effects of incomplete contracts, i.e. (cost-intensive) uncertainties. By means of so-called "soft" factors like morality or culture, the uncertainties can at least be mitigated and made more predictable. Hence, reliable behavioral predictions between contractors are possible, even without any justiciability, while the flexibility gains are maintained at the same time.

The goal of corporate ethics is therefore to give companies concrete recommendations for action in the face of incomplete contracts. Companies receive assistance on how they can and should participate in solving moral problems that cannot be solved by a single actor at the political level. It may also be necessary to reject unreasonable demands that appear to be moral when there are good reasons and arguments.

In principle, business ethics, after the systematic place of morality is on the level of regulation, and corporate ethics, which deals with problems at the level of action, must not be in conflict with each other. One example is when companies are rescued by the state in the course of economic and financial crises, since they are "too big to fail," i.e. systemically relevant. However, if companies and business partners anticipate that a company will be protected from insolvency due to its systemic relevance, the market risk premiums lose their significance and incentives are created for taking large risks at the expense of the general public. Without the implicit state guarantees, German banks would have had to be rated four or five ratings lower than they actually were (Ueda and Weder di Mauro, 2012).

Corporate ethics, then, can also be traced back to either dualism or a monistic core. Similar to the dualist business ethics, morality and competition are seen as two opposites in the dualist corporate ethics, but these take place at the level of corporate action. This everyday interpretation, which ultimately depends on appeals for morality, also reaches the limits of implementability. In the monistic corporate ethics, this is already thought about at its core in the sense of a fusion of economic interests and ethical demands.

Every company has a large number of interest groups who approach the company with their demands: The owners or shareholders want to realize profits. The employees want a secure job with good pay, local residents want less noise and traffic, and environmental organizations want environmentally friendly production. In the face of these different groups, the emergence of different united fronts is to be expected. Should expensive new air filters be installed in factory chimneys, even if this puts profitability at risk? Should the employees' desire for unlimited contracts be met, even if the economic situation is uncertain? Should production sites be moved abroad, even if the company is the most important domestic employer in a region? So, here we are dealing with the familiar problem of the two poles, which appear to be insurmountable opposites.

According to the structure of the dualistic mindset, the solution here can only be found in a weighing of each possibility—in an either-or where either economic or moral demands are satisfied. Quite in contrast to countless demands, for example for permanent jobs or the maintenance of locations, morality has a difficult time following this dualistic reconstruction of the problems.

An entrepreneur, for instance, can only achieve costly moral goals when business is good, which means for a limited period of time and at the expense of his or her own profitability. This is precisely what is demanded by the "gap theory" of corporate ethics. Here, the basic idea is that companies in dynamic competition have at least temporary financial room to maneuver, which they should use for moral actions such as to support social projects.

These claims, however, do not take into account the fact that companies—despite temporary surpluses—are still in competition with each other. Funding social projects, for instance, may mean that less money is available for investments, reserves, or dividends. As a result, the company is at a disadvantage compared to those competitors who do not spend money for social causes. If morality is systematically implemented at the expense of profits, the company has no chance in the long run.

An example of this is offered by the textile company Steilmann, founded in 1958: The company developed into the largest textile company in Europe in the post-war period by selling affordable fashions. From the beginning of the 1990s, the company came under strong cost pressure due to increasing globalization. Out of solidarity to his employees, however, Klaus Steilmann insisted on continuing the company's (expensive) production in Germany. In 2006, the company's bankruptcy could only be averted by a complete takeover of all Steilmann shares by the Italian Radici Group. The company finally went bankrupt in 2016 (Reuters, 2016).

The problem is further exacerbated by the fact that the moral commitments of some companies increase incentives for competitors to further enhance their advantage through non-moral action. For example, an entrepreneur who maintains an expensive location can induce others to minimize production costs even further, forcing their competitor out of the market once and for all. In anticipation of these risks, morality must therefore systematically fall by the wayside—no matter how good the intentions of management may be.

2.3.3 Business ethics as risk management

The example of the Steilmann company shows that morality cannot be permanently enforced against an actor's economic interests. Moral actions therefore have to be re-conceptualized as self-interested actions. One speaks here of the postulate of incentive-compatible implementability. A monistic business ethics tries to comply precisely with this postulate. Profits and morality are not viewed as opposites from the outset, but rather as common goals.

In this sense, corporate ethics is a part of a company's risk management. Especially in an information society, in which a high degree of transparency is demanded of companies and customers' awareness of sustainable and socially responsible production methods is growing, it is in the company's own interest to not ignore the moral dimension of its own actions. Because they can cause considerable damage, moral missteps can involve high risk. For example, consumer boycotts can follow the discovery of unethical corporate actions. At the same time, it is also important for a company's management of business-to-business relations to present itself as a reliable trading partner. Here, there is a direct linkage to the fundamental considerations of incomplete contracts.

In order to benefit from the advantages of flexible contracts, contractual partners must be able to rely on each other and assume the other's fairness. The reputation of the respective companies plays a crucial role here, for it then serves as a check on opportunism: The business partners know that they can rely on each other in the long term, even without specific contracts. Reliability can be signaled, for example, through collective or individual education (these mechanisms are discussed in detail in Chapter 5). Morality becomes a factor for the risk management of a company through mechanisms like reputation that are economically relevant. Morality is thus figured into the entrepreneurial calculus—moral behavior and the pursuit of profit become two sides of the same coin.

The organic or fair-trade sector offers—at least in principle—an example of the unification of corporate goals, social demands, and customer wishes. The worldwide growth of organic food sales since the end of the 2000s demonstrates the success of this business model. Since then, sales have risen from USD 18 to 95 billion (2018) (Statista, 2020).

Under a broader understanding of business ethics, we also include concepts such as Corporate Social Responsibility (CSR), Corporate Citizenship, or Creating Shared Value. Roughly speaking, they deal with how ethical claims (in the broadest sense) can be integrated into the corporate strategy. This topic is discussed in detail in Chapter 5.

In a nutshell, it can be said that corporate ethics concerns moral issues at the level of corporate action. Here, the consistency postulate requires that the behavior of the actors must be consistent with the incentives provided by the framework. For a company, this implies three types of responsibility (Homann, 2006):

Behavioral responsibility: Companies are responsible for their actions and the resulting consequences. Much of this is enshrined in the statutes that the company must comply with (compliance). Other responsibilities of companies also include product responsibility, advertising methods, location decisions, and corporate culture.

Regulatory responsibility: This means that an entrepreneur is also obliged to participate in the improvement of the social or political order and to point out new situations arising from technical innovations or international trade relations. An example of this is the United Nations Global Compact, which is discussed in more detail in Chapter 5.

Discourse responsibility: In addition, companies are called upon to actively participate in the public discourse on the social and political foundations of the global society. This reflects much more the political role of companies, which is undeniable in the globalized world.

All the same, these three different types of responsibility that companies face are subordinate to the postulate of incentive-compatible implementability: Ethics cannot require any actor (here: companies) to act permanently and systematically against its own economic interests. Profits and morality cannot be at odds with each other. Such a conflict of interests can be avoided within the framework of a company's risk management. Morality here becomes a factor of production by means of economically relevant mechanisms such as reputation.

2.3.4 Business and corporate ethics in Anglo-American and German usage

In contrast to the Anglo-American usage, where business ethics encompasses both economic and corporate ethical questions, the German usage still contains an (at least conceptual) distinction between business and corporate ethics. In this case, business ethics takes a macro perspective and deals with questions at the national or international level, whereas corporate ethics deals with corporate responsibility. This distinction can also be explained by the fact that, with the emergence of the Federal Republic of Germany, regulatory questions were stressed before corporate ethics concerns. Social justice was to be achieved through the social market economy. The development of this concept, moreover, was mainly in the hands of political leaders. The basic problem of the regulatory discourse was the economic-political positioning of the young Federal Republic between “freedom” and “justice”—seen in the classical (dualist) understanding as two poles—and also between free enterprise and the protection of the socially vulnerable. The economically and ethically significant concept of the social market economy goes back to thinkers such as economist Walter Eucken (1891–1950) and the jurist Franz Böhm (1895–1977).

The idea of placing concrete demands on companies was still not a priority. This changed increasingly in the 1970s and 1980s, for instance with the emergence of the ecological movement. Beyond this, industrial scandals, such as the Bhopal gas tragedy which resulted in several thousand deaths, made the population more aware of the issue of corporate responsibility. As a result, business ethics was dealt with in public discourse—and in scholarship. Today, business ethics research is carried out at many universities and colleges around the globe. In the German-speaking world alone, some fifteen academic institutions are engaged in this field. In Anglo-American countries, the discourse has always been more strongly influenced by corporate ethics.

A large part of the research is characterized by a strong practical orientation. Just the same, business ethics is spoken of when ethical questions concerning business and corporations are dealt with.

A unifying trend can be seen in the fact that CSR research is gaining more and more importance in the research of both Anglo-American and German regions. Essentially, this means corporate ethics, whereby both the justification of CSR and the specific application-oriented concepts are the subjects of research (see Section 6.3).

References to Chapter 2

Döring, Ulrich (2010). Der Betriebswirt: Gewinnerzielung ist moralisch. Der Shareholderansatz ist richtig. *Frankfurter Allgemeine Zeitung*, October 4, 2010. Last accessed April 5, 2020 at: http://www.genios.de/presse-archiv/artikel/FAZ/20101004/der-betriebswirt-gewinnerzielung-is/FD1201010042836427.html

Fromm, Erich (1976/2013). *To Have or To Be?* London and New York: Bloomsbury.

Hart, Oliver (1995). *Firms, Contracts, and Financial Structure*. Oxford: Oxford University Press.

Hart, Oliver and Holmström, Bengt (1987). The Theory of Contracts. In: T. Bewley (Ed.), *Advances in Economic Theory: Fifth World Congress* (pp. 71–156). Cambridge: Cambridge University Press.

Homann, Karl (2006). Gesellschaftliche Verantwortung von Unternehmen in der globalisierten Welt: Handlungsverantwortung—Ordnungsverantwortung—Diskursverantwortung. Wittenberg-Zentrum für Global Ethik, Discussion paper 2006–1.

Homann, Karl and Lütge, Christoph (2013). *Einführung in die Wirtschaftsethik* (3rd Ed.). Münster: LIT.

Homann, Karl and Suchanek, Andreas (2005). *Ökonomik: Eine Einführung* (2nd Ed.). Tübingen: Mohr Siebeck.

Lütge, Christoph (2019). *The Ethics of Competition: How a Competitive Society is Good for All*. Cheltenham, UK and Northampton, MA, USA: Edward Elgar Publishing.

Reuters (2016). Modefirma Steilmann—Von der Börse in die Pleite, press release March 25, 2016. Last accessed April 5, 2020 at: http://www.finanzen.net/nachricht/aktien/Schlechte-Geschaefte-Modefirma-Steilmann-Von-der-Boerse-in-die-Pleite-4798858

Sayre-McCord, Geoff (2012). Metaethics. In: E. Zalta (Ed.), *Stanford Encyclopedia of Philosophy*. Last accessed June 2, 2017 at: https://plato.stanford.edu/entries/metaethics/

Smith, Adam (1776/2007). *An Inquiry into the Nature and Causes of the Wealth of Nations*. Petersfield: Harriman House Ltd.

Statista (2020). Worldwide sales of organic food from 1999 to 2018 (in billion U.S. dollars). Last accessed March 13, 2020 at: https://www.statista.com/statistics/273090/worldwide-sales-of-organic-foods-since-1999/

Ueda, Kenichi and Weder di Mauro, Beatrice (2012). Quantifying Structural Subsidy Values for Systematically Important Financial Institutions. *IMF Working Paper*, WP/12/128, May 2012.

3
Historical-economic background

Premodernity and modernity

Selected learning objectives

After reading this chapter, you will be able to:

- differentiate between premodernity and modernity structurally and to fully understand the necessity of the transition from ethics of behavior to ethics of conditions
- reflect on the ethical significance of competition in the modern era
- explain why the idea of the fair price and the prohibition of interest are clear examples of premodern moral standards.

Chapter overview

This textbook expressly does not deal with business ethics from a historical perspective. Nevertheless, it is necessary at this point to introduce a historical perspective, since it is only from such a vantage point that the specific concerns of modern business ethics can be understood.

At the same time, it will become clear that ethical theories and concepts from the philosophies of past centuries cannot simply be transferred to the modern globalized world. Among other reasons, the social and economic conditions and structures have simply changed too much.

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).

DOI: 10.1093/oso/9780198864776.003.0004

This chapter will outline these changes in broad terms and their implications for business ethics issues. We proceed as follows:

First of all, premodern and modern society are systematically distinguished from each other in their characteristics. Next, the importance of this distinction for business ethics is discussed. This distinction is illustrated on the basis of two examples of historical concepts: the fair price and the ban on interest.

The historical developments of the last 200 years are unique in many ways. Mainly due to technological and economic progress, today's societies are systematically different from those of the premodern age.

Moral thinking has failed to keep pace with developments in other human realms, so that moral standards, which were originally justified under other socio-economic conditions, are in many ways no longer adequate, and may even have counterproductive effects. The following examines the paradigm shift between the premodern and modern worlds. It shows the extent to which existing moral standards are no longer applicable and describes a way to implement business ethics in a modern society. It should be noted that the description of premodern and modern society is necessarily reductive.

3.1 Ethics of behavior and ethics of conditions

Classical Western ethics is a paradigmatic ethics of behavior (Homann, 2003). The moral norms are aimed at the individual and are intended to give more or less concrete instructions on how he or she should behave ethically. However, the conditions under which the individual should perform an action are often neglected in such ethics of behavior writings. This is due to the fact that the essential conditions for action remained relatively constant until the dawn of modernity. There were hardly any caesuras that changed the structure of society, so that the conditions under which the individual acted could be assumed as "given." This does not mean that history, from antiquity to the Middle Ages, shows no ruptures or changes, only that the basic socio-economic structure of societies that changed in other respects remained relatively constant. This includes, for example, an order of society in estates, i.e. the legal subdivision of the population into groups, between which there was little or no chance of advancement, as well as the general way of life in small groups, so-called face-to-face societies. The German economist Karl Bücher (1847–1930) distinguished the stages of humankind's economic development according to its geographical dimensions: from the original village community through beginning urbanization in (small) cities to the national economy (Bücher, 1893). In today's era of globalization, this development extends beyond individual countries to the world economy.

These socio-economic structures, mostly recognized as natural or God-given, played no role in the establishment of moral norms, since they were not considered to be the result of human actions. The comparison between premodern and modern societies is justified, even if, for example, individual societies such as the Roman Empire with its formal legislation and the established bureaucracy and administrative apparatus already had elements of a modern society. For the purposes of this book, four basic structural features of a premodern society are presented in order to highlight the differences to modern society (Homann and Suchanek, 2005):

> First, the order of man and society is in principle predetermined and therefore stable. It is regarded as unchangeable by humans and thus remains constant for centuries.
>
> Second, society is organized according to estates until modern times, with degrees and permeability varying in each case. Slavery serves as a prominent example here, which was hardly questioned from antiquity to modern times and was practiced in many eras and countries.
>
> Third, premodernity is characterized by a special concept of economics. Under “oikonomia” (Greek, consisting of “house” and “law”), Aristotle understands those economic activities that serve to preserve life. Accordingly, economic activity should above all meet the minimum needs and basic provisions. In contrast, a form of economic activity oriented towards growth, which Aristotle calls “chrematistics,” was ethically less acceptable. It was spurned and vilified as a form of “moneymaking.”
>
> Fourth, premodern societies are characterized by a low degree of mobility and, along with it, a high measure of social control. Interactions, both in the personal and the business sphere, were mostly conducted through known partners, so that a simple and effective means of controlling social behavior was possible.

This social structure of the premodern world constitutes the background against which most of the basic concepts of Western ethics developed (Homann, 2003; Homann and Lütge, 2013). These concepts include, for instance, human dignity, charity, or solidarity. As Homann observes, these terms show “clear traces of their premodern origin” (Homann, 2003). A contemporary business ethics must examine the extent to which its significance for modern society still plays a role. After all, modern society has different requirements. As growth-based societies, they are able to bring prosperity to a far larger number of people and to re-conceptualize the social order through institutionalized competition. The four structural features of the premodern society cited above can be contrasted with the changed structures of the modern world.

First, modernity is characterized by the fact that people are increasingly able to gain control over the conditions of their actions. Their actions no longer take place exclusively in predetermined structures, since people can influence their behavioral conditions. This happens, for example, through participation in the political sphere, which enables individuals to improve the existing structures and institutions and adapt them to new needs, provided that they win a majority for their proposals. A predetermined order of things according to a "plan of God" or traditional norms is present only to a very limited degree and is increasingly losing its influence. Due to the lack of a universally recognized external authority (this is the Christian God in the European tradition), it is to be presumed that there is a multitude of different goals and beliefs.

Second, individual people's lifestyles are very different in the modern age. The social environment of the individual is no longer more or less identical for all people. Instead, there is a strong increase in individual mobility (Homann, 2003), which manifests itself above all in geographic, social, cultural, and professional dimensions. At the same time, the range of possible life plans is almost unlimited, meaning that every individual has to be conceptually recognized in his or her individuality.

Third, since the beginning of the Industrial Revolution, and even more intensively since 1945, the material wealth of humanity, which was previously largely constant, has grown exponentially.

In the run-up to the Industrial Revolution, which historically represents the starting point of modern society, growth was only gradual. Along with rapid economic development, the world population has also grown rapidly. Modern society currently sustains the existence of about 7 billion people; according to population experts (Cohen, 1995), it can support up to 12 billion. It creates more freedom for the individual through the simultaneous increase in wealth. While this is true to varying degrees for the different regions of the world, the general trend and the—although sometimes slightly delayed—development of some regions, clearly point to an emerging path.

This unprecedented growth of the last 200 years has been due to various factors. In addition to technological progress, the introduction of competition and increasing international trade were particularly important. Economic transactions took place in premodern societies, especially face to face. Few people acted outside their immediate place of residence. For the first time since the beginning of the Industrial Revolution and the division of labor in society, centers formed with a high level of production that quickly freed a large number of people from absolute poverty and since then have enabled greater wealth. This prosperity, which satisfies the basic needs of a large number of people, in turn permitted people to work creatively outside of their work for the purpose of earning a living, to further their education, and to produce innovations (see Figures 3.1–3.4).

Since 1990, we have witnessed a similar kind of development, only much faster than before: Countries with enormous populations such as China, Indonesia, Vietnam, and others have realized the transition to a market

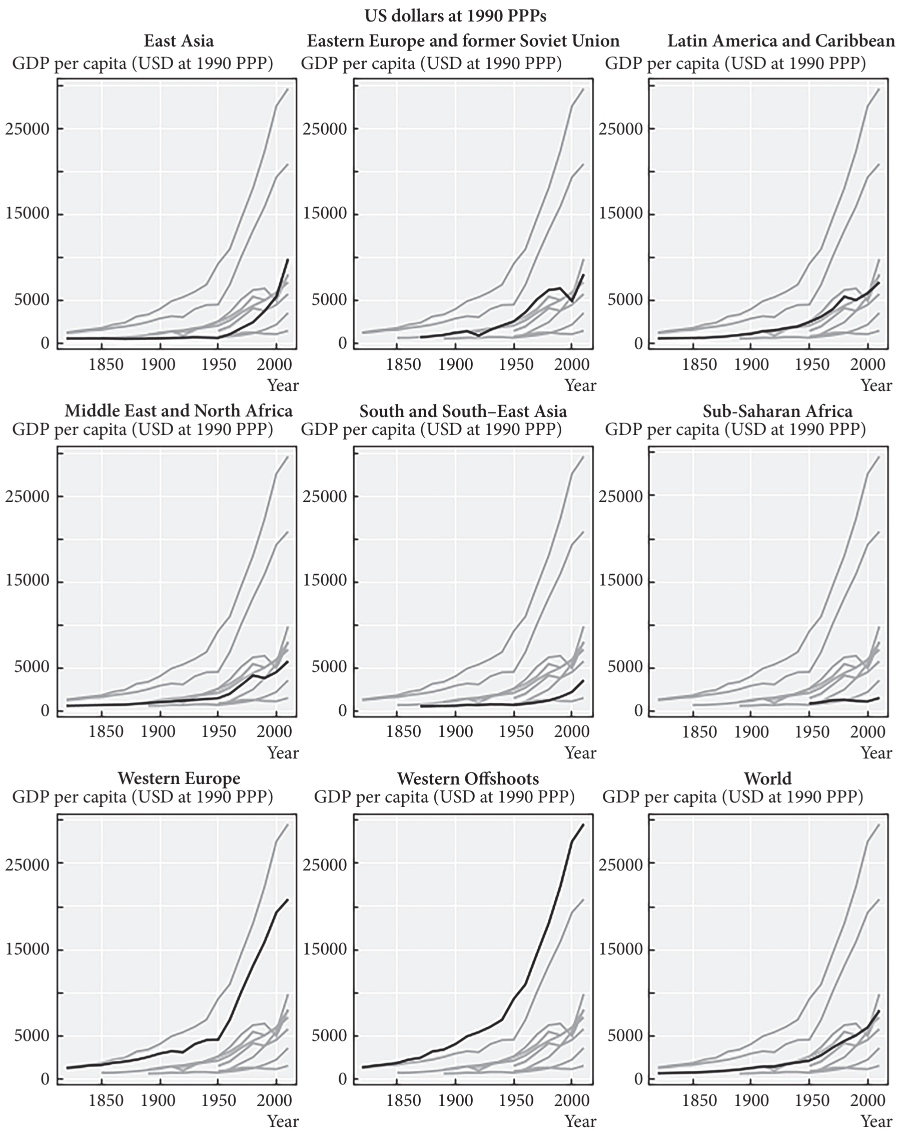


Figure 3.1 Regional averages of gross domestic product per capita, 1820–2010
Source: van Zanden et al., 2014

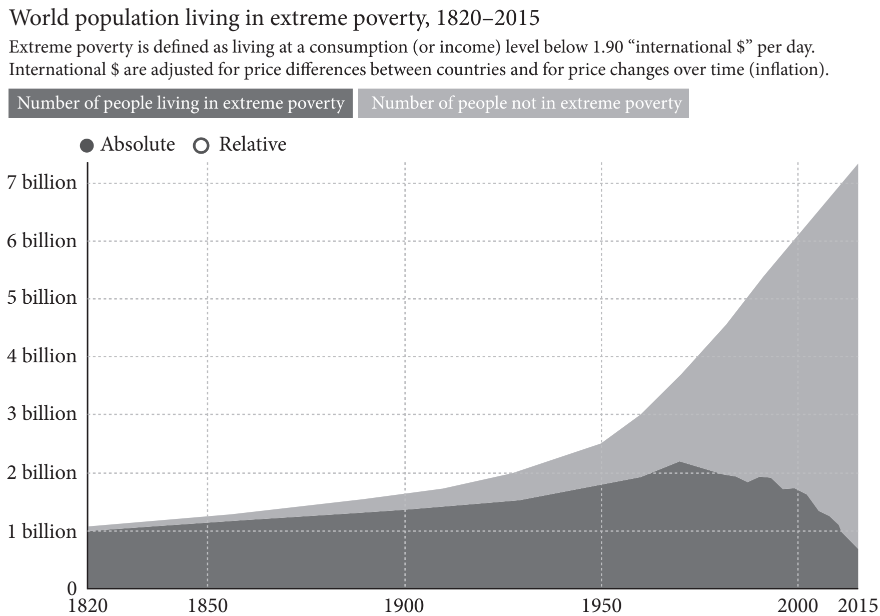


Figure 3.2 Development of the proportion of the world's population living in extreme poverty, 1820–2015
Source: Our World in Data (2019)

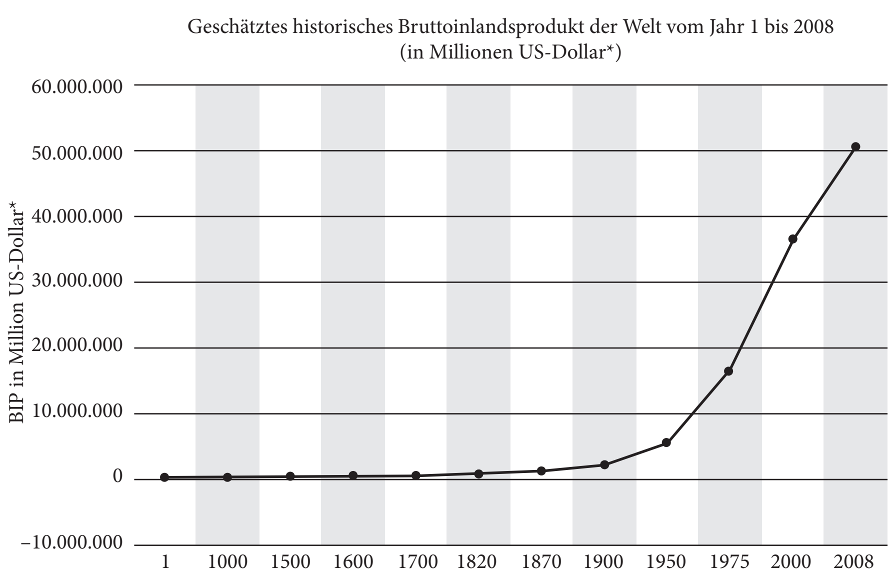


Figure 3.3 Estimated historical gross domestic product of the world from year 1 to 2008 (in million US dollars)
Source: Statista (2010)

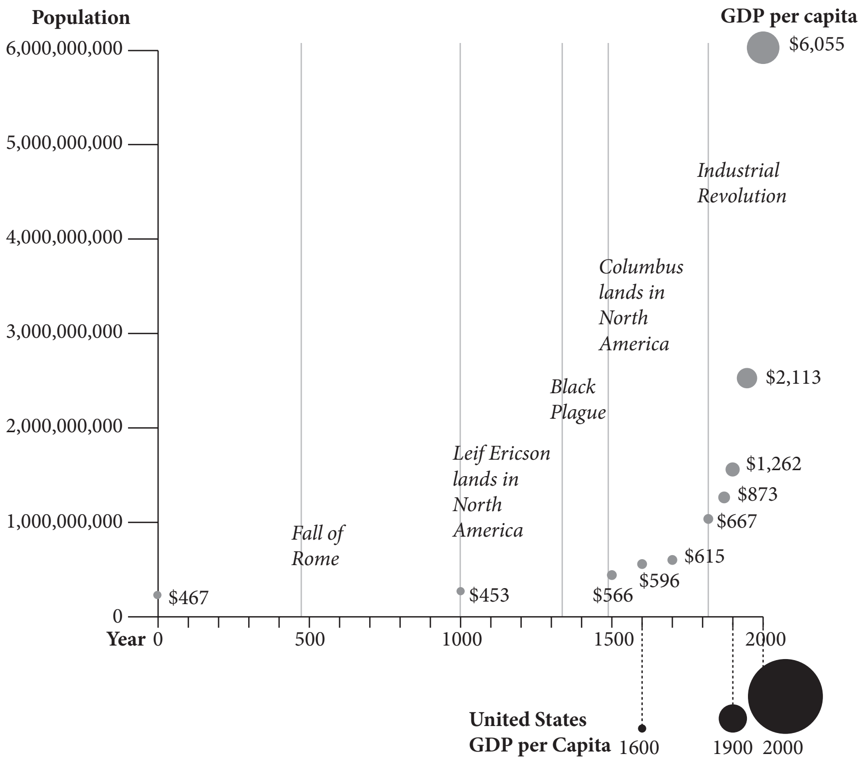


Figure 3.4 World income and population for last 2,000 years
Source: Visualizing Economics (2007)

economy. As a result, 1 billion people have been liberated from extreme poverty since 1990 (Figure 3.5) (see also Section 5.1).

Fourth, modern society is characterized by the fact that individuals can to a relative extent escape the direct "moral" control of their fellow human beings. Accordingly, ethics under the conditions of modernity must assume that adherence to a rule cannot be effectively monitored through face-to-face control. For this reason, ethics requires a new control system.

Based on the developments listed above, it is noticeable that the paradigm of modern ethics can no longer be the classical ethics of behavior.

At their core, traditional ethics systems—Western as well as Far Eastern or Islamic (Mohammed, 2013)—are ethics of moderation in many respects. In the modern world, however, where the economic system is oriented towards the principles of market economy and competition, those who base their actions unreflectingly on premodern principles of moderation risk competitive disadvantage. Traditional Western ethics is out of its depth in the modern age and moderation can lead to a company being taken over by the

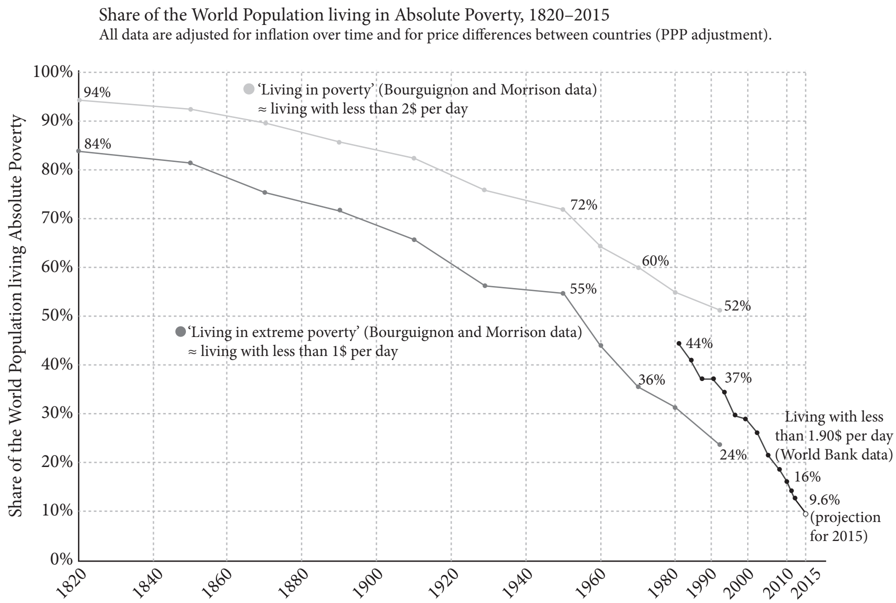


Figure 3.5 Share of world population living in extreme poverty, 1820–2015
Source: Our World in Data (2013)

competition or foundering (see the example of Steilmann in Chapter 2, Section 2.3.2).

The task of contemporary business ethics is therefore to supplement traditional ethics and make it productive for the present and the future. An ethics that wants to prevail in the modern world must systematically think about the behavioral conditions and take account of the context of possible actions. If, in a certain situation, honest people are systematically foolhardy, they must necessarily either disappear from the market or change their behavior. This does not mean that ethics in the form of an ethics of behavior no longer has any significance. It is important to understand, though, that alone, it is insufficient for the modern globalized world (Figure 3.6) and must be tied to an ethics of conditions.

In the premodern context, the primacy of moderation is easy to understand: In the context of a subsistence economy, which was able to produce just as much as was required for the population's survival, there was a constant fear of deprivation. Individual crop failures alone could threaten the existence of entire groups. In good times, therefore, it was less important to hoard goods (which was difficult anyway due to unsophisticated storage and preservation methods), than to be mindful of potentially difficult days ahead. In the modern world, most of the moral intuitions that influence our moral assessments of others arose under these economic conditions. Traditional

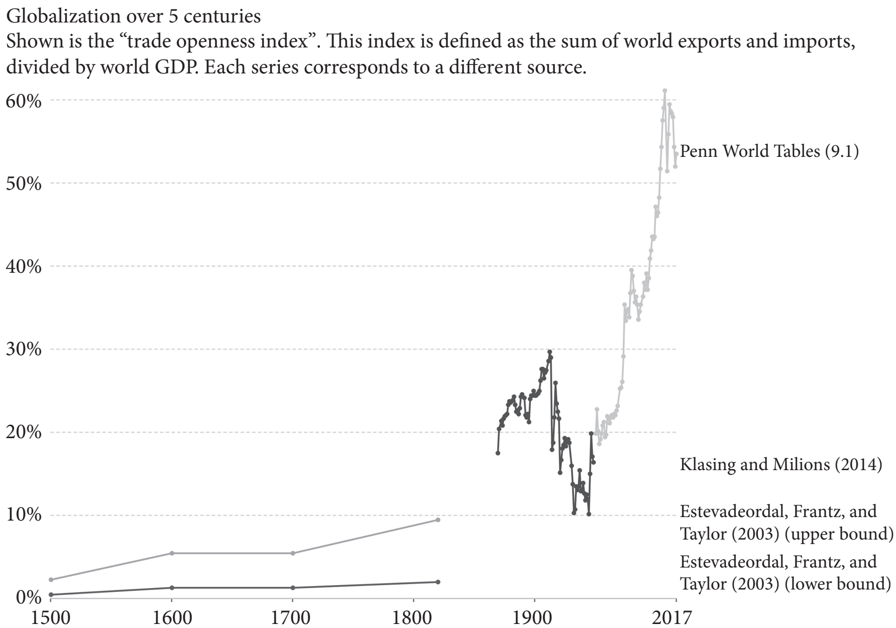


Figure 3.6 Globalization over five centuries
Source: Our World in Data (2014)

ethics emphasizes the avoidance of risk, not the opportunities that risky actions often yield. This explanation is based on the biological evolution of human beings. It can be supplemented by cultural evolution, in which the virtue of moderation stems from the fact that society is a zero-sum game. The prevailing view was that the same cake could only be divided up differently. A concept of growth was missing. A symptomatic statement for this view can be found in Giovanni Rucellai, a Florentine merchant of the fifteenth century who found that "by being rich, I make others poor I may not even know." In fact, much of human history human beings lived within a range of marginal growth. In such a situation, moderate consumption is understandable (see Table 3.1).

One of the few (perhaps the only) historical exceptions may have been the Roman Empire, which—according to some[1]—showed economic growth over several hundred years. This was also reflected in the ethical observations of the time. Thus, in Cicero's *De Officiis* (Cicero, 1913) there is a positive assessment of wholesale trade, which is unimaginable at other times:

> Now in regard to trades and other means of livelihood, which ones are to be considered becoming to a gentleman and which ones are vulgar, we have been taught, in general, as follows:

Table 3.1 Regional average wages from 1820s to 2000s

	Number of subsistence baskets that a daily wage buys, decadal averages								
	Western Europe (WE)	Eastern Europe (EE)	Western Offshoots (WO)	Latin America and Caribbean (LA)	East Asia (EA)	South and South-East Asia (SSEA)	Middle East and North Africa (MENA)	Sub-Saharan Africa (SSA)	World
1820s	12.6	7.2	..	5.7	3.3	4.1	6.5	2.9	5.7
1830s	11.2	6.5	..	7.0	2.8	5.2	3.8	3.1	5.6
1840s	11.2	4.9	..	4.0	2.8	4.2	3.7	3.4	5.2
1850s	11.0	6.3	..	7.3	2.0	4.4	3.8	3.3	5.3
1860s	11.5	8.1	43.9	6.6	2.8	4.7	5.2	3.1	6.3
1870s	12.5	8.1	50.2	7.6	3.8	4.1	5.1	3.4	7.2
1880s	14.7	9.8	62.6	9.0	4.3	4.5	5.0	4.1	9.0
1890s	17.8	9.6	63.7	9.5	4.9	4.2	4.4	4.7	9.9
1900s	19.0	13.1	..	10.3	4.8	3.6	4.7	4.9	11.1
1910s	16.9	20.4	77.2	10.6	4.3	3.7	4.6	4.4	12.5
1920s	18.7	7.7	68.9	..	3.9	4.1	..	6.3	11.2
1930s	24.8	9.9	74.1	12.4	4.0	5.3	8.1	7.6	13.4
1940s	26.2	9.6	75.8	14.4	5.2	4.3	13.4	6.2	13.8
1950s	21.3	10.7	98.9	18.5	6.5	6.3	19.3	7.9	16.8
1960s	31.8	15.0	103.9	20.9	11.1	5.2	16.4	8.1	20.1
1970s	49.4	25.1	145.5	21.3	19.4	4.7	20.1	6.1	26.4
1980s	64.8	27.8	143.7	26.0	26.3	7.8	41.3	8.0	30.9
1990s	105.2	29.2	168.1	29.9	26.9	8.5	46.2	11.0	35.3
2000s	163.3	38.6	169.8	26.5	36.6	10.0	71.6	18.3	43.0

Note: For an assessment of data quality, see Table 4.2.
Source: Clio-Infra, www.clio-infra.eu.
StatLink http://dx.doi.org/10.1787/888933096844

> First, those means of livelihood are rejected as undesirable which incur people's ill-will, as those of tax-gatherers and usurers. Unbecoming to a gentleman, too, and vulgar are the means of livelihood of all hired workmen whom we pay for mere manual labor, not for artistic skill; for in their case the very wage they receive is a pledge of their slavery. Vulgar we must consider those also who buy from wholesale merchants to retail immediately; for they would get no profits without a great deal of downright lying; and verily, there is no action that is meaner than misrepresentation. And all mechanics are engaged in vulgar trades; for no workshop can have anything liberal about it. Least respectable of all are those trades which cater for sensual pleasures: "Fishmongers, butchers, cooks, and poulterers, and fishermen," as Terence says. Add to these, if you please, the perfumers, dancers, and the whole *corps de ballet*. But the professions in which either a higher degree of intelligence is required or from which no small benefit to society is derived—medicine and architecture, for example, and teaching—these are proper for those whose social position they become. Trade, if it is on a small scale, is to be considered vulgar; but if wholesale and on a large scale, importing large quantities from all parts of the world and distributing to many without misrepresentation, it is not to be greatly disparaged. (Cicero, *De Officis*, I 42.150–1 f.)

This assessment is atypical for most of the rest of human history. It is obviously to be viewed against the background of the success and the positive effects of competition in the Roman Empire. After the fall of the Roman Empire, however, the positive evaluation of wholesale trade as a source of prosperity also disappeared for centuries—until the burgeoning civil societies of England and the Netherlands at the beginning of modernity resumed intensified competition for innovation and goods.

This is good example of the need to reevaluate the role of competition and solidarity among people from an ethical standpoint. Often, as described above, the idea still prevails that fierce competition redistributes limited goods from the vulnerable to the strong and that the actions promoted by competition dissolve solidarity between people. These considerations are based on the idea that the capitalist system of competition still mostly plays zero-sum games, which means that all the gains of one supplier must have been taken from another market participant. However, this way of thinking has arisen in the context of the premodern subsistence economy, an economic order which produced hardly any growth and little innovation. Against this backdrop, the concept of competition is almost necessarily associated with a decline in solidarity and cooperation.

But this view is incorrect: Competition by no means stands in opposition to solidarity. On the contrary, it is the most effective instrument of "social interaction for the benefit of all, including the disadvantaged" (Homann, 2003, p. 13). The normative lines of argument are still trapped in the premodern paradigm of the subsistence economy and zero-sum games. Empirical findings prove beyond a doubt that the market economy and the accompanying competition made possible a previously unknown rise in prosperity. However, in order to be able to fully exploit the aspects of a market economy that promote prosperity, conditions for competition must be put in place that are different from those found in the premodern era. A modern system of competition is not a "war of all against all," which is free of rules and regulations. Rather, the main focus of a sensible business ethics must be on the conditions, i.e. on the rules of competition. The rules of competition, which are laid down in the framework, thus apply to all participants and prohibit certain types of behavior such as violence, fraud, and tax evasion. In the best case, competition focuses on the quality and cost of the products, which benefits both consumers and competitors. The competitors always have the opportunity to reach new customers or to retain existing customers by improving their products, for example through innovation. Under the right conditions, competition becomes a performance competition and thus an "engine of growth" (Homann, 2003). By instituting an appropriate performance competition, societies manage to escape the premodern subsistence economy and overcome thinking in the zero-sum paradigm. It is precisely in this sense that competition becomes an ethical imperative under the right conditions. The ability to bring prosperity to an ever-increasing number of people by constantly augmenting the cake that can be distributed leads to the following thesis: "Competition is more constitutive of solidarity than sharing" (Homann and Blome-Drees, 1992, p. 111).

In order to be able to escape from premodern patterns of thinking, it is necessary to reevaluate competition and the individual striving that goes along with it (Lütge, 2019). For many people, the neoliberal theory of the market economy—in particular because of its model-theoretical assumption of homo economicus (see Section 4.2)—is a justification of "egoism" and of pure self-interest. The story of St. Martin symbolizes this viewpoint, which is critical of the market economy: When St. Martin encounters a freezing beggar on his journey; he unceremoniously slices his cloak in two with his sword, giving one half to the man. This "altruistic" act is frequently considered to be the epitome of a good deed. This point of view, however, is now insufficient in modern society. Even in the original legend, one cannot help but wonder whether after dividing the coat, both actors did not freeze given the functional loss of the garment. Modern societies, which generate almost exclusively positive sum games, operate according to another principle. The obvious problem of the freezing beggar is not solved through the sacrifice of an individual's prosperity, but rather through investments and competition. This would have ensured, in this case, that more and better coats were produced and that no one has to freeze again. Following a moral system adapted to modern society, St. Martin would invest in the production of winter clothing, which would then enable every person in need to buy an inexpensive and functional coat.

Traditional ethics, conceived as ethics of behavior, has only the improvement of the individual's character in mind and tries to change or "improve" behavior in general via appeals. In doing so, the conditions of action are systematically ignored. The concept of "self-interest," which has traditionally had a bad reputation, must be reassessed in the course of social development and the possible structuring of framework conditions. One reason is the decrease of control in people's social environment. A moral system that cannot rely on a social control system has never worked in the long term. The premodern social control system is on the decline due to numerous lifestyle changes.

People in the premodern era were trapped in relatively manageable social structures, which ensured that the same interaction partners met again and again in the forms of family, village community, or local market. Outside of the nuclear family and a tightly knit working environment, however, this form of social control can no longer be effectively enforced in the modern world. In the premodern era, it was easy to develop social control over face-to-face mechanisms in a low-cost and effective way. The individual could de facto hardly escape this form of supervision. Moral misconduct was easy to detect and easily sanctioned by the respective peer group. Possible sanction mechanisms included, for example, exposure to ridicule within the (small) social group or the complete discontinuation of cooperation in the worst case.

In the modern world, which is chiefly characterized by strong differentiation, the individual has different functions and assumes different roles. Within these differentiated systems, people encounter ever-changing cooperation partners, which means that they can affordably escape social control, i.e. face-to-face control, and that possible sanction mechanisms lose much of their deterrent potential. Every action in modern mass societies can have hard-to-identify and far-reaching effects on people who are away from their individual environment. The consequences of a certain behavior can have an effect on the actions of many others within a mass society like ours today—to a certain extent, they become the conditions for their actions. A morality that pursues individual ethical concepts such as the principle of charity without adapting to the conditions of modernity can therefore easily overburden the individual.

Modern ethics must adapt to the changing conditions of mass society. For if an ethics cannot be permanently implemented in the absence of the old form of control, then a new form of control must be developed. If control by others is no longer necessary, then control in the form of self-control must take its place. A form of self-control relies on the conscience of the individual. Through appeals to "good" actions, an effort is made to induce the individual to internalize moral norms and thereby to control their own observance of morality. This form of self-control can theoretically be justified, but it quickly reaches its limits in empiricism, that is, in the realities of human life. In an economic order based on competition, voluntary moral action that is costly and beyond what is legally required is risky, for such a behavior is exploitable: "Self-control along morally internalized informal norms is therefore doomed to failure" (Homann, 2003, p. 16). People, groups, and companies risk being put at a competitive disadvantage, which can lead to their exit from the market.

While a focus on tropes such as charity and altruism cannot be taken for granted, even within the small group, it is on the other hand far more difficult to pursue these motives if an unmanageable number of people are affected by an individual's actions. Apart from this, the very attempt to orientate one's actions towards traditional motifs seems absurd. Acquiring a general overview of the effects of different actions is impossible so that, even if one really wanted to, one could hardly achieve this orientation for reasons of limited cognitive capacity. Only a certain form of self-control takes into account the conditions of modern society: self-control vis-à-vis one's own interests. Under a suitable framework which penalizes certain acts and under the conditions of a functioning competition, the only possible form of control is an incentive-compatible self-control. Thus, the notion of self-interest is also normatively upgraded, as it is the necessary condition for self-control to function under the conditions of the modern market economy. The framework, i.e. the behavioral conditions that a society sets out for itself, has a central role to play. It should be designed in such a way that only those who can offer something of value to their fellow human beings on the market, i.e. who take others' interests into account, should be able to make constant and systematic profits.

The ethically desirable actions are thus brought to bear in the slipstream of self-interest. This form of justifying self-interest, which was already developed by Adam Smith, has the advantage of adapting to empirical needs and enabling moral behavior in the long run. It is in this sense that the famous remark of Adam Smith is to be understood:

> It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. (Smith, 1776/2007, pp. 9–10)

A morality that continually requires the individual to act against his or her own interests has little chance of implementation. If the individual always comes up short and sees himself systematically disadvantaged and exploited, he or she will either turn away from morality over time or leave the market for economic reasons. For the self-control traditionally demanded by moral norms often leads to situations that are verbalized in proverbs like "Nice guys finish last."

A second reason for the need to reassess self-interest is the fact that the pursuit of individual advantage under suitable conditions brings more advantages for fellow human beings than any other form of motivation. Indeed, self-interest—given the appropriate framework—might be understood as a kind of "modern form of charity," since it promotes prosperity and induces people to produce what benefits their fellow human beings the most.

Business ethics is changing from a renunciatory premodern ethic of moderation to a modern ethics of investment and an "ethics of competition" (Lütge, 2019), which puts individual striving at the service of everyone's welfare. The traditional conflict between "good" altruistic behavior and "bad" egoism is therefore no longer valid. The decisive factor for a good action under modern conditions is the individual's pursuit of his or her own advantage, which, in turn, improves the lot of others. Self-interested action at the expense of others must be made more onerous through a suitable framework (formal or informal) that makes it not worth doing.

Translating moral norms into the language of self-interested advantages gives rise to the benefit of having a sharper focus on behavioral conditions. A framework that guides people to perform out of self-interest exactly those actions that serve them and their fellow human beings the most, creates the right conditions, first, by enabling moral action (without the risk of exploitation) and, second, by solving the thorny problem of how to control the individual socially in modern society.

The ethical quality of competition therefore lies in its systemic ability to produce good results. As "system ethics," a competitive market economy pays tribute to the realization that in today's world there are many highly complex systems that cannot be steered by morality, i.e. appeals to the individual. Individual ethics is highly intuitive. Indeed, in the Kantian tradition it inquires: "What should I do?" and tries to find answers to that very dilemma. However, the conditions for putting individual values into practice have changed fundamentally. An ethics that ignores the complexity of today's dominant systems cannot be successful in the long run. Trying to enforce ethical values without considering the framework conditions of today's society easily can easily lead to unintended consequences (see also practice box 3.1: Burning ivory in Kenya).

The following should be kept in mind when using the term "self-interest": The term "self-interest" refers to the pursuit of individual advantage in the

Practice box 3.1 Burning ivory in Kenya

In 2016, the Kenyan government decided to burn 105 tons of confiscated ivory. President Kenyatta personally set fire to the large pile of seized material. What at first appears to have been notable success in the fight against illegal poaching and the eradication of an entire species, could ultimately have serious negative consequences. While the Kenyan government's action was a powerful statement against poaching, it may soon prove to be a Pyrrhic victory.

If we can assume that most poachers primarily hunt elephants to gain as much profit as possible, and not out of sheer pleasure, the effects of the ivory burning campaign are easy to anticipate. For if the demand for ivory does not diminish (that is, before and after the action, an equal number of people want to buy ivory, even illegally), then the burning of 105 tons of ivory greatly depletes the overall supply

To begin with, the black market was likely dealt a heavy blow. However, if there is a decline in supply in a free market—and in this respect black markets are free—equal demand means an increasing price. Price increases make the prospect of obtaining ivory even more attractive to active poachers and fencers. This, in turn, results in a significant expansion of elephant hunting, as higher prices logically offer a greater incentive.

If systematic connections are overlooked, even well-intentioned acts can often lead to unforeseen and above all unwanted consequences. A contraction of supply has devastating consequences. Instead of making the elephant hunt less attractive to poachers, for example with the gradual sale of the 105 tons, the price of ivory will be pushed upwards, increasing the incentive for each individual elephant hunter. On the other hand, the gradual sale of the ivory under certain conditions would lower the price of ivory, poachers would receive less money for their plunder on the black market, and the incentive to hunt elephants—which is undoubtedly fraught with risk—would continue to decline.

Source: Biggs, Duan, Holden, M. H., Braczkowski, A. R., and Possingham, H. P. (2016). Track the impact of Kenya's ivory burn. *Nature*, 534(7606), 179.

sense of an open benefit concept (Becker, 1976). By no means does this refer to only monetary or material advantages (in the narrow sense), but rather to exactly what the respective individual perceives as an advantage. People have different goals, but apart from material prosperity and wealth there are also goals such as health, the realization of a life plan, or joy in the well-being of one's fellow human beings.

3.2 The benefits of the market and competition

It was mentioned above that the institution of competition has been the primary factor in the unique prosperity growth of the world over the last 200 years. The ability to compete is essential for economic ethics, since an increase in prosperity and the voluntary exchange paradigm do justice to the individual's personal freedom. But this insight requires closer examination: How did the institution of competition make this general growth in prosperity possible? And what institutional framework should competition be given, that is, what limits should the principle of competition have and what kind of interventions in free competition may be required?

3.2.1 Conceptual history and linguistic usage

Here, some conceptual clarifications are necessary in order to define the concept of competition in a meaningful way and to make it fruitful for further observations (Lütge, 2019). Competition is a state of competitive striving between several players. Contrary to "struggle" (or "combat" in general), the competition of the market economy is by no means natural and cannot be sustained on its own.

Competition in a market economy requires a corset of rules that has a stabilizing effect and makes possible and accentuates the positive characteristics of competition. Without a suitable set of rules, competition as an artificial structure can quickly lead to a "ruinous competition" (Hobbes, 1642). The distinction between competition and struggle is also important with regard to the consequences. The economist and liberal Ludwig von Mises described this difference as follows:

> It is merely a metaphor to call competition competitive war, or simply, war. The function of battle is destruction; of competition, construction.
>
> (Mises, 1922/1951, p. 320)

Competition has not always existed but is a product of civilization—and thus cannot permanently sustain itself. Competition only acquires stability through the introduction of rules. These rules, which essentially define the framework for the competition, have always been central to sports competitions. From the Olympic Games in antiquity to medieval tournaments, where the nobility measured themselves against each other in feigned battle situations, sports competition (in accordance with specific, typically injury-minimizing rules) has always connoted something positive (Wetzel, 2013).

The term competition is derived from the Greek word "agon" (conflict, struggle, or contest). Competition and victory were concepts that permeated the lifeworld of Greek antiquity. In Latin, there are the verbs "competere" ("trying to achieve something at the same time") and "concurrere" ("collide, converge"). Competere originates from the judicial sphere and describes the formally regulated interaction of opposing parties (Richter, 2012). Concurrere refers to direct combat, both the joint taking-of-arms and the clash with the enemy to defeat him. Concurrere thus designates less a concrete goal contested by several parties than the combat itself. Therefore, unlike competition—derived from the verb competere, it does not take place according to fixed rules (Richter, 2012).

In English, the term competition refers to both competition and rivalry. According to the Oxford English Dictionary definition, competition goes back to the Latin verb competere, which refers to the competitive situation between two parties over the same object (Richter, 2012). In German, the two terms fall apart. "Konkurrenz"—which is derived from the Latin concurrere—refers to the basic notion of a contest against another party. The term "Wettbewerb" is somewhat more complex: In the Grimms' dictionary, "Wettbewerb" is described as a key concept of liberal economics and social science. "Wettbewerb" is also put into other contexts: for example, "politischer Wettbewerb" (political competition) is the struggle of nations for the favor of third parties; "künstlerischer Wettkampf" (artistic competition) is the competition to create the best work of art; and "biologischer Wettkampf" (biological competition) concerns the survival of species.

In order to assess the economic benefits of a market economy, it makes sense to compare its performance in relation to an economic system that embodies exactly the opposite: the planned economy. In a planned economy, all decisions about what is produced and who produces it are made centrally and then applied to an entire economy. The approach is therefore based on the premise that an economy as such can be planned and that, if the right people are utilized, it is possible for a central committee to correctly predict all the needs of a country or an economy and to optimize production toward this end. A look at the empirical attempts to put this economic order into practice clearly shows that this form of planning is at best inadequate and at worst catastrophic. The socialist states of the twentieth century lacked important principles of a competitive market economy (even if there were some competitive elements: Lütge, 2019, pp. 15f.). Ultimately, the alignment of the interests of the people in planned economic systems on the supposed principle of the common good resembles the failed attempt in the premodern era to extend the standards that applied for the small group to a national economy. Even decades of educating people in the former Eastern bloc states did not translate the mentality of the small group to a large group of several million people.

In the following, six reasons will be examined in more detail that are inseparably linked to the success story of market economies.

3.2.2 The market as an instrument for the use of distributed and local knowledge

The economist and Nobel Prize laureate Friedrich August von Hayek (1899–1992) describes economic relations and human needs as a complex and spontaneous order. In contrast to a market economy, the planned economy makes the mistake of recognizing complex social structures in their entirety through scientistic analyses, just as in the natural sciences it is possible to describe and correspondingly optimize by way of general laws. Hayek describes this as a "presumption of knowledge" (Hayek, 1973) and contrasts this approach with the free market as an information catalyst.

The needs of people and their production skills are too complex and inconsistent to be recorded and evaluated by a central office. Even if this could be done magically for a time, the needs of the people and the conditions of the world would change far too quickly, making even a perfect one-off analysis useless. Rather than relying on the plans of a central authority that sets general production quotas and prices, the free market is able to process the knowledge of all individuals to constantly adapt to changes in the environment or people's needs. The market is able to coordinate existing and distributed knowledge and act as a catalyst for all information.

The medium through which the market bundles the information and makes it available to all market participants is price. A great deal of information figures into the price of a given product—in fact, much more than a central planning committee would ever be able to determine or even notice with sufficient speed. Information dissemination and processing via price also has the advantage that the actually relevant causes for a price change do not need to be known to the individual for them to optimally adapt their behavior to the new conditions. Let us assume for a moment that a fire in a South American copper mine results in a production stoppage there for several weeks. This would consequently diminish the supply of copper on the world market, albeit still marginally, which would then increase the price if demand remains constant. This information would enable a medium-sized German company, which uses precious metals for its products, to adapt its production to the new conditions. For example, it might replace copper with another precious metal, which is now cheaper to obtain due to higher price of copper. This optimization of limited resources happens at the other end of the world and probably without the German company even knowing why the raw material copper has become scarce. The market mechanism has the ability to transmit information about scarcity instantaneously. As a result, every entrepreneur can respond to this new information and change their production accordingly. In the free market, price thus allows participants in the market economy to use objective information that they would otherwise not be able to access.

That said, the discovery function of the market is not limited to adjusting production and services due to changing circumstances. Rather, the "functionality of decentralized knowledge processing [...] is based on competitive market forces whose impersonal, indiscriminate pressure to adapt enables civilizational progress" (Pies, 2003, p. 11).

3.2.3 The market as a method of discovery

Closely linked to the first point is the description of the market as a method of discovery. As already discussed, economic activity in modern society no longer takes place in the zero-sum paradigm, but in the growth paradigm due to increased productivity or innovation, both in production and in the more efficient use of existing resources. Competition makes it possible, through the constant exchange of information and the constant pressure of competition, to create goods, concepts, services, and even ideas that were not known before. At the same time, it discovers new methods and orders which, because they were previously unknown, cannot be sensibly controlled.

With the help of competition as a method of discovery, we can recognize facts that "without its existence would either remain unknown or at least not be made use of" (Hayek, 1969, p. 249). For this reason, one could even say that the term "market economy" is an oxymoron. Competition and the market stand for a competitive order, the economy for their predictability. However, the market process itself creates a permanent framework in which the spontaneous order can unfold and remain stable over the long term. The competitive order, which Hayek calls "catallaxis" (from the Greek "katallage" = exchange), is thus a method for the unplanned discovery of new facts made possible by the free exchange and voluntary cooperation of different individuals.

Due to the parallelism of different approaches to solving economic problems, competition and the market itself become learning systems. By exploiting the knowledge of millions of people, competition discovers solutions that either spread through evolutionary processes—or atrophy in failure. It should be noted that these findings may not only affect products or services, but also spheres of human coexistence in general (Lütge, 2019, chapters 4–8).

3.2.4 The market as an engine of innovation

It seems self-evident that societies that have a free economic system are also more innovative. Competition acts as an engine for innovations and improvements in products and services. The transition from a small-group economic order based on zero-sum games to modern society and its generation of wealth based on the division of labor is largely due to the ability of competition to drive innovators and stimulate them through certain incentives, such as pioneer profits, improvements to production, and the invention of new products and services.

Merchants and entrepreneurs have made a major contribution to overcoming the zero-sum games of the premodern era. Still, there are different views on what causes this growth in prosperity. The classical thesis, prominently represented by Joseph Schumpeter, states that the responsibility mainly goes to a certain type of person: the "dynamic entrepreneurial type." This type of human being is particularly prevalent in market economies. It is his or her actions in the process of "creative destruction" that ensure the improvement and new development of products (Schumpeter, 1912/2012 and 1942/1976). To a certain extent, this interpretation of the entrepreneur can be traced back to the genius cult of the nineteenth century, which largely attributed important social developments and outstanding achievements to the work of extraordinary individuals. This hypothesis has a real grain of truth in that some outstanding individuals, scientists, inventors, and entrepreneurs have indeed improved the world through their own dedication, or simplified production, or generally increased human knowledge. All the same, this approach does not seem to explain why such an increase in prosperity was possible precisely with the onset of the Industrial Revolution. After all, there have been outstanding and ingenious individuals at all times whose impact nevertheless failed to transcend the zero-sum paradigm.

Therefore, recent research, in particular William Baumol (2002), presumes that a rules-based market economy with competition itself brings forth this type of entrepreneur, which it needs for its success. The incentive systems of competition rewarding successful action are the starting point for the development of a new and creative type of entrepreneur. The institution of competition is seen as the reason for the increasing success of modern societies—and by no means the sudden (inexplicable) appearance of many exceptional individuals.

In premodern times, competition was often suppressed or obstructed in some way, so that free enterprise could hardly develop. This is illustrated by the example of the guilds, which forced economic activity into a closely regulated system and undermined excessive competition by restricting the admission of providers. On the very limited supply side, there was little real competition between the various providers, and the incentives for innovation and continuous development were weak. By contrast, the modern market economy, which makes competition the central principle, manages to recognize the function of competition as a "driving mechanism" and harnesses it. The free development of individuals, the resulting competitive situations, and the opportunity to be the "architect of your own fortune" drive innovation and the constant striving for personal advantage through improvements in products and services. After all, competition only rewards those who offer products and services that are demanded by other free individuals. A similar development has taken place in Asia in recent years. The freeing up of competition in new market-based systems has not only increased material wealth in numerous countries there (e.g. China, South Korea, Indonesia, Vietnam), but also boosted innovation activities. This is demonstrated above all by South Korea (Samsung, Hyundai, Kia, etc.), but also in earlier decades Japan (Sony, Toyota, Panasonic, etc.).

According to Baumol, however, this initial development of free market forces through competition and the subsequent innovation boom is not the only advantage. Rather, competition and the innovations that become necessary as a result give rise to a feedback effect. The innovations intensify the competition. And the competition reinforces the mechanism that made innovation activity possible in the first place. At the end of the day, no company can rest on the laurels of its new innovations. The development of new products and services is constant, and companies that lag in their innovation performance are quickly left behind. There is no shortage of examples here: Baumol (2002) cites historical examples ranging from the automobile market to steam propulsion and radio communication (Baumol, 2002, pp. 287f.).

3.2.5 The market as a control mechanism

As already mentioned, modern society is also characterized by the elimination of simple and intuitive face-to-face control. The mere possibility of social control, as was common in premodern times, falls prey to the vast number of possible interaction partners and their geographical and cultural distance. While an untrustworthy business partner in a small premodern community could be sanctioned and punished—culminating in the termination of all business relations—this is not possible in today's globalized economy. To be sure, legal framework conditions create rules that can theoretically be enforced in court. However, the costs and the duration of this path weaken the actual effectiveness of the legal process enormously.

Competition counteracts these disadvantages of pure formal jurisprudence by means of a characteristic that can solve or at least mitigate many of the aforementioned problems. In an economy based on the principle of competition, market participants serve as de facto controllers of their respective counterparts. Competition itself consists of a multitude of control mechanisms that take effect at different levels, ensure the fulfillment of contracts and prevent the conduct of individuals aimed at unlawful enrichment. The control functions in the market are primarily assumed by competing companies, each of whom wants to bring their products to the customer. If a competitor does not play by the rules, it will not remain hidden from the competition for long. If a company demands an "inflated" price for a product, the market likewise controls the provider through the competition. By undercutting the price, the competition can win customers and thus bring down the price overall.

Corporations are also proactively involved in control mechanisms: It is the shareholders within a company who—in the case of public limited companies—monitor the behavior and activities of the executives through the Annual General Meeting and, even more so, through the Supervisory Board. Externally, companies are interwoven with a wealth of commercial relationships with suppliers, customers, and other stakeholders. Each of these, in turn, provides control over the company. The discipline of competition compels companies to pursue the most effective strategy in order not to fall behind the competition.

3.2.6 The market as an instrument of disempowerment

An important advantage of an economy based on market forces is that it systematically prevents the concentration of power. Franz Böhm (1895–1977) called competition "history's greatest and most ingenious instrument of disempowerment" (Böhm, 1961, p. 22). On the one hand, this means that the market mechanism is impartial insofar as it rewards only what meets demand and those producers derive benefits who are best able to meet the customer's demands. Well-functioning competition does not favor anyone for any reason other than performance and the ability to successfully fulfill a need.

This does not mean that power positions can never emerge in a market economy based on the principle of competition—on the contrary, it happens very often. However, these positions of power are immediately threatened by competition, so that an abuse of this very position of power is systematically kept in check—and more effectively than in alternative economic systems with little or no competition. Even companies with a large market share and thus a certain power position (e.g. Microsoft in the late 1990s) can never be sure that they will not have competitors, or that they will be able to maintain their market share, or that their products will not become obsolete. Others, then, will take over the market leadership. Competition thus assumes a socio-political function that extends well into the political realm (Lütge, 2019).

3.2.7 The market as an instrument of self-discipline

One of the social functions of competition is to promote the self-discipline of the players in the market. Since a business transaction in a market economy only occurs when both parties believe that they benefit from the exchange, competing companies need to reconcile their own idea of advantage with that of their future partners. To a certain extent, competition in the market limits pure greed recklessly aimed at one's own advantage. To be successful in a market economy based on the principle of competition, the interests of the other must be addressed. In other words, under competitive conditions even the pure egoist can only succeed if he or she is willing to forgo short-term exploitation for cooperation gains, i.e. to cooperate and seek a common solution.

This thesis is also confirmed by empirical-experimental research. In the famous ultimatum game (Güth et al., 1982), a participant receives a certain amount of money, which he can divide between himself and an unknown partner at his own discretion. This distribution is submitted to the partner for approval, which is made as soon as the latter agrees. Yet, if the partner rejects the proposed split, neither participant receives anything. In microeconomic theory, it would be considered irrational to offer more than the smallest possible amount, or for that matter if the partner refused a positive amount. On the other hand, empirical research has come to the realization that people offer more than theoretically predicted, and that they also sometimes do without large sums of money. Rather than accepting a seemingly unfair distribution, they prefer to go empty-handed. Contrary to the reputation of the market economy as an instrument of greed, experiments show that those very participants who come from a culture of the market and the modern economy often propose distributions that approximate an equal distribution of the amount. In fact, the strongest factor that can explain whether equality-based sharing will take place is whether a participant comes from a culture of competition or not (Ensminger, 2004).

This apparent contradiction can be resolved as follows: Through constant interaction with strangers in different contexts, the conviction emerges in a market economy that these interactions can generally be mutually beneficial. Reputation building and the need to be viewed as a trustworthy partner are factors that still play a role even if, as in the case of the ultimatum game, they cannot be decisive due to the anonymity of the participants. The self-discipline of participants from market economies with competition thus extends beyond the actual use and keeps excessive egotism in check. The habit of interacting with strangers leads to much more cooperative behavior. Unlike people from modern market economies, people from more isolated economies tend to be skeptical of strangers, are more likely to classify them as a threat, and distribute the amount in the ultimatum game more unequally for their own benefit.

The advantages of the market listed here, however, are based on the existence of functioning competition—that is, they rely on the fact that companies can be successful through innovation and quality but can also fail if they are not competitive. Many people intuitively believe that certain businesses should be in the hands of the state and privatization should be rejected as a matter of principle. But it is important to recognize that the failure of entrepreneurship is an important aspect of competition and the free market economy. Solutions that have not proven useful must be discarded and resources tied up in them must be used more productively.

3.3 The fair price

In the following, the theory of the fair price, on the one hand, and the prohibition of interest, on the other, will be discussed in more detail as examples of premodern moral standards. The latter, it should be mentioned, persists in the Islamic tradition up to the present day.

3.3.1 Ancient Greece

Ancient Greek philosophy with its preeminent representatives Plato and Aristotle, was already concerned with the question of just economic activity and the fair price (iustum pretium).

Plato (427–347 BCE) tries in his work "Nomoi" (*The Laws*) to achieve a reform of society and the state culminating in an order guided by reason, freedom from arbitrariness, and laws (Plato, 2013). People's aspirations are to be organized according to their moral virtue. Here, the citizens' commitment to virtue comes first and the acquisition of money last. Plato is chiefly concerned with the citizens' state-sponsored pursuit of virtue. In his view, commercial activity for profit is to be rejected because it is not based on labor, but a form of wealth creation lacking effort. In his ideal state, Plato also generally recognizes an upper limit on a citizen's degree of ownership. Plato wants to strongly regulate the daily economic transactions, which were carried out in the polis on the agora (the marketplace) and above all served to supply the citizens. The price of a good may only be determined by the seller once a day and may not be changed afterwards. A profit is permitted only within modest margins, that is, as a moderate premium on the "value" of a price or service. The value of an item is not explicitly named or calculated, but Plato claims that every seller knows the "value" of his or her goods.

Aristotle (384–322 BCE) dealt with the doctrine of price in more detail. In the fifth book of the *Nicomachean Ethics*, he discusses "compensatory justice," which bases the price of a good or service on proportionality. The measure of proportionality is once again the need, which must be assumed to be mutually present. Otherwise, no exchange could take place. In Aristotle, the price of a commodity, which is measured in monetary units, already has the function of bundling certain information such as the scarcity of a good. The price of a commodity should depend on the need.

In this context, Aristotle's distinction between economics (the art of keeping house) and chrematistics (the study of wealth) is important: The first category mainly includes goods that are useful or necessary for the family or the state. The principle of demand fulfillment applies. That said, ultimately and in principle, a family's need for essential goods must be met. The basic use of money to cover needs is therefore not contrary to nature and therefore morally permissible. The area of chrematistics stands in contrast to this, however, for it does not impose any restrictions on profit and is therefore unnatural. Significant profit through trade means that one person enriches himself at the expense of another (zero-sum game). Doing business with money itself is to be rejected in particular: The pure accumulation of capital, which arises through interest, is immoral, since it generates a profit from the money itself and not from its exchange function. Aristotle thus generally disapproves of charging interest.

3.3.2 Roman Republic

The notion of a just price in the Roman Republic can be found above all in Cicero (106–43 BCE). In one of his examples (*De officiis* III, 12), a merchant with a supply of grain is heading to the island of Rhodes, where a famine and an extremely high grain price prevail. At the same time, the merchant is aware that other grain deliveries are already en route. Cicero contemplates whether the merchant may conceal his knowledge of the subsequent deliveries in order to sell his grain for the most profit, or whether he is obliged to refer to the other deliveries. This information would, in turn, significantly reduce the price he receives for his goods.

Cicero discusses this question in the form of a dialogue between two philosophers. One takes the prohibition on exploiting an information advantage as a subversion of the right to property; the other argues that the world community would forbid such exploitation. Cicero agrees with the latter and argues that the seller should disclose all the information that affects the transaction. The same applies to the buyer. To illustrate this, he cites the purchase of the house of the jurist and politician Scaevola, who found the asking price of a house too low and voluntarily paid 100,000 sesterces above the offer. Herein lies the idea, which was widespread in antiquity, that ultimately every human being knows about the "value" of a good—that it lends itself to a kind of objective determination of value. The good and the useful were considered congruent, since any infringement would be punished by a loss of reputation (*De Officiis* III, 13, 57).

3.3.3 Middle Ages

The surviving works of ancient philosophers had a great influence on the world of ideas in the Middle Ages. The traditional teachings of ancient philosophy were united with Christian doctrine, which is why it is necessary to discuss the religious claims on the fair price ("pretium iustum").

In the Old Testament (Lev. 25:14), Moses already made the clear demand that no one should "take advantage of his brother" in a transaction. Once again, it is assumed here that sellers and buyers already have an idea of the "fair" price. At the same time, however, there would be no exchange unless the two contracting parties assess the value of a commodity differently. The seller necessarily estimates the value of his commodity below the value of the money; for the buyer the opposite is true. In general, the view is expressed that the risk of one party fleecing the other is eliminated if they both act in good faith, i.e. without the intention of doing harm.

One particularly interesting aspect of the Old Testament, however, is the fact that economic activity was generally subject to an ex-ante suspicion. There is an unambiguous warning in the Book of Jesus Sirach (Sir. 26:29) about commerce as a moral danger: "A merchant can hardly keep himself from doing wrong, or a huckster from sin."

In the New Testament, too, which is steeped in antique influences, there is a notion of economic activity that is primarily aimed at moderation. The Apostle Paul (1 Thess. 4:6) clearly expresses this when he writes that "No one should go too far" and take advantage of his or her trading partner. Another well-known dictum is found in Matthew (Matt. 6:24), who teaches that one cannot serve God and "mammon" at the same time. These principles were widespread and widely accepted in early Christianity. However, one can hardly speak of a true doctrine of the economy. The teachings of the value of a thing and of any distributional justice remain too general.

There are two main reasons for this: First, in early Christianity the view was widespread that the Last Judgment and thus the end of this world was imminent anyway. Hence an accumulation of wealth would have made little sense or even thought to have been detrimental to the soul's salvation. Second, most early Christians lived in tightly knit communities committed to an ideal of communal equality, in which the transfer of money to the weaker was regulated through donations. Plato is evoked both with regard to the restriction of trade to those goods that serve everyday needs and the general elevation of spiritual values over the purely material, which may be traded.

In the subsequent course of history, however, no coherent picture emerges as to whether or not Christians are allowed to engage in commercial activity. Among the Church Fathers, one finds the entire spectrum of views: While some argue for tolerating trade out of economic necessity, others want to limit the pursuit of profit or—at the opposite extreme—de facto abolish the occupation of the merchant in order to preserve man's salvation (Gilomen, 2014, pp. 8f.). In general, however, the Church Fathers make rather superficial demands in their statements on the fair price and hardly offer a well thought out and consistent theory.

An exception to this is Augustine (354–430), who in his *De Civitate Dei* (The City of God) establishes a first theory of values and a ranking of these values as follows: It is generally true that living beings stand above the non-living, and the reasonable above the unreasonable. The purchase price, however, is based exclusively on human needs. In no way can we start from a subjective theory of value, as characterizes the modern economy and according to which every person (with his or her personal preferences) ascribes a very individual value to things. Rather, Augustine has in mind a very definite ranking of human needs—one determined by experience, which he considers to be objective and thus valid for all human beings. He thus writes that it is obvious that a horse is more expensive than a slave, since the former is better at fulfilling human needs (e.g. as a means of transport or beast of burden). Unlike many of his contemporaries and predecessors, Augustine does not see trading gains as something bad per se (although he also points out the moral dangers). As long as the profit does not exceed the limit of what is socially merited, it is not morally reprehensible. Augustine is particularly important because his reflections had far-reaching influence over the entire Middle Ages. Furthermore, through the spread of Christianity, his view had considerable impact on the development of the economic order throughout Europe.

Despite his prominence, the question of the fairness of a purchase (and thus of the price) remained of secondary importance in the day-to-day reality of people's lives. The social structures in Europe consisted mainly of local small groups and a broad urbanization, and large-scale trade was still largely unknown. In addition, free trade was also limited in its scope by the feudal regime. This changed for the first time with the increasing emergence of pilgrims in Franconia in the ninth century. Since contact with strangers no longer took place exclusively in small socially integrated and controlled groups, it gave rise once again to the question of transactional justice. Under Carloman II (King of West Francia, 879–884), priests were urged to preach to their faithful that they should not sell their goods to strangers more dearly than they would sell on the market. This is an indication of the existence of a market price, although it cannot be determined with certainty whether this is a genuine market price (pretium naturale), i.e. formed by supply and demand, or a price fixed by the state (pretium legitimum). This distinction only became clear a few centuries later.

3.4 The prohibition of interest and usury

3.4.1 Ancient Orient

In the Old Testament, there are already numerous explicit prohibitions on taking interest. Thus one reads in the Book of Exodus (2 Exod. 22:25): "If you lend money to one of my people among you who is needy, do not treat it like a business deal; charge no interest." And in the book of Leviticus (3 Lev. 25: 35–37) it says: "If your brother becomes poor and cannot maintain himself with you, you shall support him as though he were a stranger and a sojourner, and he shall live with you. Take no interest from him or profit, but fear your God, that your brother may live beside you. For thou shalt not lend him thy money in interest, nor victuals for an additional charge."

What is particularly remarkable is the fact that this prohibition applies only to "peoples," i.e. to members of the group closely linked from a moral point of view. A moral rule that can be maintained in the small group is consequently not applied to behavior towards outsiders. The Jews in the Old Testament are expressly permitted to take interest: "You shall not take interest from your brother, neither for money nor for food nor for anything for which one can take interest. You may charge interest to a foreigner, but to your countrymen you shall not charge interest, so that the LORD your God may bless you in all that you undertake in the land which you are entering to possess" (Deut. 23:19–20).

As far as we know, no other peoples of the ancient Orient had a ban on interest (Kolb, 2004). From the time of Hammurabi (1792–1750 BCE) to the Persian period, there is evidence of interest being taken on financial transactions of up to 20 percent and evidence that up to 30 percent was possible for a loan of other goods (mainly in kind).

3.4.2 Greek-Roman antiquity

Greek-Roman antiquity offers a differentiated picture. In practice, there was always the possibility to give or take credit. The absolute level of the interest rate fluctuated strongly and is highly correlated with the political situation, i.e. higher interest rates are demanded in politically unstable times and lower interest rates in epochs that are more stable. Cicero reports that interest rates fluctuate between 4 and 8 percent, but in rare cases fluctuations up to 12 percent are possible. Already in the Twelve Tables of the Romans, which originated in the fifth century BCE, the Romans recognized the peculiar financial character of moneylending: “[that] there is money which does not exist in coins but only in figures, mostly in debt registers, and that this money is capable of complicating the socio-economic life of individuals and society as a whole” (Mrozek, 2001, p. 9). In Rome, compound interest was also widespread, so that it was not only customary to take interest on the borrowed amount, but also to pay interest on the interest itself, especially in the event of temporary liquidity problems. Roman history also includes the case of debt relief, which was granted to provinces, for example, if the debt burden was too high and therefore de facto no longer repayable.

Despite the indisputable practice of taking interest, the most important ancient philosophers take a negative attitude towards interest. Thus, Plato and Aristotle, as part of Greek antiquity, and Seneca, representing the Roman era, speak out against moneylending with interest. Plato, for instance, writes in the *Laws*: “No one shall deposit money with another whom he does not trust as a friend, nor shall he lend money upon interest; and the borrower should be under no obligation to repay either capital or interest (*Laws*, 5.742 C).

For Plato, interest or the multiplication of money through loans, which is characterized by the fact that no direct work is done to acquire money, is a danger to the state order, which Plato holds to be the most important institution. In the Athens of Plato’s time, taking interest was ubiquitous. Above all, many citizens attained personal wealth through shipping. Plato opposes this because the power that a large fortune brings with it can undermine measures and laws of the state. The philosopher establishes here a contrast between state and capital, which became very influential (it was taken up by Karl Marx, for example). The state “[can say good-bye to] shipping and merchandise and peddling and inn-keeping and customs and mines and loans and usury, and countless matters of a like kind” (*Laws*, 8.842c). While the sources of the Old Testament cited above reject the prohibition of interest in the community for reasons of aid among members of a tribe or people, Plato’s argument is more abstract: the state (in Plato’s conception)—including the foreigners residing there—must be strengthened as the highest moral good. Any freedom of individuals, on the other hand, which clearly enables them to make a large fortune, has the potential to weaken the state and to counteract the enforcement of the basic moral order in the body politic or at least to complicate and impede it. Plato rejects the practice of lending money at interest because it can destroy the social order.

In his work *The State* (8.555 E 2f.), Plato further explains how moneylenders gathered in a market and did not dare to look their customers in the eye. From Plato’s point of view, even those who profit from credit trading with interest are well aware of their wrongdoing, because they know that they are increasing the number of the poor in the state. An exception to the ban on interest is only provided for in the case of artisanal services. If a customer does not pay for the completed work, the craftsman can demand the money with additional interest. This interest is morally acceptable, since the handicraft represents productive work and the craftsman is dependent on the punctual payment.

In sum, Plato's rejection of interest taking is justified in two respects. On the one hand, interest, as a mere multiplication of existing money, undermines the power of the state by giving individuals financial means and thus potential power against the state. On the other hand, Plato refers to commonly shared intuitions that interest is generally perceived as evil (even by those who profit from it) and should therefore be morally rejected.

As with the pure commercial profit, Aristotle considers the profit generated through interest to be "unnatural," whereby the latter is to be rejected even more unambiguously. Commercial profit is unnatural, because it does not arise from productive work, but from the money itself. Money, however, is a means of exchange and unable to create anything new in itself:

> As this is so, usury is most reasonably hated, because its gain comes from money itself and not from that for the sake of which money was invented. For money was brought into existence for the purpose of exchange, but interest increases the amount of the money itself. (Aristotle, 1944, 1, 10, 1258b)

3.4.3 Christian doctrine

After moneylending against interest had already received strong philosophical criticism in ancient Greece and Rome, the subject took on a new dimension during the time of early Christianity. In 325 CE, the ban on interest was incorporated into Roman law at the Council of Nicaea. Emperor Constantine, who personally and actively participated in the Council, concretized the Council's decisions in legislation. The Council of Nicaea concluded that trade against interest should be punished with excommunication—a severe punishment at that time, since it prevented the salvation of the soul for the faithful.

The subsequent development also shows how the ban on interest rates became increasingly legal in character. For example, the German *Lexikon für Theologie und Kirche* (Hilgenreiner, 1965) states: "The II and III Lateran council (1139, 1179) and the II Council of Lyon (1274) generally condemned the rapacity of usurers (= interest takers) and threatened them with deprivation of all ecclesiastical rights and with the punishment of infamy; the Council of Vienne (1311) punished those who claimed that usury was not a sin as heretics; the V Lateran council (1517) renewed the earlier church bans on interest (D 739). Civil legislation was generally consistent with ecclesiastical legislation."

3.4.4 Islam

In today's Western world, interest is not only allowed but even required for things like the pension system. Nevertheless, even in the twenty-first century, the world of Islam continues to this day to have an interest ban, which has led to unique developments in Islam-dominated countries. The ban on interest (Arabic: Ribā) includes certain financial transactions that are prohibited by Islamic law. Sharia generally prohibits the charging of interest. Not only the demand for interest, but also for its payment is unlawful. Thus, a Muslim living according to Islamic law may not take out loans or the like from non-Muslims, i.e. on the global capital market. Islam's finance system must comply with the rules of Sharia law and the prohibition of interest is one of its central characteristics. The interest rate is regarded as unethical, since the increase in capital takes place without "performance" and is determined in advance. In the Qur'an (Rodwell, 2011), we find the following statement:

> But those who devour interest become like the one whom Satan has bewitched and maddened by his touch. This because they said, "Selling is the same as taking interest." But Allah has allowed selling and forbidden taking interest. Henceforth, if one abstains from taking interest after receiving this admonition from his Lord, no legal action will be taken against him regarding the interest he had devoured before; his case shall ultimately go to Allah. As for him who returneth (to usury) – such are dwellers of the (hell) fire. They will remain in it forever. (Sura 2, verse 275)

It is also apparent elsewhere that taking interest is not a godly way of doing things. The Qur'an states that capital lent with Ribā (i.e. interest prohibited by Islamic law) "so that it may multiply through the assets of men, does [not multiply] with Allah" (Sura 20, verse 39). In the Islamic world, interest is thus understood as an exchange of assets for a one-way premium, whereby this premium is not met by a commensurate quid pro quo. The prevailing idea in the Western world that the renunciation of consumption represents such a service in return—which the moneylender is prepared to take on

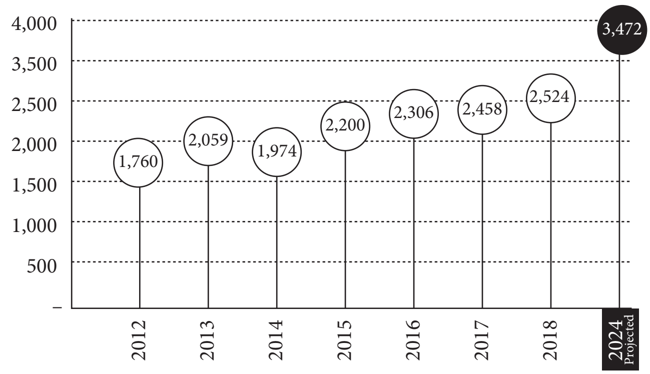


Figure 3.7 Islamic finance assets growth, 2012–2018 (US$ billion)
Source: Islamic Corporation for the Development of the Private Sector and Refinitiv (2019, p. 8)

himself by granting the loan—is decidedly missing. However, since conventional banking is based on interest income, there has been a discernible development for some time that is referred to as "Islamic finance" (Mahlknecht, 2008). It tries to address the needs of Muslim customers. This development is taking place both in the expansion efforts of traditional Western banks in Muslim states and in the Western world itself (Figure 3.7) (El-Mogaddedi, 2007; Najaf and Najaf, 2016).

"Islamic banking" tries to avoid predetermined interest rates by allowing a creditor to participate in both the profit and loss of a credit-financed company. This corresponds to the Western economic model of equity as it is known in the form of shares or investments. Just the same, this narrowing of investment opportunities has (at least) one major disadvantage: In Western-oriented financial systems, a strict distinction is made between equity and debt. This distinction not only refers to the existence of a predefined "price" for borrowed capital (i.e. interest payments); it also points to the rights and obligations associated with the respective form of investment. In the event of a company's financial collapse, the outside creditors are serviced from the insolvent assets first ("debt capital has precedence"). Accordingly, lenders assume a smaller risk of loss than the investor of equity (with shares in the company). Of course, lenders are unable to benefit should the company experience extraordinary growth due to a usually fixed interest rate. On the other hand, the lower risk gives them an incentive to provide the money in the first place, which is critical for many companies. According to Islamic law, however, a Muslim may only make a profit if he or she also bears the risk of loss.

The Islamic ban on interest also has some disadvantages beyond the specific area of investment: Most social policy instruments, for example, depend on interest, especially when it comes to pension schemes or life insurance. The prohibition of interest makes both financial planning options significantly more difficult. Generally speaking, all kinds of insurance policies are rejected in Islam according to the traditional understanding if they are not based on donations. The reason for this is the fact that an insurance policy pays exactly when a previously unknown event occurs. Contracts within the meaning of Sharia law, however, require a precise list of the goods to be exchanged, including a specific date.

3.4.5 Hinduism

Even if there are no clear references to moneylending as usual phenomenon, ancient Indian religious texts suggest that giving and taking of credit existed in one form or another already in the Vedic period (approximately 1500–500 BCE) (Dixit, 2012). From the Rigveda onwards, the term ऋण (rina—debt) is repeatedly mentioned, often referring to debts contracted at dicing (Jain, 1929). While there is uncertainty as to whether interest has already been charged at this time, the Sutra texts (700–200 BCE) provide evidence that a system of moneylending with fixed interest rates existed more than 2,000 years ago. Vasishtha, one of the oldest Vedic rhisis (wise men), formulated a law in his Dharmasutra (300–100 BCE) that explicitly prohibited the highest two castes of the Brahmins (priests) and Kshatriyas (warriors) from lending money at interest. However, the same text sanctions moneylending at interest as a lawful profession for the caste of Vaishyas and prescribes legal interest rates varying with the particular caste of the borrower, with the highest caste having to pay the lowest interest rate (Jain, 1929).

Sentiments of contempt against moneylending at interest beyond the legally stipulated rates become evident in several other Hindu scriptures, where two terms for moneylending, Vardhusa and Kusida, are distinguished. Although both words are commonly translated as “usury,” they are used very differently in the original writings: While the latter describes the religiously and legally tolerated profession of the “moneylender,” the former refers to borrowing money at low interest rates and lending it at usurious, i.e. exorbitantly higher, interest rates to pocket the difference as profit, which is condemned as a “heinous act” (Dixit, 2012, p. 99). Baudhâyana, for instance, rates usury as a crime worse than murdering a member of the Brahmin caste

(Baudhâyana I, 5, 10, 23 as translated by Bühler, 1882, p. 175) and the Yajnavalkya Smriti counts usury as one of the Upapātakas, the minor sins (Yajnavalkya Smriti, 13–20 as translated by Shastri, 2002, p. 315). Thus, it can be concluded that ancient Hindu sages and lawgivers tolerated interest rates within a narrow range but attached the stigma of condemnation and social boycott to usurious moneylending.

Note

1. See, for instance, the results and figures presented by Jongman (2009).

References to Chapter 3

Aristotle (1944). *Politics* (Translated by H. Rackham). Cambridge/London: Harvard University Press/William Heinemann.

Baumol, William J. (2002). *The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism*. Princeton, NJ: Princeton University Press.

Becker, Gary S. (1976). *The Economic Approach to Human Behavior*. Chicago/London: University of Chicago Press.

Böhm, Franz (1961). Democracy and Economic Power. In: Institut für ausländisches und internationales Wirtschaftsrecht (Ed.), *Kartelle und Monopole im modernen Recht* (pp. 25–45). Karlsruhe: C. F. Müller.

Bucher, Karl (1893). *Die Entstehung der Volkswirtschaft: Sechs Vorträge*. Tübingen: Laupp.

Bühler, Georg (1882). *The Sacred Laws of the Âryas as taught in the schools of Âpastamba, Gautama, Vâsishtha and Baudhâyana*. Part II: *Vâsishtha and Baudhâyana*. London: Oxford University Press (The Sacred Books of the East translated by various oriental scholars and edited by F. Max Müller, Vol. XIV).

Cicero, Marcus Tullius (1913). *De officiis* (Translated by Walter Miller). Cambridge, MA: Harvard University Press. Last accessed August 6, 2020 at: http://data.perseus.org/citations/urn:cts:latinLit:phi0474.phi055.perseus-eng1:1

Cohen, Joel E. (1995). Population Growth and Earth's Human Carrying Capacity. *Science*, 269(5222), 341–6.

Dixit, Shailini (2012): Ancient Indian Attitude Towards Money Lending in Brahmanical Literature. In Proceedings of the Indian History Congress 73, pp. 95–103. Last accessed August 4, 2020 at: www.jstor.org/stable/44156194.

El-Mogaddedi, Zaid (2007). Wachstumsmarkt Sukuk: Islamic Finance. *Die Bank: Zeitschrift für Bankpolitik und Praxis*, 8, 28–31.

Ensminger, Jean (2004). Market Integration and Fairness: Evidence from Ultimatum, Dictator, and Public Goods Experiments in East Africa. In: Joseph Henrich, Robert Boyd, Samuel Bowles, Colin Camerer, Ernst Fehr, and Herbert Gintis (Eds.), *Foundations of Human Sociality: Economic Experiments and Ethnographic Evidence from Fifteen Small-Scale Societies* (pp. 356–81). Oxford: Oxford University Press.

Gilomen, Jörg (2014). *Wirtschaftsgeschichte des Mittelalters*. Munich: Beck.

Güth, Werner, Schmittberger, Rolf, and Schwarze, Bernd (1982). An Experimental Analysis of Ultimatum Bargaining. *Journal of Economic Behavior & Organization*, 3(4), 367–88.

Hayek, Friedrich August von (1969). *Freiburger Studien*. Tübingen: Mohr Siebeck.

Hayek, Friedrich August von (1973). Die Anmassung von Wissen. *Ordo: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft*, 26, 12–21.

Hilgenreiner, Karl (1965). Zins. In: *Das Lexikon für Theologie und Kirche* (Vol. 10). Freiburg: Herder.

Hobbes, Thomas (1642). Elementorum Philosophiæ: Sectio Tertia; De Cive. Paris.

Homann, Karl (2003). *Anreize und Moral* (Edited by Christoph Lütge). Münster: LIT.

Homann, Karl and Blome-Drees, Franz (1992). *Wirtschafts- und Unternehmensethik*. Göttingen: Vandenhoeck & Ruprecht.

Homann, Karl and Lütge, Christoph (2013). *Einführung in die Wirtschaftsethik* (3rd Ed.). Münster: LIT.

Homann, Karl and Suchanek, Andreas (2005). *Ökonomik: Eine Einführung* (2nd Ed.). Tübingen: Mohr Siebeck.

Islamic Corporation for the Development of the Private Sector, Refinitiv (Eds.) (2019). Shifting Dynamics: ICD-REFINITIV Islamic Finance Development Report 2019. Last accessed August 3, 2020 at: https://icd-ps.org/uploads/files/IFDI%202019%20DEF%20 digital1574605094_7214.pdf

Jain, Lakshmi Chandra (1929). *Indigenous Banking in India*. London: Macmillan.

Jongman, Willem (2009). Archeology, Demography, and Roman Economic Growth. In: A. Bowman and A. Wilson (Eds.), *Quantifying the Roman Economy: Methods and Problems* (pp. 115–26). Oxford: Oxford University Press.

Kolb, Frank (2004). Das Zinsverbot in Antike und Christentum. Unpublished lecture manuscript. Last accessed April 8, 2020 at: https://publikationen.uni-tuebingen.de/xmlui/bitstream/handle/10900/43989/pdf/zins.pdf?sequence=1

Lütge, Christoph (2019). *The Ethics of Competition: How a Competitive Society is Good for All*. Cheltenham, UK and Northampton, MA, USA: Edward Elgar Publishing.

Mahlknecht, Michael (2008). *Islamic Finance: Einführung in Theorie und Praxis*. Weinheim: Wiley.

Mises, Ludwig von (1922/1951). *Socialism: An Economic and Sociological Analysis* (Translated by J. Kahane). Auburn: The Ludwig von Mises Institute.

Mohammed, Jawed (2013). Islamic Foundations of Business Ethics. In: C. Lütge (Ed.), *Handbook of the Philosophical Foundations of Business Ethics* (Vol. 2) (pp. 871–931). Wiesbaden: Springer.

Mrozek, Stanisław (2001). *Faenus: Studien zu Zinsproblemen zur Zeit des Prinzipats* (No. 139). Stuttgart: Franz Steiner Verlag.

Najaf, Khakan and Najaf, Rabia (2016). Growth of Islamic Banking in Pakistan. *Global Journal of Management And Business Research*, 16(5).

Our World in Data (2013). Share of the World Population Living in Absolute Poverty, 1820–2015. Last accessed August 4, 2020 at: https://ourworldindata.org/uploads/2013/05/World- Poverty-Since-1820.png

Our World in Data (2014). Globalization over 5 Centuries, World. Last accessed August 4, 2020 at: https://ourworldindata.org/grapher/globalization-over-5-centuries?time=..2016

Our World in Data (2019). World Population Living in Extreme Poverty, 1820–2015. Last accessed August 4, 2020 at: https://ourworldindata.org/grapher/world-population-in-extreme-poverty-absolute

Pies, Ingo (2003). Theoretische Grundlagen demokratischer Wirtschafts- und Gesellschaftspolitik: Der Beitrag F. A. von Hayeks. In: I. Pies and M. Leschke (Eds.), *F. A. von Hayeks konstitutioneller Liberalismus*. Tübingen: Mohr Siebeck.

Plato (2013). *Delphi Complete Works of Plato (Illustrated)*. Hastings: Delphi Classics.

Richter, Sandra (2012). *Mensch und Markt. Warum wir den Wettbewerb fürchten und ihn trotzdem brauchen*. Hamburg: Murmann.

Rodwell, John M. (2011). *The Koran* (Translated from the Arabic by J. M. Rodwell, Foreword and Introduction by Alan Jones). London: Phoenix.

Schumpeter Joseph (1912/2012). *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle* (Translated from the German by Redvers Opie, with a New Introduction by John E. Elliot). New Brunswick/London: Transaction Publishers.

Schumpeter, Joseph (1942/1976). *Capitalism, Socialism & Democracy*. London: George Allen & Unwin.

Shastri, Jagdish Lal (Ed.) (2002). *The Garuda-Purana*. Translated and annotated by a board of scholars. Part I.1. ed., reprint. Delhi: Motilal Banarsidass Publishers (Ancient Indian Tradition & Mythology, Vol. 12).

Smith, Adam (1776/2007). *An Inquiry into the Nature and Causes of the Wealth of Nations*. Petersfield: Harriman House.

Statista (2010). Geschätztes Historisches Bruttoinlandsprodukt der Welt vom Jahr 1 bis 2008. Last accessed August 4, 2020 at: https://de.statista.com/statistik/daten/

studie/252728/umfrage/geschaetztes-historisches-bruttoinlandsprodukt-der-welt-nach-regionen/

van Zanden, Jan, Baten, Joerg, d'Ercole, Marco Mira, Rijpma, Auke, and Timmer, Marcel P. (Eds.) (2014). *How Was Life?: Global Well-being since 1820*. Paris: OECD Publishing. DOI: http://dx.doi.org/10.1787/9789264214262-en

Visualizing Economics (2007). Last 2,000 Years of Growth in World Income and Population (Revised). Last accessed August 4, 2020 at: https://www.visualizingeconomics.com/blog/2007/11/21/last-2000-of-growth-in-world-income-and-population-revised

Wetzel, Dietmar (2013). *Soziologie des Wettbewerbs: eine kultur- und wirtschaftssoziologische Analyse der Marktgesellschaft*. Wiesbaden: Springer.

4

Foundations and tools of business ethics

Selected learning objectives

After reading this chapter, you will be able to:

- define the basic concepts of the ethical assessment of norms and differentiate between the three central conceptions of the justification of norms under dissent
- reflect on the importance of the assumption of rationality in economics and to distinguish criteria for assessing social conditions
- model dilemma structures, to understand their important role in business ethics, and to discuss ways of overcoming them.

Chapter overview

4.1 Philosophical foundations and tools

4.1.1 Introduction

The aim of this section is to introduce some of the key foundations of ethical norm assessment and to present essential tools for ethical conflict resolution. In the first part, we will become acquainted with the two main theories of the ethical justification of norms—deontology and consequentialism. In addition, using the means of reflective equilibrium, we will contemplate an

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).
 DOI: 10.1093/oso/9780198864776.003.0005

instrument that is capable of enhancing moral value judgments and uncovering and correcting contradictions in persuasive systems.

Modernity, as already discussed in detail in Chapter 2, is characterized by broad and deep dissent in moral as well as socio-economic questions. This dissent on a moral level presents a challenge to much of classical ethics. For many of its exponents, the goal of ethics has always been to conclusively and convincingly answer the questions of the just social order and to generate binding norms of action in order to finally resolve moral problems.

In response to the existing pluralism of values, norms, and principles, ethics developed a set of tools to deal with this moral and sometimes socio-economic dissent. In the second part of this chapter, we will therefore focus on the question of how we can establish norms as a society—against the backdrop of moral dissent. In particular, we will discuss different versions of social contract theory, the democratic process, and discourse theory.

4.1.2 Deontology

In ethics, a distinction is made between two types of theories: deontological and consequentialist ethics. Deontological ethics is characterized by the fact that it evaluates the ethical correctness of actions on the basis of characteristics that affect the action itself. Such a feature, for example, may be the intention with which an action is performed or the compatibility with a particular formal principle. The term deontology or deontological ethics derives from the Greek "deon," which essentially means duty or obligation. Deontology can thus be translated as duty ethics.

To convey what deontological ethics is all about, it makes sense to start with a practical example: Since the 2000s, large and medium-sized companies have increasingly tried to project a social or environmentally friendly image through certain marketing and PR measures. Often, as part of these measures, companies donate sizable sums to combat certain social ills, improve their environmental footprint, or work with NGOs to more effectively monitor the conditions of production among suppliers. Nevertheless, many citizens refuse to positively assess this commitment of companies as ethically genuine. The public does not treat such corporate social responsibility (CSR) programs with respect, but rather with ridicule. Critics often argue in these cases that companies are not really concerned with rectifying grievances, but only with polishing up their own image and ultimately maximizing their bottom line, albeit it in a more sophisticated way. Regardless of whether the CSR projects in question contribute to improving some of the issues, critics are more concerned about companies launching these projects for the wrong reasons.

In a nutshell, one might say that deontological ethics not only looks at the result for making ethical judgments, but also at certain characteristics of the behavior. One characteristic here could be the correct intention of an action.

Basically, one can differentiate within the family of deontological ethics between strict and not strict variants (Birnbacher, 2013). Strict deontological theories assess the ethical correctness of an act or even a law entirely without reference to the result of an action. Strict deontological ethics are thus fundamentally less sensitive to empirical conditions. Whenever a deontological ethic comes to the conclusion that lying is fundamentally morally wrong, then lies are morally reprehensible in *every* conceivable situation.

Many deontological ethics are also shaped by a certain value attitude: They are concerned with being mindful of, protecting, or respecting certain values when taking action. The basic mode of deontological ethics is therefore a relation of respect. Consequentialist ethics, in turn, is about maximizing or minimizing certain values. In this respect, both primary ethics can be distinguished on the basis of their values.

An interesting example of this is the attitude towards the fundamental right to physical integrity. Article 2 of the Basic Law of the Federal Republic of Germany states: "Everyone has the right to life and physical integrity. Personal liberty is inviolable." This principle has a clear deontological trait, which may be demonstrated as follows: Let us assume a plane is hijacked and headed straight for a sold-out football stadium. Assuming it would be impossible to evacuate the stadium quickly enough, a government would have to ask whether or not it should shoot down the plane. A strictly deontological ethic, which respects the second article of the Basic Law, would conclude that the passenger plane should not be shot down. For this would conflict with the duty of the state to preserve the physical integrity of the individual. In contrast, a consequentialist ethic would tend to weigh the lives of those affected against each other. So, while a deontological ethics concerns preserving integrity, a consequentialist ethics primarily deals with minimizing damage.

One of the biggest problems with strictly deontological theories is that they sometimes impose duties that seem absurd and contradict our inner moral compass. To understand the difficulty with a strictly deontological ethics, we just have to change our example a bit. Assuming that the hijacked passenger plane was heading straight toward a nuclear power plant, and a collision would endanger millions of people in a nearby city, a strictly deontological ethics would continue to prohibit shooting down the aircraft. This trait of deontological ethics gave rise to the criticism that it follows the motto: For the sake of justice, the world should perish. Even better known is the Latin version of the motto: Fiat iustitia et pereat mundus.

Immanuel Kant (1724–1804) is responsible for developing the most famous deontological ethics in the German-speaking world and elsewhere (Kant, 1902 ff., 1976). Kant argues that an action is only obligatory if it satisfies the categorical imperative. There any numerous formulations of the categorical imperative, which is best understood as a way of determining morally permissible types of behavior. Most philosophers who are attracted to Kant's views are because of the Humanity Formulation of the categorical imperative (Johnson and Cureton, 2016).

> So act that you use humanity, whether in your own person or in the person of any other, always at the same time as an end, never merely as a means.
>
> (Kant, 1785/1998, p. 38)

Johnson and Cureton (2016) argue that the Humanity Formula does not rule out using people as means to ends, as this would be an absurd demand, because we do this all the time in morally appropriate ways. After all, what we eat, what we wear, and what we drive has been developed through the exercise of the wills of other people. The difference between a horse and a taxi driver is not that we may use one and not the other as a means of transportation, but that, unlike the horse, the taxi driver's humanity must at the same time be treated as an end in itself (Johnson and Cureton, 2016). Our humanity is what makes us distinctively human. In supposing that the taxi driver freely pursues her own goals, we make permissible use of her capacities only if we behave in a way that she would, when exercising her rational capacities, consent to, for instance, by paying an agreed on price (Johnson and Cureton, 2016).

In business ethics, Norman E. Bowie, for instance, pursues a Kantian approach. In his book *Business Ethics: A Kantian Perspective*, Bowie (1999) examines how a company can be managed under the conditions of the market economy in line with Kantian principles (see practice box 4.1: Sweatshops and Kantian ethics). Bowie's goal is to create a corporate ethics that is both viable and profitable in a global economy. Even discourse-ethical approaches to corporate ethics are ultimately based on a Kantian approach, albeit by way of the discourse theory of Habermas.

Practice box 4.1 Sweatshops and Kantian ethics

Sweatshops are workplaces, especially in the clothing industry, with socially unacceptable or illegal working conditions. In the typical case, people work in sweatshops because they believe that they can earn more money working there than they can in alternative employments, or they work in sweatshops because it is better than being unemployed. In many developing countries, workers are moving from rural to urban areas, because agriculture can no longer sustain the population base.

Kantian ethics puts human dignity at its center. The obligation to respect others requires that we do not use them as means only, but treat them as capable of autonomous law guided actions. Coercion obviously violates a person's negative freedom (see also Section 5.2) and it treats the subjects of coercion as mere tools, i.e. as objects that lack the rational capacity to choose for themselves how they shall act. When people make an undesirable choice because no better alternatives are available, are they coerced?

One may argue that psychological coercion in sweatshops appears widespread. When a worker is threatened with being fired by a supervisor unless she agrees to work overtime, and when the supervisor's intention in doing so is to ensure compliance, then the supervisor's actions may be understood as coercive. Respecting workers requires that they be free to decline overtime work without fear of being fired. According to Kantian ethics, the attempted coercion by a supervisor is morally objectionable, even if the victim successfully resisted in some way. This is because the coercer acts as if it is permissible to use the employees as mere tools. Managers that encourage or tolerate these kinds of coercion disavow their own dignity and that of their workers.

Managers of multinational enterprises have a duty to respect their employees as well as the employees of their subcontractors. One could argue that they are even better positioned to play a constructive role in ensuring the dignity of humanity, because their companies have well-defined internal decision structures in place that, unlike the individual supervisors, are not susceptible to weakness of will.

Source: Arnold, Denis G. and Bowie, Norman E. (2003). Sweatshops and Respect for Persons. *Business Ethics Quarterly*, 13(2), 221–42.

4.1.3 Consequentialism

Alongside deontological ethics, consequentialism is the second important alternative ethical theory. Consequentialism—understood as a related group of theories—measures the moral correctness of an action or a law solely on the basis of (foreseeable) consequences.

The difference between consequentialism and deontological ethics can be seen in the CSR example from the last section: From the perspective of consequentialism, the motives of a company to invest in CSR play no role. For the ethical evaluation of a company's CSR program, the only decisive considerations relate to the impact on society, wildlife, nature, or social harmony. As long as a CSR program on balance promotes certain moral values or, more generally, helps to solve certain social problems, the program can be considered ethical. This also applies if a particular CSR program was merely motivated by the desire to improve the image of a company or increase sales.

To better understand consequentialist ethics; let us discuss some facets of this type of ethics. One of the central questions in consequentialism concerns which behavioral (or legal) implications should be borne in mind for the respective ethical evaluation. It seems clear that not all behavioral implications are relevant. This can be illustrated by a simple example: Suppose that a child falls into a fountain just a few yards away from John. John sees what happened, sprints over to the fountain, but startles a bumblebee in the process. The bee then winds up in the cab of a truck, at which point the driver loses control of his vehicle and drives headlong into a crowd of people. From a consequentialist perspective, the question is: Was John's attempt to rescue the child immoral? After all, however unintentional, John on balance caused more harm than good. On the other hand, such an assessment seems fairly implausible. In the evaluation of behavior or norms, consequentialism is more interested in the foreseeable consequences of an action. If one believes that John neither saw the bumblebee nor could anticipate that it would cause such damage, then it is possible to ignore the unintended consequences in the moral assessment of John's action.

In other questions, though, variations of consequentialist ethics are less in agreement. They mainly differ in three main dimensions, which are best characterized by three questions.

First, in the individual conceptions, what is the target variable or the bundle of targets to be maximized? Utilitarianism—probably the best-known variation of consequentialism—has a simple answer: The goal is to maximize the happiness of individuals. Nonetheless, there is no consensus in utilitarianism about what exactly constitutes happiness and whether every kind of happiness should be counted the same. John Stuart Mill (1806–1873), for example, distinguishes between different qualities of happiness. Recent utilitarian points of view, such as that of Peter Singer, suggest that the variable to be maximized should be preference fulfillment. In this case, however, we are not necessarily aiming at arriving at a particular cognitive state of happiness but at achieving certain aims. Whether or not the achievement of the goal is accompanied by a cognitive state of happiness is not important. Other consequentialist theories point out that the bundle of goods to be maximized is in per se open in consequentialism, for example for variables such as freedom, friendship, love, or any other values.

A second distinguishing feature between consequentialist theories relates to the question of what consequences we should be interested in. Should we maximize the favorable consequences for all people living today or for all those living today and those who will also live in the future? The latter distinction is relevant, for instance, for issues of intergenerational justice. When it comes to maximizing happiness, the question remains whether to maximize human happiness or the happiness of all sentient beings in general.

A third distinguishing feature relates to the object of the consequentialist calculus. Traditionally, the consequentialist calculus is applied to actions, rules of action, and institutions.

Like all ethical conceptions, the different consequentialist ethics have their weaknesses. On the one hand, consequentialist ethics threaten to overburden the individual, since in every behavioral situation he or she is basically required to maximize the benefit for everyone, however it may be defined. This would thus seem to mean prima facie that the individual must constantly weigh which action would be universally the best. Hence, everyday decisions like whether to spend the evening in front of the TV or to go to the gym would have moral import. Moreover, it is obviously difficult for the individual to determine which action has the greatest likelihood of maximizing everyone's happiness. Another weakness of consequentialist theory options is that they often imply that, for moral reasons, the happiness of the individual must be sacrificed to the happiness of the whole. For example, under a utilitarian-behavioral maxim, a tribe of cannibals could be called upon to eat a missionary—assuming it would maximize the happiness of all. (In principle, however, it must be noted that these traditional problems no longer apply to the more current concepts of consequentialism to the same extent, since they have usually already been responded to.)

4.1.4 Reflective equilibrium

Every day, we are constantly confronted with situations in which we do not know exactly what we should do. Entrepreneurs or managers of large corporations, for example, often face a whole series of demands, interests, and divergent norms that need to be reconciled. Thus, an entrepreneur may be forced to make a choice of either paying expensive bribes in a developing country to win a contract for a large-scale project, or to forgo bribery, thereby jeopardizing jobs in her company. In the first case, she would ethically violate the prohibition of bribery. At the same time, she is obligated under the corporate code to care for her employees. If the company does not receive the contract for the large-scale project, she would no longer be able to pay a large part of her workforce. In this instance, the conflicting obligations consist in the various demands arising from the prohibition on bribery, on the one hand, and the corporate code, on the other.

Not only can norms conflict with each other, but so can norms and one-off judgments. Whereas opposing norms reflect a horizontal conflict, the clash between norms and individual cases is a vertical conflict. This can be illustrated by an example known in the philosophical literature as the trolley problem (Foot, 1967): Suppose Judy is a utilitarian. She thus follows the norm that an action is only morally correct if the action maximizes the happiness of all. Imagine that Judy runs across a bridge one day. To her horror, she notices five people have been chained to the railway track that runs under the bridge. To make matters worse, just at this moment, an out-of-control trolley is bearing down on the group from the other side. After some quick thinking, Judy decides that the only way to save the group is to push a very obese woman watching the spectacle off the bridge to block the track. Judy, however, reflects again for a moment and concludes that it would be neither ethical nor necessary to throw the fat woman off the bridge to save the group. To be sure, it is not surprising that Judith would reach such a value judgment. Few would be prepared in similar cases to sacrifice the woman for a small group. But Judy's favored ethical norm ("Maximize the happiness of all!") is now in conflict with her well-considered individual judgment ("It would be wrong to push the woman off the bridge!").

What are we to do if, in our moral assessment, we run into a contradiction between general principles and cases of individual judgment? John Rawls suggests that we should try in such cases to bring our norms and one-off judgments into reflective equilibrium in a process of mutual adjustment (Rawls, 1971). In general, it is possible to distinguish between reflective equilibria of the first and second type. In the first type of reflective equilibrium, the goal is to weigh well-considered individual case judgments and general principles; in the second type, the focus is on weighing different general principles. The aim of this method is to establish a coherence between intuitions, individual case judgments, norms, and highest principles. Coherence here means two things: First, the various moral judgments and principles must be compatible without contradiction. Second, the various judgments and principles should also be mutually supportive and plausible. The idea is thus to "abrade" our everyday judgments and intuitions as well as our general principles until they fit together and form a harmonious whole. In this process, judgments on the various moral levels must necessarily be modified or abandoned altogether. As a rule, it is not possible to form coherence from an incoherent quantity of elements without changing the related elements.

Within the web of individual moral judgments and general principles, Rawls recommends first searching for individual elements that seem particularly plausible to the individual in questions. At the same time, those individual one-off judgments should be discarded that seem to lack plausibility or cannot withstand closer scrutiny. Having thus reduced the basic set of general principles and judgments, it is necessary to successively shape the remaining elements into a coherent whole in a deliberative process.

Even if the reflective equilibrium for justifying individual ethical judgments and general principles is a compelling approach, it has clear weaknesses. On the one hand, from a pragmatic point of view, the extent to which the idea of a reflective equilibrium can be actually put into practice is not clear. There is, however, another—perhaps even more significant—weakness to this approach. In short: A coherent system of individual moral judgments, intuitions, rules, and general principles must neither hold true nor be necessarily acceptable. As we know, slavery was essential to the social and economic order of ancient Greece. A young man growing up in ancient Athens learned that slaves were not treated with the same respect, much less accorded the same rights as the citizens of Athens. It is not difficult to imagine that such a young man—assuming he brought his beliefs into a reflective equilibrium—could very well have had a coherent system of beliefs that did not grant certain people fundamental rights. Justification strategies in ethics based on a criterion of coherence are thus susceptible to the criticism of ethical relativism, which regards norms and values as time-bound, as an expression of a respective epoch, and rejects eternal ethical claims.

4.1.5 Norm justification under dissent

Modern societies are pluralistic societies, especially in major cities such as Chicago, London, Berlin, Sydney, or Paris. These urban areas are teeming with millions of people of different backgrounds. Even though they live together in confined spaces, they often speak different languages and have different lifestyles and hobbies. Thus, while some people might shop at the health food store and play sports in their free time, others might be interested in motorcycles and eat junk food. Some might go to the theater, while others play online video games. Some might be politically active, while others are fundamentally apolitical. And, finally, while children might figure prominently in the life plans of some, they may be categorically excluded from the life plans of others. To sum up: In philosophy, one speaks of the fact that in pluralistic societies there is no consensus about what it means to lead a good life.

The citizens of our modern societies not only have disagreements when it comes to leading a good life, but even when decidedly moral decisions are pending: There is a whole series of issues that repeatedly produce ethical controversies, particularly in the context of business and ethics. Is there something like a fair price? Is there something like a just wage? Where does freedom stop and exploitation begin? Should we really accept and recognize as binding all contracts between adults? Are there goods that should not be for sale? Should there be markets for blood, organs, sex, surrogacy, or euthanasia? There are even more wide-ranging questions in this field of tension concerning macro-phenomena such as the distribution of wealth within a market economy. For example: To what extent is inequality socially acceptable and when does it become problematic?

One of the crucial questions in modern pluralistic societies is how to deal with our moral disagreements. Moral conflicts are already easy to distinguish as phenomena from differences in opinion about the good life. Generally speaking, we have no problem with our fellow human beings pursuing other hobbies than ourselves. We have no problem with others preferring chocolate ice cream if we have a strong preference ourselves for vanilla. The situation is different for moral dissent. Imagine Anthony telling his friend Carl that he actually believed people of color were simply not as valuable as white people or that women belonged "in the kitchen." In this instance, it would certainly be understandable if Carl were to confront Anthony or deny him his friendship. However, disputes do not only occur in society or among friends if one of the parties takes an extreme position. The question of whether one should shop at Primark or H&M can end a friendship, while others might argue over whether it is okay to eat meat or necessary to be vegetarian. The reason for this lies in the nature of morality. Morality is not about personal preference but about generally binding principles. If Anthony breaks a general moral principle, Carl has a duty to reprimand or punish Anthony, as long as he has the power to do so. Moral issues—and this is central here—are always socially explosive. Moral dissent and moral differences have the potential to jeopardize the stability of society. The protests during the financial crises, such as the Occupy Wall Street rallies or the Monday protests in Germany against "Agenda 2010," showed how quickly economic issues can spark massive moral conflicts. One of the central questions in ethics and political philosophy is therefore how we can generate ethically binding norms that enable us to live together despite our differences of opinion.

In the following, we will consider three different philosophical tools. The purpose of these tools is to generate ethical principles to deal with differences of opinion. Just how this purpose presents itself exactly is (sometimes) very different depending on the approach.

4.1.6 Contractual concepts

Contractual concepts have a long history in normative ethics. Some of the most famous contract theorists are Thomas Hobbes (1588–1679), John Locke (1632–1704), and Jean-Jacques Rousseau (1712–1778). While social contract theory had long receded into the background in the wake of Kant and Hegel, it has enjoyed increasing popularity in philosophy, especially over the last 30 years. Important contemporary contract theorists include John Rawls (1921–2002), David Gauthier (b. 1932), and James Buchanan (1919–2013).

The basic idea behind social contract theory is fairly simple. According to social contract theory, moral norms, social institutions, and the institutional structures of societies are only morally good, legitimate, or justified if they have the consent of the population. Contract theories are not interested in contracts that were actually settled at a fixed point in time or de facto agreement. In other words, they are not concerned with actual, but with hypothetical contracts—not with actual agreements, but the capacity for agreement.

For our purposes, it is helpful to understand contract-theoretical logic as a kind of thought experiment. Starting from the problem of the fundamental plurality of opinions, a contract theorist asks whether a particular moral principle, law, or institutional structure of society would be acceptable from the perspective of a multitude of different contractors. It is not so much a question of whether these parties would empirically agree, for example in spontaneous surveys, but rather whether their agreement (for example) could be expected on the basis of long-term interests and preferences. The different models for this will be discussed below.

By and large, contract theories can be categorized according to different criteria. In the English-speaking world, in particular, one differentiates between contractarianism—contract theories in the tradition of Hobbes—and contractualism—contract theories in the tradition of Kant. The two conceptions of contract are distinguished by the fact that the contracting parties in the Hobbesian tradition are modeled as selfish maximizers, while in the Kantian tradition contracting parties are morally motivated agents. The most appropriate model depends on the underlying ethical problem. In a nutshell, the conditions for applying each of the contract theories can be outlined as follows: Hobbesian modeling is chiefly suitable in situations in which the parties have strongly divergent interests in a moral conflict and have very little moral common ground. Examples include moral conflicts in highly pluralistic societies or moral conflicts between societies with divergent cultural backgrounds and very distinct interests. Modeling in the Kantian tradition, in turn, is appropriate when it comes to moral conflicts within societies or communities that share a strong moral and cultural foundation.

4.1.6.1 Hobbesian contractual concepts

Apart from Thomas Hobbes himself, the most well-known representatives of Hobbesian contract theories are David Gauthier and James M. Buchanan. In Germany, the Buchanan expression of Hobbesian social contract theory has had a significant impact on economic and business ethics through the work of Karl Homann, Ingo Pies, Christoph Lütge, and others (e.g. Homann, 2002; Homann and Kirchner, 1995; Lütge, 2012a, 2012b, 2013, 2015, 2016, 2019; Lütge and Mukerji, 2016; Lütge et al., 2016; Pies, 1996). This business ethics approach is referred to as order ethics or "Ordnungsethik" in German-speaking countries. Related terms include "ordonomics" (Pies, 2012) and "economic ethics" (Suchanek, 2001).

Hobbes' contract theories are fundamentally based on two insights: The first is that any kind of conflict between groups of people (moral, religious, interest-based) has the potential for war and destruction. For Hobbes, whose magnum opus *Leviathan* was published only three years after the end of the Thirty Years War (1651), the horrors of armed conflict were very present. Peace is therefore a central good for Hobbesians, since peace is both a necessary condition for the good life in private and a basic condition for a productive—or even just—social coexistence. The second insight of Hobbesians is that peaceful cooperation creates additional value for everyone. Cooperation enables production gains through specialization and economies of scale. As the economic principles are discussed in more detail elsewhere, we can consider a simple thought experiment here to make the underlying economic principles plausible. Let us assume that 10 million families lived on 10 million small, isolated islands. It would be difficult to imagine that these families could ever attain more than a subsistence minimum. If the same 10 million families joined together, they could gradually build a modern society based on division of labor, lead lives far beyond subsistence, and also offer advantages (e.g. through trade) to others. Prosperity, it may be stated, arises from cooperation.

The central normative criterion of Hobbesian contract theories is the consensus of all and thus the (strong) Pareto principle (see Section 4.2). Contract theorists in this tradition are always looking for solutions to moral conflicts which, from the point of view of all those involved and affected, are better than the respective moral status quo.

One example would be the question of whether there should be a market for surrogacy. Broadly speaking, the debate may be outlined as follows. One side argues that women should be allowed to rent out their uteruses for money. Here, proponents argue that a ban on commercial surrogacy unduly undermines women's autonomy. They moreover contend that there are many couples who currently have an unfulfilled wish for a child and that their only option of starting a family is through surrogacy. On the other side, the opponents of commercial surrogacy argue, among other things, that women would have difficulty identifying with the state of maternity. The concern, then, is that the surrogate mothers might no longer want to give the child away after giving birth—and, what's more, that fulfilling the surrogate mother's contract in such cases could lead to major psychological harm to the surrogate. At the same time, critics and advocates alike recognize that a prohibition on surrogacy would lead to it being increasingly outsourced to third-world countries. This would give rise to a kind of surrogacy tourism, with sometimes highly problematic consequences for the surrogate mothers in the respective developing nations. In the face of this problem, a contract theorist in the Hobbesian tradition would ask whether a moral rule or law could be found that represents moral progress, both from the perspective of the advocates and the opponents. A regulated surrogacy market might represent such moral progress or a Pareto improvement. In some US states, for example, surrogacy is generally allowed. Yet only women who already have children of their own and are familiar with the emotional situation of motherhood are allowed to become surrogate mothers. This provision aims to curb any potential psychological dangers. At the same time, legalization is causing the black market for surrogacy to dry up and counteracting the moral dilemma associated with it.

In the Hobbesian variant of social contract theory, the model is intended to at least partially capture the actually existing divergent interests and moral perspectives. The idea here, then, is to model the interests and moral perspectives that actually exist in a given conflict. It is the philosopher's job to clarify and polish the everyday moral judgments in language and thought. The moral philosopher here thus primarily serves as a kind of "restaurateur." His or her main concern is to preserve existing moral positions in their substance and lay bare their strongest versions argumentatively. On this very point, there is the conspicuous difference between Hobbesian and Kantian contract theories.

4.1.6.2 Kantian contractual concepts

The most well-known contractual concept in the Kantian tradition is arguably that of John Rawls. Further representatives include Thomas Scanlon and Stephen Darwall. As with contractual concepts in the Hobbesian tradition, an overview necessarily greatly simplifies matters. In principle, there are three main differences between Kantian and Hobbesian concepts of a contract:

The first is the different modeling of the contract situation. While a Hobbesian social contract theory seeks to portray the real power relations in the thought experiment, if only partially, Kantian theories incorporate certain moral ideals (usually equality and fairness) into the initial situation of the contract. The basic moral intuition behind this decision is easy to conceive: After all, contract negotiations under inequality seem predestined to produce solutions that favor the stronger party. In a word, inequality invites exploitation. This can be illustrated with a simple example. Let's say a multinational company manufactures shoes in a developing country and sells them in Europe for 150 euros. Of this amount, the company keeps 80 euros for itself, and the shoe workers in the developing country get 1 euro. The remaining 69 euros fall under other costs. Undoubtedly, the worker and the company are both better off producing and selling the shoes. It is therefore a Pareto improvement. At the same time, it is just as obvious that the added value generated in this collaboration goes for the most part to the company. If we ask ourselves how such a contract—which some would deem unfair—could come about, we must remember the contract's starting position before it was concluded. This skewed distribution was made possible by the unequal bargaining power between companies and workers in the developing country. The example thus illustrates that the starting position of a contract greatly determines its outcome.

It also introduces en passant a second essential feature of Kantian contract theories: Kantian contract theories reject the Pareto principle as ethically inadequate. They believe that morality cannot be reduced to a mutual exchange of benefits, since—as our example has shown—merely improving both sides' position can run counter to essential intuitions of fairness. (Just the same, whether intuitions can be a suitable yardstick for ethics in the globalized economy is more than questionable in the light of our remarks in Chapters 1 and 2.)

The third distinguishing feature is closely tied to the first two. It concerns the type of communication between the contracting parties. In Hobbesian social contract theory, the participants (apparently) discuss, above all, the means that would best promote everyone's various aims. The question, though, is whether one should not also deliberate the various aims. Let us return to John and assume that he decides on his 30th birthday to not have any children because they would confound his personal life plan. While one could ask how John might best achieve his aim, it would also be possible to question the choice of the goal itself. (Here, Hobbesians would respond that, contrary to what Kantians believe, discussions about aims and means cannot be strictly separated. Many aims depend on the availability of appropriate means.)

In Kantian contract theories, the parties to the contract discuss the choice of means and objectives separately. Kantian contract concepts require the contract participants to abstract from their own contingent wishes and to ask themselves—quite independently of their own preferences—what justice predetermines for a given case. For the earlier case of the shoe manufacture, this would mean that both the company representatives and the workers would have to abstract from their own desires, and then ask, in a second step, what would be a just wage in this particular case. It not easy, however, to abstract away from one's own background, abilities, weaknesses, and desires. Rawls therefore elaborated a philosophical tool in his book *A Theory of Justice* (1971) intended to abstract from these idiosyncrasies: the so-called "veil of ignorance." Whenever we want to solve a moral problem, Rawls states, we should imagine discussing it behind a veil of ignorance with our contractual partners. This implies that none of the participants know about their social status, religious or ethnic affiliation, or their intellectual and physical nature. According to Rawls, this is the only way to ensure that the discussion of such a decision-making situation is unbiased and that the results of a hypothetical contract are actually ethically acceptable. Basically, the veil of ignorance serves to transform the discussion of (potentially) self-interested individuals into a discussion of how it can (potentially) be conducted by impartial observers.

Kantian contractual concepts demand stronger ethical conditions than those that are Hobbesian: They presuppose that the citizens of a society have certain common abilities or characteristics that can be described as "moral added values" (Lütge, 2015). Furthermore, these concepts represent a rather juridical point of view: With their tools (similar to the veil of ignorance) they tend to produce ethical judgments that an impartial observer would make, in a sense as an independent judge with no interests of his own. Whether the juridical perspective is always appropriate, especially in economic ethical questions, is debatable. At the same time, these contract theories also risk ethically overburdening the actual parties to the dispute—and thus generating solutions that are difficult or impossible to implement.

4.1.7 Democratic majority principle

One of the key tools modern societies use to deal with disagreements is simple voting. Voting not only takes place in politics, but also routinely in everyday life. Whenever disagreements exist within a group of members with equal rights, the most straightforward approach is to designate a set of possible alternatives and to vote on them in accordance with the majority principle. It is irrelevant at first whether these alternatives are candidates for class president, different holiday destinations, different prototypes, or venues for the corporate Christmas party. In principle, we can also set ethical rules and legal norms by means of voting. Even if the majority voting system in modern states has proven on the whole to be a very useful tool for producing acceptable results over time, relying on majority voting as a tool for setting norms and dispute resolution has its own problems from a philosophical point of view. In fact, the problems with this straightforward approach are so serious that the majority principle in its simple form hardly plays a role as a tool for justifying norms in academic discussions.

For example: Let's assume that a university has just finished construction on a new dorm. The dorm rooms were awarded in a lottery. At the start of the new semester, the new roommates sit in the common kitchen and discuss what they want to cook together in the future. As it turns out, four of the five students are vegetarians, while Valerie only eats meat. If they were to now vote on a norm to determine their meal plan, Valerie would undoubtedly get the short end of the stick. The question arises, however, as to why such a majority decision should be better from an ethical standpoint than the opposite decision.

In fact, some questions cannot be resolved in a majority vote. Democracies, in particular, are aware of the need to protect minorities—otherwise in a country like Germany

- a majority (e.g. the Protestants and atheists) could ban Catholicism,
- a majority (e.g. cyclists, pedestrians, and public transport users) could ban automobiles, or
- a majority could ban same-sex partnerships (which actually happened in Germany and was in force until 2001).

For this reason, in modern democracies the majority voting system is supplemented and framed by fundamental rights. In Germany, for example, Article 4 of the Basic Law protects the freedom of religion. In principle, the majority principle alone cannot guarantee that the result of a vote is normatively permissible. Even if it is not accompanied by a robust series of fundamental rights, the majority principle can lead to the suppression of minorities.

4.1.8 Justification and deliberation

Justifications are at first quite routine. They are well exemplified by the answers to a series of simple questions. If Peter, for instance, makes the ethical judgment that the welfare state is morally good, we can ask him why. His answer might be the following: Because all people should have the opportunity to live with dignity. We could then ask further: But wherein lies human dignity? Peter could answer: A person's dignity derives from having human rights. But what are human rights founded upon? To what extent are there human rights and how are they justified? If one pursues these justificatory arguments long enough toward their foundation, classical ethics usually at some point would posit an argument about God. In lieu of the divine as the ultimate ground, philosophers have proposed filling this void with various surrogates. Immanuel Kant, for instance, asserted it was the human faculty of reason.

In this section we will deal with one of the most potent answers to the question of the justification of norms: so-called discourse ethics. Discourse ethics goes back to the German philosophers Karl-Otto Apel (1922–2017) and Jürgen Habermas (b. 1929). Its underlying idea is relatively simple. Discourse ethics takes as its point of departure the idea that every citizen has a moral sense of justice, or at least a moral conscience, and is generally capable of deciding which moral acts are good or bad. Nevertheless, we often make mistakes: We are guided in our judgments by prejudice or unconsciously favor our family members or friends; we are motivated by self-love or overlook important arguments.

These considerations of discourse ethics at first seem very plausible. As individuals, we are aware that our own judgments cannot always claim ultimate wisdom. We realize that we are often guided by our own interests and can be irrational (in whatever sense) or unable to adequately weigh all the essential arguments. This also explains why we often turn to friends and family—especially when it comes to very important questions. When we discuss our problems with friends and, ideally, critically examine our motives and arguments, we often succeed in identifying weaknesses in our own judgment. We better weigh arguments against each other, eliminating prejudices in our own thinking, and arrive at a generally more balanced judgment. In ideal circumstances, through joint reflection with people we trust, we are typically able to make sounder judgments.

Discourse ethics basically builds on this fundamental idea. Specifically, we can only arrive at ethically correct judgments through a circuitous yet domination-free path in which the better argument wins out. Like social contract theory, discourse theory (at least prima facie) is a processual or procedural ethics: It does not teach us which actions are right or wrong, nor does it give us moral principles (as utilitarianism does) for deciding whether an action is morally right or wrong. Discourse ethics instead offers a process that should enable us to arrive at correct ethical judgments.

However, it is disputed to what extent discourse ethics is actually a pure procedural ethic. Indeed, discourse ethics sets out certain norms that a discourse must adhere to in order to arrive at ethically correct results. Habermas (1990, pp. 87–89), for example, provides the following standard framework for a fruitful discourse:

(1.1) No speaker may contradict himself.
(1.2) Every speaker who applies predicate F to object A must be prepared to apply F to all other objects resembling A in all relevant aspects.
(1.3) Different speakers may not use the same expression with different meanings.
(2.1) Every speaker may assert only what he really believes.
(2.2) A person who disputes a proposition or norm not under discussion must provide a reason for wanting to do so.
(3.1) Every subject with the competence to speak and act is allowed to take part in a discourse.
(3.2) a. Everyone is allowed to question any assertion whatever.
b. Everyone may introduce any assertion into the discourse.
c. Everyone is allowed to express his attitudes, desires and needs.

(3.3) No speaker may be prevented, by internal or external coercion, from exercising his rights as laid down in (3.1) and (3.2).

It is worth paying special attention to condition (3.3). This condition stipulates that the right to universal access to discourse and the right to "equal participation in discourse can be realized without even the most subtle and veiled repression" (Habermas 1990, p. 89). Overall, these framework conditions should ensure a "non-hierarchical discourse" in which the better argument prevails.

The discourse is fundamentally aimed at reaching consensus. This means that the goal of discourse is to find solutions that are agreeable to everyone. Discourse ethics is supported by the hope that a non-hierarchical discourse, in which only the better argument counts, can fundamentally eliminate the dissension that prevails in a group. Although it is questionable whether the efficacy of arguments is actually as strong as discourse ethicists suggest, it seems intuitively plausible that discourses can certainly help to resolve dissension by enabling the respective parties to put themselves in the shoes of their counterpart.

At the same time, discourse ethicists are (for the most part) aware that actual discourses seldom run completely free of domination, in most cases not all people affected by a decision can participate, and consensus can only rarely be reached. The discourse ethicist Peter Ulrich (2008, p. 91) identifies three difficulties that confront every de facto justification discourse: For fundamental reasons, often not all those affected by a moral or legal norm can participate in a justification discourse. This applies, for example, to babies, but also to people who have not yet been born. Keyword: intergenerational justice. For pragmatic reasons in many cases it is moreover not possible to have all those affected participate in a discourse, because the number of those affected is often simply too large to ensure a meaningful discourse. Ulrich also draws attention to the fact that discourses often fail because individual participants are unwilling to seek a solution that is morally acceptable to all. Thus, already for motivational reasons it can be difficult to uphold the procedural conditions proposed by discourse ethics.

Frequently, however, it is not even possible to actually bring the concerned parties together. In this case, the discourse ethicist is called upon—in the absence of an actual discourse—to essentially simulate a discourse between the affected parties. Here, the discourse ethicist is tasked with arranging the motives, goals, interests, and arguments of the various sides as truthfully as possible according to the "principle of charity" and bringing them into discussion. Between a simulated dialogue and contract theoretical concepts, in practice the differences are sometimes less pronounced than in theory. In fact, both concepts appear to strongly overlap, especially in the practitioner's application.

On the regulatory level, Ulrich's discourse-ethical business ethics calls for more involvement of citizens in political decision-making. In order to ensure this, a "communicative infrastructure" must first be present "in which life-world claims regarding the design of the people's, regional, local or individual economy (enterprise) are publicly debated and clarified" (Ulrich, 2008, p. 399). Only through more involvement from the critical citizenry is it possible to make sure that the regulatory policy is oriented to the needs of society.

At the level of business ethics, Ulrich devised the central idea of deliberative corporate policy. Even though he continues to recognize the company's goal of generating profits and thus proposing a "meaningful value creation concept for the enterprise," he says at the same time: "but to ensure a legitimate distribution of created and depreciated value and thus business integrity, this [profit] is to be subject unconditionally to a company deliberation process with the stakeholders and justified to all those affected" (Ulrich, 2008, p. 475).

This means that businesses should critically examine the goal of generating profits. Whether this is both theoretically and practically feasible is another matter. Generally speaking, discourse ethics must provide an answer to the question of how norms, even if they have been arrived at in domination-free discourse (with all its difficulties), can actually be effective in the globalized economy.

4.2 Economic and socio-scientific foundations and tools

4.2.1 Introduction

This chapter presents some basic economic concepts and tools that are relevant to business and corporate ethics. They serve, on the one hand, to analyze human decision-making and, on the other hand, to assess in a normative way alternative states or processes. We will first turn to the concept of economic rationality, which forms the core of economic decision theory. We will then deal with result-oriented concepts of justice, especially with different social welfare functions and with the Pareto principle as a prominent test procedure for social conditions. Subsequently, we turn to a criticism of the result-oriented justice criteria prevailing in traditional economics and present an alternative to this with process-oriented justice conceptions. Afterwards, dilemma structures will be discussed in detail, as they represent a central aspect of modern business ethics. The theory of incomplete contracts is an important economic tool for justifying the importance of corporate ethics. This chapter concludes with some reflections on the importance of experimental economic research for business and corporate ethics.

Since a distorted picture is occasionally drawn of the prevailing economic doctrine, we are also concerned in this chapter with discussing the methodological expediency of the presented tools. Especially in our remarks on human rationality it should become clear that the concern is less with anthropological assumptions about humanity than an instrument that enables a systematic analysis of human decision-making behavior in interaction situations in modern societies.

As we will see below, the strength of economics as a science lies in its ability to rigorously analyze the efficacy of different means for achieving certain aims. The results of such an analysis can have repercussions on the choice of objectives, as some objectives may be assessed as systematically unattainable. At the social level, economics thus offers a technical set of tools that often forces us to explain diffuse social value judgments. For instance, the concept of justice—which is used in everyday language and is substantively highly polymorphic—is operationalized. The premises and procedures of value judgments are plainly disclosed. This will be particularly evident in our discussion of social welfare functions. We will also discuss the fact that this approach can, in turn, lead to difficulties, for it suggests a kind of ideal which is raised as an unrealistic comparison criterion independently of the process. Furthermore, we will also see that the focus of economics on interactions and its sensitivity to the gap that often exists between intentional individual behavior and the overall result is especially valuable in business ethics.

4.2.2 Rationality

The concept of rationality plays a central role in economics. It is derived from the Latin "ratio," which can be translated as "calculation" or "reason." Generally speaking, Max Weber was the first to distinguish between instrumental rationality and moral rationality. It is also useful to introduce the pair of concepts of individual and collective rationality.

4.2.2.1 Instrumental rationality and value rationality

Instrumental or purposive rationality describes the relationship between a goal and the means by which this goal can be achieved. The goal here is exogenous and is not further scrutinized. Only the means of achieving this objective can be more or less purposive. The result is a hypothetical imperative: "If objective A is to be achieved, then means B is purposive." This idea is reflected in economics in the frequently used concept of efficiency. Efficiency is denoted when "things are done right"—in this case, however, something can only be right in relation to a certain predetermined goal.

On the other hand, value rationality describes the reasonableness of a certain goal. In this context, it is possible to speak of effectiveness. Something is effective when "the right things are done." Whether an aim is correct depends on whether it can be justified according to certain criteria. According to Max Weber, moral, religious, or aesthetic reasons can play an important role here. We have already presented several concepts with which norms can be justified.

However, there is interdependency between objectives and means (Homann, 1980). They cannot be considered in isolation. It is therefore not enough for economics to focus solely on instrumental rationality. Feedback between objectives and means is consequently necessary in the course of a permanent feasibility study. In the sense of "should implies can," this feedback means that there is ultimately no strict separation between instrumental rationality and value rationality.

Finally, it should be emphasized that there is an open concept of advantage in economics. In other words, the question of meaning in relation to the pursuit of a certain objective can only be answered by the respective individual him- or herself. In an essay published in 1977, George Stigler and Gary Becker transferred the old saying that matters of taste cannot be disputed to the theory of rational voting (Stigler and Becker, 1977). The title of the essay is "De gustibus non est disputandum." For methodological reasons, the authors argue against making preferences themselves the subject of study and instead focus on the role of situative restrictions. The focus on preferences is methodologically unproductive, since any action can be explained in reference to changed preferences, and economics, moreover, lacks a satisfying theory on the development of preferences. It was therefore methodologically expedient to consider preferences as exogenous and stable and to rather center the analysis on the restrictions. Unlike preferences, they are objectively observable across individuals and thus allow an interpretation of the corresponding behavioral conditions.

4.2.2.2 Individual rationality and assessment of social conditions

The rationality considerations presented so far have related to the individual. The task of politics—for example, in the area of economic politics—is to create a rational state of affairs for the members of a group of individuals. This would not be necessary if the goals of individuals were in complete harmony. One could then simply refer to the pursuit of individual rationality, which in the aggregate led to a desirable social state. The situation becomes more difficult, however, when there are conflicts between the goals being pursued by individual members of society. These can arise either because different goals are mutually incompatible or because the pursuit of individual goals leads to conflicts owing to a scarcity of resources. If this is the case—and, empirically, it tends to be—we need a concept for assessing social conditions. As the next section will demonstrate, such an assessment must always be based on the individual. Neither a collective nor a society as a whole can act rationally or irrationally.

Therefore, we will first deal with individual rationality and then with the assessment of social conditions.

4.2.3 Individual rationality

In this section, we will deal with the facets of individual rationality. We first deal with methodological individualism, which represents an important Archimedean point of economics. Methodological individualism demonstrates why economics always approaches the individual methodically when analyzing social phenomena. The proverbial homo economicus and the subjective concept of benefit are then elucidated. The discussion in this section is intended to help clarify concepts and to dispel some of the common prejudices and misconceptions regarding the position of orthodox economists.

4.2.3.1 Methodological individualism

Methodological individualism describes the doctrine of beginning any analysis of society with the individual and proceeding from there to an explanation of social phenomena. Its primary point of departure is the fact that all social interactions are based on the interactions of individuals. Methodological individualism is located at the level of meta language. It is therefore to be strictly distinguished from ontological individualism, which seeks to make statements about the true nature of man. This means that methodological individualism makes a statement about how to develop a good theory about social phenomena, without saying anything about the actual form that human behavior should take.

Hayek and Popper had favored methodological individualism primarily for political reasons. In the "Grand Theories" of Comte, Hegel, and Marx, they identified dangerous intellectual tendencies, such as collectivism, rationalism, and historicism, which made societies vulnerable to totalitarianism. The notion is put rather bluntly in Margaret Thatcher's denial of the existence of society in an interview with *Woman's Own*. "(A)nd who is society?" she asked rhetorically. "There is no such thing! There are individual men and women and there are families [. . .]."

The term "methodological individualism" was first explicitly mentioned by Schumpeter in his postdoctoral thesis. In doing so, he turns against psychological assumptions of all kinds, finding them irrelevant to the teaching of pure economics. What ultimately matters is not how things actually behave, but how they are systematized and conventionalized (Schumpeter, 1908, p. 92). Max Weber, Schumpeter's mentor, is responsible for working out theoretically the doctrine of methodological individualism in the first chapter of his book *Economy and Society* (Weber, 1922/1978). For Weber, a commitment to methodological individualism is closely linked to an explanatory approach in sociology. The reason for the preference of individual actions in sociology is that only actions can be subjectively understood. "Actions" thus refer to behavior that is practiced in intentional states: While a cough is a behavior, the subsequent apology is an action. An essential aspect of this concept is therefore the intentionality of actions. The meaning of an action consists in the fact that we approach it interpretively: We have the capacity to understand the underlying motives of the actors. The action-theory perspective is essential because without an understanding of why people do what they do, it is not possible to comprehend the broader phenomena that interweave these actions.

The main methodological goal of social scientists—which explains their commitment to methodological individualism—is to avoid certain errors (Heath, 2015). These were widespread in the social sciences of the nineteenth century. Perhaps the biggest of these errors was the tendency to underestimate collective-action problems in groups, and all too easily to draw conclusions about individual interests based on an identification with the interest of the group. One way to avoid this error is to always look at an interaction from the perspective of the participants to see what kind of preference structure governs their respective decisions.

Paul Samuelson's "The Pure Theory of Public Expenditure" (1954), Mancur Olson's *The Logic of Collective Action* (1965), and Garrett Hardin's "The Tragedy of the Commons" (1968) each provided clear examples showing that the present shared interest did not ensure that this interest could be realized through individual actions. The advent of game theory, especially the prisoner's dilemma, in the social sciences led to a reaffirmation of the interest in methodological individualism. All major advances in the explanation of social phenomena can ultimately be ascribed to the tendency of the respective authors to apply the individualistic method (Mantzavinos, 2001). This is particularly evident in the prominence of economics in the social sciences. Arrow compares the role of the individual in economics with the role of the atom in chemistry. It is no coincidence that both terms, the first borrowed from Latin, the second from Greek, denote the "indivisible." The individual thus constitutes the smallest unit of model design. In the sense of critical rationalism, this concept offers the possibility of generating predictions about social phenomena that can be criticized empirically.

In contrast to methodological individualism, methodological collectivism or holism assumes that individual behavior is based on social circumstances and that macro phenomena cannot be explained by individual behavior. An example of this is the systems theory of Talcott Parsons and Niklas Luhmann. It is based on the fundamental assumption that systems as a whole have certain peculiarities and a certain internal law that does not merely result from the aggregation of entities.

Weimann (2009) describes methodological individualism and the demand for efficiency as the philosophical basis of neoclassical economics, which reflects the value structure of liberalism and the scientific understanding of critical rationalism.

4.2.3.2 Subjective benefit and the homo economicus

The subjective concept of benefit means that the value of a good depends on the individual benefit it brings to the respective consumer. In this sense, there are no objective benefits, i.e. no utility that exists independently of the person's own estimation. A fundamental theorem of consumer-choice theory, known as Gossen's first law, states that the marginal benefit of a good decreases with increasing consumption. An anticipation of this marginal principle can already be found in a work by John Law (1705), who states the following (see also practice box 4.2: The classical paradox of value):

> Goods have a Value from the Uses they are applied to; And their Value is Greater or Lesser, not so much from their more or less valuable, or necessary Uses: As from the greater or lesser Quantity of them in proportion to the Demand for them. Example: Water is of great use, yet of little Value; Because the Quantity of Water is much greater than the Demand for it. Diamonds are of little use, yet of great Value, because the Demand for Diamonds is much greater, than the Quantity of them.

Practice box 4.2 The classical paradox of value: Why is a diamond more expensive than water?

The gap that can exist between the utility and the exchange value of a good posed a problem for classical economics for a long time. This is why it's called the "classical paradox of value." It is also referred to as the "water-diamond paradox," for these two commodities illustrate the paradox in a way that is particularly easy to grasp:

While water clearly has a very high utility and low exchange value, diamonds are just the opposite. Adam Smith, who was aware of the paradox, already made a distinction between the two value concepts. He also pointed out that there is no direct link between them. The labor theory of value, which has had a strong influence on classical economics for a long time, assumes that the value of a good can be explained by the time that is spent working on it. But this form of objective value theory is unable to resolve the classical value paradox. The paradox can only be solved in the context of a subjective value theory, namely marginalism, which sees the individual benefit of a good directly tied to its available quantity. Goods have a marginal utility that decreases with their amount. For instance, while the exchange value of the last liter of water among the members of a desert expedition can soar to fantastical heights, it remains very low in a society that can simply turn on the faucet.

Revealed Preference Theory constructs a utility function from the actors' observed choices. If, for example, we repeatedly notice that a decision-maker, when given the choice between good A and good B, decides in favor of good A, we may conclude that he prefers good A to good B. He has thus directly revealed his preference. Let us further assume that we observe that the same decision-maker decides on good B when choosing between good B and good C. He has now directly revealed a second preference in a second pair of items. It appears that he prefers good B to good C. From the two observed sets of choices, a complete order of preference can now be determined for the decision-maker for goods A, B, and C. It is therefore possible to assume that the decision-maker prefers good A to good C, even though we have not observed this particular choice in a pairwise comparison. Here, the assumption of "transitivity" is understood to have been met: If a decision-maker prefers good A to good B and at the same time prefers good B to good C, then he must consequently also prefer good A to good C. This last preference was revealed indirectly.

According to the logic of revealed preferences, a decision-maker does not prefer good A over good B, because this decision maximizes his utility.

Rather, we conclude from his observed choices that his utility function must be designed in such a way that maximizing it implies a preference of good A over good B. The utility function is thus merely a formulation of consistent individual choices. Certain consistency requirements must be imposed on the choices, since completely idiosyncratic behavior that, for instance, violates the assumption of transitivity, can simply no longer be modeled. Empirical studies that violate certain fundamental theoretical assumptions (axioms) are therefore a challenge for neoclassical theory formation. In this context, it should be emphasized that the description of behavior through utility functions is merely an "as if." The use of utility functions is thus purely instrumental in character. A model is successful from an instrumental point of view, if, for example, it adequately predicts the behavior of its actors. Whether this is the case, however, largely depends on the frame of reference.

An ordinal utility function can be specified when the axiom of transitivity is fulfilled and when preferences can be fully stated. This means that any pair of alternatives can be compared. That is, it can be specified for any pair of goods X and Y whether the decision-maker prefers good X or good Y or is indifferent to the two alternatives. Indifference means that she favors good X as much as she favors good Y. This is not to be confused with indecisiveness. If a decision-maker is undecided between two goods, she may ask for more time to weigh the respective benefits of the two goods. In the case of indifference, however, such a period of reflection is unnecessary.[1] She knows that she likes both alternatives equally well. If the two axioms of completeness and transitivity are met for any set of alternatives, this implies the existence of an ordinal utility. The alternatives can accordingly be ranked from best to worst.

The fulfillment of the two axioms mentioned is a sufficient criterion for the existence of an ordering of ordinal preferences. Of course, there are other axioms of decision theory that can be posed as additional demands on the rationality of a decision-maker. These additional requirements are then intended to exclude certain behaviors, which also are reconcilable with the rationality of a decision-maker. The irrelevance of third alternatives is one such example. This view states that when good X is preferred from the quantity of good X and good Y, the preference relation between good X and good Y should not change through the addition to the quantity of good Z.[2]

A decision-maker who rationally maximizes her benefits is called a homo economicus. Strictly speaking, the homo economicus is merely a postulate of consistency for decision-making, and not, as is often falsely implied, a construct that ascribes selfish motives to man. On the contrary, economics proceeds from an open concept of advantage, which places it entirely at the discretion of the individual, what exactly benefits her. The actions of a Mother Theresa, who puts the welfare of children above her own, is thus entirely compatible with the homo economicus model, as long as the behavior is consistent. The view that homo economicus usually acts selfishly (in the narrow sense of the word) in his actions in anonymous markets is due to the logic of the situation in which he finds himself. The homo economicus has for some time been successfully used in empirical studies in other disciplines, such as sociology, political science, or anthropology.

The homo economicus is typically criticized on either empirical or normative grounds. Empirical criticism rejects the homo economicus' assumptions, arguing that economic subjects simply behave differently in numerous contexts. In this sense, it should be regarded as a misrepresentation. Normative criticism, as practiced for example by Amartya Sen, notes the fact that the human embeddedness in social relations is ignored, undermining the moral foundation shaped by the sense of community and citizenship. Homann (1994) sums it up this way: Where empirical criticism imputes a reductive view of mankind to the homo economicus, normative criticism imputes a dangerous one. In support of normative criticism, studies are cited which show that students of economics actually behaved more selfishly in the course of a "theory absorption" than students of other disciplines (for a review, see e.g. Laband and Beil, 1999). This clearly shows that the de facto normative criticism often starts from an exceedingly narrow definition of the homo economicus, which assumes that the figure solely seeks to maximize her own monetary income.

The homo economicus, however, above all reflects a behavioral assumption for a limited set of questions. This assumption is a prerequisite for the fundamental possibility of modeling human behavior under conditions of scarcity. The world of "anything goes," which allows for actors' idiosyncratic behavior, prohibits any abstraction of contingent circumstances and thus effectively prevents any kind of modeling. The utter rejection of the homo economicus, whether for empirical or normative reasons, necessarily raises the question of an adequate substitute.

According to Popper, social-scientific explanations consist of two classes of elements (see Homann, 1994, p. 76). First, the analysis of the social situation, including the level of information of the actors. Second, the reactions of the actor to this situation, which are assumed to be "rational" in the sense of "adaptive." Popper sees the principle of rationality as a pure methodological postulate, which clearly has no universal validity. In the case of unexpected empirical findings, the rest of the theory, not the principle of rationality, should be blamed, especially the analysis of the situation. Economists model the actors' actions as maximizing expected benefits under constraints. The explanation is thus based on the logic of the situation and the resulting restrictions. This research strategy is considered fruitful because it tells us more than when we entertain psychological approaches as explanations, such as "irrationalities," "weakness of the will," or "emotions." Thus, the principle of rationality in Popper does not constitute an empirical or psychological statement and, in this sense, is a falsifiable statement. For him, it is a methodological assumption that allows for a particular research focus, namely on the constraints (Homann, 1994, p. 77).

Here, empirical findings are always only right or wrong in relation to a given problem. The fact that economics is successful in applying the concept of homo economicus despite the actual or supposed falsification of the concept by psychology and behavioral science is therefore due to its particular presentation of the problem. The economic approach is more a situational than behavioral theory. As a consequence, other legitimate questions concerning reality, the worldview of human beings, or their genetic disposition, are deliberately ignored. It does not focus on the true motivation of the actors. In this respect, as Homann stresses, actors do not act as homines economici, but react by incorporating the actions of others in their decision, depending on the situation. An interaction process is modeled in which an individual actor, due to the situational incentive structure, compels the others to adapt their behavior, even if they "originally" do not want to (Homann, 1994, pp. 78–81).

4.2.4 Assessment of social conditions

Methodological individualism considers it important that the explanation of social phenomena begins with the individual. The subjective concept of benefit and the homo economicus represent instruments that are inherent to economics for describing and analyzing human behavior.

Williamson (2000) differentiates between four levels of analysis of social problems. At the first level, the level of social embeddedness, informal institutions are examined, such as customs, norms, and traditions. They are the backdrop against which the deliberate design of organizations takes place. At the second level, the level of the institutional environment, the formal rules of a society are established, such as codified laws and regulations. At the third level, the level of control structures, institutional arrangements are analyzed, which ensure the interpretation, compliance, and implementation of these formal rules. This concerns, for example, questions of police violence or jurisdiction. Finally, the fourth level, the level of resource allocation, considers individual decisions using the blueprint of the first three levels just mentioned. These are, in particular, the production and consumption decisions of the individual actors, which are thus influenced by informal and formal institutions and their control and incentive structures.

Economics essentially answers questions about the type, quantity, and method of production of the goods to be manufactured and the distribution of these goods among the members of society. In the next step, the question arises as to the choice of suitable institutions to implement the answers that have been found. While microeconomics is concerned with the analysis of the actions of individual actors under already established parameters, economic policy in the form of regulatory policy is dedicated, on the one hand, to shaping an economic framework and, on the other hand, in the form of process policy, to influencing the process of economic activity. In regulatory policy, the most central question is whether certain rules or institutions have desirable consequences. What may be considered desirable, however, depends on the value judgments of the individual. If one is guided by such an open concept of benefit, however, the question still arises as to how the benefit of each individual should be measured so that a social condition is desirable. Operationalization is necessary. In the course of such operationalization, economics can help give greater definition to the often diffuse concepts of the "common good," to disclose the often implicit value judgments, and, in doing so, to open them up to discussion.

In principle, consequentialist and procedural theories of justice can be distinguished. Following the economist Friedrich August von Hayek, a distinction is also made between distributive and procedural justice (Hayek, 1967). He clearly preferred the fairness of the rules to the fairness of results. Utilitarianism is probably the best-known theory of distributive justice. In utilitarianism, happiness is interpreted socially, insofar as a state is considered just when it is associated with the greatest happiness of the greatest number. These and other concepts of distributive justice can be exhibited in the context of specific social welfare functions. Another concept of distributive justice is the Pareto criterion, which can be understood as a kind of result-oriented minimum consensus. A detailed discussion of these concepts will follow. James M. Buchanan, who favors a concept of procedural justice, has voiced wide-ranging criticism of criteria for distributive justice. This concept will also be discussed in detail later.

4.2.4.1 Distributive justice

Economics ascribes value judgments to the desires and needs of individuals—a concept that is also called normative individualism. Here, every member of society is considered to have the ability to assess his or her own situation. Furthermore, the individualism of economics is of a methodological nature. That is, there is no overriding social value that cannot be attributed to the value judgments of the individual members of society.

The question of implementation is critical for economics. An institution should manifest a certain structure of justice. At the same time, one could demand every theory of justice to prove that there is an institution that actually embodies it.

The concept of utility function plays only a functional role in economic theory. In modern decision theory, individual objectives are indirectly derived from the choices individuals make. If certain consistency requirements are assumed, the preferences disclosed in this way can be described using a utility function. The reason for this is to eliminate metaphysics as much as possible from decision theory. In this sense, individuals do not "have" a utility function. Rather, their behavior can be described in the form of a utility function. They then behave as if they were maximizing this function.

To be able to establish social goals on an individualistic basis, however, the problem arises of how to aggregate the individual benefits of individuals. For benefits to be meaningfully compared for individuals, they must exhibit a cardinal scale. This allows the distances between the utility values to be meaningfully interpreted. Furthermore, the benefits need to be intersubjectively comparable. A number of social welfare functions have been proposed that aggregate the benefits of individuals in different ways.

The general utilitarian social welfare function is as follows:

$$W^U = \sum_{i=1}^{n} \alpha_i u_i(x)$$

Social welfare is defined here as the weighted sum of individual benefits. As special utilitarian welfare function is the special case where $\alpha_1 = \ldots = \alpha_n = 1$. This special case thus describes a criterion according to which the benefit of all individuals enters into the utility function with equal weight.

The Nash welfare function can be described as the weighted product of people's individual benefits:

$$W^N = \prod_{i-1}^{n} [u_i(x)]^{\alpha_i}$$

This welfare function proves to be more sensitive to the variation of individual benefits than the utilitarian welfare function. To appreciate this, image a large society in which the benefit of a member of society falls to zero. Due to the aggregation of the individual benefits, the effect in the special utilitarian welfare function would be comparatively small. On the other hand, social welfare was reduced to zero on the basis of the Nash welfare function due to the multiplicative combination of individual benefits.

Another welfare function, for example, is Rawls' welfare function, which is based on John Rawls' *Theory of Justice* and operationalizes the maximin criterion. This utility function is thus maximized in a situation in which the worst-off individual of a society realizes the highest possible benefit:

$$W^M = \min[u_1(x), \ldots, u_m(x)]$$

All the welfare functions presented here share the fact that they need to aggregate the benefits of multiple individuals. Indeed, this is their defining characteristic. And yet such intersubjective comparability is rejected in modern economics. The contemporary interpretation of benefits—already within the individual him- or herself—only allows for ordinal statements, i.e. statements of a ranking nature. It hardly makes sense to say that the consumption of a beer, which gives the individual a benefit of 100, is ten times higher than the consumption of a tomato juice, which only gives the individual a benefit of 10. It is therefore unsurprising that a comparison of benefits for individuals within the framework of such a benefit concept is dismissed by most contemporary economists.

The best-known criterion for comparing social conditions, which does not include the problems of social welfare functions mentioned so far, is the Pareto criterion. The concept stems from the economist and sociologist Vilfredo Pareto (1848–1923). Recalling that a social state can always be assessed from the point of view of individuals, then the concept of Pareto efficiency is easily defined by comparing two states as follows.

State A is Pareto-superior compared to B if at least one individual in state A is better off, while no other individual is worse off. Using this concept, all

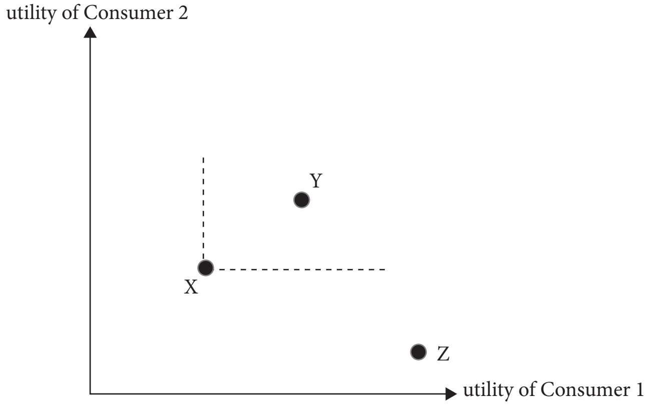


Figure 4.1 Pareto efficiency

possible states can now either be classified as states in which a Pareto-superior situation can be found or in which such a situation cannot be found. Graphically, Pareto-efficient states can be characterized by marking the so-called utility possibilities frontier. One such limit is the solid curve shown in Figure 4.1.

Let us first look at the state X in the figure. State X is a point in the utility space that is characterized by a certain benefit level for consumer 1, which can be read at the abscissa, and a certain benefit level for consumer 2, which can be read at the ordinate. State X is below the utility possibility curve and is therefore not Pareto-efficient. This means that starting from state X, both consumer 1 and consumer 2 could be better off without the other being worse off. State Y even describes a point in which both consumers are clearly better off than in state X. Thus, state Y is Pareto-superior or Pareto-better compared to state X. This applies to all points located to the northeast of state X. Finally, let us turn to state Z. State Z is on the utility possibility boundary. It is therefore Pareto-efficient. This means that—starting from state Z—no state can be reached which allows for the improvement of an individual, while no other individual is worse off. The movement from state X to state Z represents a movement from a Pareto-inefficient state to a Pareto-optimum. At the same time, however, this movement does not mean any Pareto improvement. The reason is this: Compared to state X, state Z means an improvement of consumer 1, but the benefit of consumer 2 decreases. The example clearly shows that a movement from a Pareto-inefficient state to a Pareto-optimum does not have to be accompanied by a Pareto improvement. Conversely, a Pareto improvement does not have to mean that there has been a movement to a Pareto-optimum: Thus, every point northeast of state X, but below the utility-possibility curve, starting from state X, is a Pareto improvement, but not yet Pareto-optimum.

Pareto improvements are generally recognized as desirable. After all, who would object to one side being better off if the other side does not suffer? It is this minimal consensus that gives the principle of Pareto improvement its "normative appeal" unlike the much more problematic social welfare functions.

The Pareto criterion presented here is the so-called strong Pareto principle. A state is thus already preferred if at least one individual prefers it without another being made worse off. In contrast, the weak Pareto principle requires that a group of individuals prefer a new state to an old state when all individuals in the new state have a higher benefit. The terms "strong" and "weak" may be a little confusing in this context, because the weak principle—contrary to its name—places higher demands on a new state. To remember this, you might bear in mind that the weak Pareto principle deserves its name because it is naturally empirically more difficult to fulfill.

4.2.4.2 Procedural justice

Procedural theories are based on an ideal of equality surrounding formal civil liberties. As the name implies, questions of procedural justice are paramount. While the discussed social welfare functions and the Pareto criterion inherently represent result-oriented concepts of public welfare, procedural concepts of public welfare are based on procedural questions.

Two procedural concepts of justice, which regard market results as fundamentally fair and see state redistribution with skepticism, are those of Robert Nozick and Friedrich A. von Hayek.

Robert Nozick's entitlement theory, which he explicated in his major work *Anarchy, State, and Utopia* from 1974, is certainly one of the best-known theories of procedural justice (Nozick, 1974). According to this concept, distribution is desirable precisely when everyone has a claim to the goods that they possess according to this distribution. Since, as part of this context, claims can only be acquired through voluntary exchange, Nozick generally rejects state redistribution as unfair. By contrast, distribution resulting from market processes is fair. The entitlement theory grants individuals ownership rights to their initial endowments, which consist of inherited material goods and natural abilities. As the owner of material assets, the testator is thus granted the right to determine the heir of their property themselves. In the concept, an inheritance tax cannot be justified. Congenital natural abilities are the property of every individual, for otherwise they would have to be regarded as slaves to the state (Breyer and Kolmar, 2014).

Another form of procedural justice was advocated by Friedrich A. von Hayek, who gave primacy to the market in social systems as a place of spontaneous order (Hayek, 1963). Within the market, individuals act according to their own interests and produce an equilibrium that tends towards self-correction. Widely distributed knowledge can also be better utilized here than in a centrally planned organization. Hayek is opposed to constructivist rationalism, which presumes that order can only result from planned proposals. He points to the disagreement over general principles of justice or public welfare concepts and considers any exogenous definition of such criteria as arbitrary. Against this backdrop, the liberal market serves as a procedural criterion for correct action. A limited set of rules form the framework within which the self-coordination of the actors can take place. Goal-related consequentialism is exchanged for a means-based proceduralism. The market, in effect, creates justice. Justice, however, cannot be justified substantively (Kirste and Tschentscher, 1999). One of the most important criticisms of the presented criteria for distributive justice comes from James M. Buchanan, who was awarded the Nobel Prize in economics in 1986 for his work on constitutional economics. Buchanan starts by criticizing the tendency of economists to introduce Robinson Crusoe into their deliberations (Brennan and Buchanan, 1985). The description of the economic cardinal problem of scarcity on the basis of the individual case all too easily tempts us to simply transfer it from the individual to society. This often leads to an unquestioned leap from individual benefit maximization to a preoccupation with benefit maximization for society. In doing so, the essential interactions between the various individuals that constitute society would be hidden. For him, economics is at bottom interaction economics.

Buchanan's approach is accompanied by some basic upheavals in the economic category system. He proposes shifting the focus of economics from a study of choices to a study of acts of exchange. In particular—like Nozick and Hayek, who influenced him—he views the tendency in welfare economics towards intervention science critically. This is due to the fact that the criteria of distributive justice suggest an orientation towards a theoretical ideal, like the Pareto-optimum, and tend to call for state intervention if this ideal is not achieved. Welfare economics has developed as a market theory and further developed the criterion of Pareto improvement into the Pareto-optimum.

Any equilibrium that comes about in full competition is a Pareto-optimum. However, since full competition is a theoretical ideal, its essential efficiency criterion is quixotic. Buchanan sees the focus of welfare economics on efficiency as a shift of discipline away from a criterion of justice to an abstract benchmark that is unsurprisingly likely to fall on deaf ears among the public. It is not surprising, then, that economics has largely lost its orientation function. In this sense, Buchanan's program is also a communication program designed to enhance the economy in public discourse by making it more accessible.

Traditional welfare economics determines the efficiency ideal of the Pareto-optimum independently of the market process and thus separately from the desires of individuals. Nonetheless, the ideal condition of full competition will never be achieved in reality. The market is merely understood as a gigantic "calculation machine" (Samuelson, 1954, p. 388). The elimination of the status quo from the Pareto-optimum is then interpreted as market failure, as the latter is prevented from doing its calculative work. Whether the corresponding correction, however, takes place via democratic process or is carried out by a benevolent dictator is at first irrelevant. Welfare economics raises efficiency to a normative requirement, which is to be achieved by state control without taking into account the actual desires of those affected (Lütge, 2001).

Buchanan has repeatedly pointed out that compared to nirvana approaches, neither markets nor politics fare particularly well. He therefore demands that these comparisons should not be limited to an ideal, but that an internal and not an ideal criterion should underlie the comparison of different arrangements. What can such a concept consist of? It is a criterion of agreement, of consensus. Consistent orientation is based on the status quo, not on the ideal of some kind of final state. Can a situation be created from the here and now that all participants agree with? The focus in Figure 4.1 is thus on the states, starting from state X, that can reach a consensus between the players. Accordingly, there is a gradual movement in a northeastern direction. The reference point is the status quo and not the external Pareto-optimum of full competition. Starting from state X, all improvements on both sides can hope for a consensus of those involved.

The consensus criterion is a heuristic that changes from the external perspective of efficiency to the internal perspective of political processes. With its demand for common interests, the principle of consensus offers a heuristic orientation for positive research that makes it normatively usable.

The elevation of the Pareto-optimum to the external efficiency ideal has changed how economists view the market. It is no longer understood as a process of interaction for mutual improvement through acts of exchange, but as an algorithm whose performance has to be measured against the ideal of efficiency. Buchanan wants to move away from the Pareto-optimum distribution criterion and return to the Pareto improvement procedure criterion. However, this should not refer to individual actions, but to rules.

According to methodological individualism, social phenomena are understood as unintended results of intentional action, which are channeled by rules. This means that there can be a discrepancy between interest in the rules and interest in action. A vote therefore does not take place via actions, but rules to which all individuals must, so to speak, submit themselves. At issue here is a constitutional consensus criterion. In the following section, we turn to the gap that can exist between an interest in rules and in action.

But can there at least be rules that all individuals implicitly agree to? Yes, if these rules in turn can be traced back to meta-rules or higher-order rules, which are eventually sufficiently general to reach unanimous agreement. The establishment of a state with a monopoly on the use of force to escape the Hobbesian war of all against all may be such an example given the universal peace dividend.

4.2.5 Dilemma structures

4.2.5.1 Pure coordination games

To begin with, pure coordination problems should be strictly distinguished from the dilemma structures. A pure coordination problem exists if in principle there are no diverging interests between the individuals, but they cannot successfully coordinate themselves without a generally understood rule.

A well-known example is the left or right side driving requirement. The assumption here is that no driver has a preference for driving on the left or right side. However, each individual prefers that all the others also drive on the left or the right side of the road. While in Great Britain, for example, the left-side driving requirement has become established, the same is true of the right-hand driving requirement in continental Europe. Once coordination has already taken place, as in these cases, no individual interested in

		Player 2: drive left	Player 2: drive right
Player 1	drive left	I a, a	II b, b
	drive right	III b, b	IV a, a

Figure 4.2 Pure coordination games

preserving their own life has an incentive to deviate from the established rule. Such a pure coordination game is shown in Figure 4.2. The equilibrium in a coordination game is self-enforcing. Rule violations thus do not have to be sanctioned here. This is the essential difference to a dilemma-structure situation, to which we now turn.

4.2.5.2 The prisoner's dilemma

Dilemma structures are characterized by the fact that cooperation gains, which are theoretically possible and desired by all sides, cannot be realized. This means that due to the individual incentive situation all sides are worse off than in the reference situation and thus a Pareto-inferior equilibrium is achieved. The main reasons for this are that there is behavioral interdependence, i.e. that none of the interaction partners controls the result alone, and that anyone who makes an advance payment with regard to the common interest exposes themselves to exploitation (Homann and Suchanek, 2005, p. 47).

Numerous ways of thinking and speaking, which are also found in economics, suggest the maximization of a common benefit. For example, people often speak of "collectively better" solutions or "macroeconomic growth." However, no benefits are added or offset here. What happens, then, when the benefit of one person increases while the benefit of another person decreases? People never maximize a collective maximand, but always only their own individual benefit. The actors thus act as rational benefit maximizers in the sense of economic behavioral theory. Characteristic of a dilemma situation is that they miss potential cooperation gains precisely because of the behavior individual rationality forces them to undertake.

Probably the most famous dilemma structure is the "prisoner's dilemma" (Homann and Suchanek, 2005, pp. 32–3). In its simplest form, a prisoner's dilemma depicts an interaction structure between two people. There exists here behavioral interdependence: None of the two people can determine the result of the interaction alone. They find themselves in identical situations and they each have two strategies: cooperating and defecting. A decisive point here is the assumption that no effective behavioral commitments have been established in advance. The easiest way to display a prisoner's dilemma in its normal form is using a payout matrix. In this case, Player 1 is guided by convention as a "row player," Player 2 as a "column player." This means that the strategies available to Player 1 are placed in front of the rows of the matrix. The strategies available to Player 2 are written above the rows. Each quadrant of the matrix is identified by a Roman numeral and summarizes the payouts to the two players in positive utility values. The number before the decimal point represents the benefit to Player 1, while the number after

		Player 2	
		cooperate	defect
Player 1	cooperate	I 2, 2	II 0, 3
	defect	III 3, 0	IV 1, 1

Figure 4.3 Example of a prisoner's dilemma

the decimal point represents the benefit to Player 2. The matrix in Figure 4.3 is an example of a prisoner's dilemma.

If you now put yourself in the situation of Player 1, the "defect" strategy is better if Player 2 cooperates (the benefit of Player 1 is 3 instead of 2) and also if Player 2 likewise defects (the benefit of Player 1 is 1 instead of 0). If you put yourself in the situation of Player 2, it is completely analogous. Thus, regardless of what Player 2 does, the defection strategy is the best strategy for Player 1. Game theorists speak here of a dominant strategy. Since Player 2 is in a completely analogous situation, he makes the same considerations and arrives at an identical judgment. Both players choose "defection" and land in quadrant IV. The point reached is equilibrium, since none of the players has an incentive in this particular situation to change his strategy unilaterally—which means, therefore, that the other player sticks to his strategy. The outcome here is a so-called Nash equilibrium.

The resulting quadrant IV, however, is Pareto-inferior compared to quadrant I, which would come about if both players cooperated. Thus, the individual rational behavior of the two actors leads to the social rationality trap: The players land in a Pareto-inferior Nash equilibrium, a point from which a mutual improvement would be possible. In this model of the situation, the two actors cannot succeed in improving their outcomes on their own. The realization of common interests—mutual cooperation—fails because of the structure of the interaction situation.

The prisoner's dilemma: a useful paradigm

Some authors have pointed out that the people in the prisoner's dilemma are effectively cooperating, not defecting. This criticism is misleading, however. The prisoner's dilemma is a helpful example—a tool (if you will: a tool of thought)—and not an empirically falsifiable assumption about human behavior. Thus, when an experiment "shows" that participants in a prisoner's dilemma cooperate "in actual fact," then it is only a supposed prisoner's dilemma. In this context, the distinction between a payout in utility values and monetary units is critical.

To illustrate why, let us assume that two human players each receive two cards labeled "cooperate" and "defect." They both must now simultaneously show the experiment leader one of the two cards. Let us assume that the two players receive cash payments in euros according to the decisions they made according to the payout matrix shown in Figure 4.3. Let us further assume that both players now have the card "cooperate" and receive a payment of 2 euros each. At this point, a critic would claim that the prisoner's dilemma is falsified because both players obviously cooperated. After all, they each would have had the opportunity to even receive 3 euros instead of 2 by unilaterally changing their strategy. This individual rational consideration should have forced the players into the rationality trap, leading to a result in which both receive only 1 euro. How is this argument misleading? It overlooks the fact that in the present case the monetary units obviously do not represent utility units. The players might be friends in this context and therefore unselfish. Or they might be afraid that they could come to blows afterwards and decide to cooperate to avoid this. Considerations along these lines, however, already transform the utility values of a payout matrix. The prisoner's dilemma is not falsified. In this particular context, the participants are simply not playing a prisoner's dilemma. But it's also possible that no one claimed this to begin with.

It should be noted that the actual utility values shown in Figure 4.3 are not necessary to constitute a prisoner's dilemma. The concept of benefit used here is ordinal. The distances between two utility values, in other words, cannot be meaningfully interpreted: For example, a benefit of 2 is not "twice as much" as a benefit of 1. What matters, finally, is the ranking of benefits. This order of precedence also remains identical for an affine transformation of all utility values, i.e. if each utility value is multiplied by the same factor and a constant is added. Basically, a prisoner's dilemma always exists if $a > b > c > d$ applies in the following payout matrix.

Some authors deny that most social situations can be reconstructed as prisoner's dilemmas. Binmore (2011), for example, points out that the prisoner's dilemma is a situation in which the cooperation signals are as bad as they can be. Various authors have therefore pointed out that other dilemmas offer a better description of reality. In the end, however, this is not decisive. The prisoner's dilemma is rather to be understood as a paradigmatic case, which vividly addresses the cooperation problems that are due to the structure of the situation (Figure 4.4).

		Player 2: cooperate	Player 2: defect
Player 1	cooperate	I b, b	II d, a
	defect	III a, d	IV c, c

Figure 4.4 The generic prisoner's dilemma

The argument we put forward at the end of this section on overcoming dilemmas therefore refers to a broader class of problems than the prisoner's dilemma.

4.2.5.3 Deer hunting

Another dilemma that plays an important role in the literature is the so-called stag hunt. This game is based on a parable by Jean-Jacques Rousseau. He introduced it in a work on forming collective rules in the context of contradictory social behavior.

The game models the incentives of two hunters who can decide to continue hunting rabbits on their own or join forces to hunt down a deer together. The divided stag hunt is more beneficial to both hunters than the divided rabbit hunt: While the rabbit can be killed alone, the stag requires the hunters' joint effort. Thus, if one of the hunters sticks to the agreement to hunt the stag, while the other violates the agreement by hunting rabbits, then the latter will kill the rabbit and the former will go away empty-handed. The situation can be represented with the following generic payout matrix, where a > b > c. To the left of the comma is the benefit of hunter 1, to the right of the comma is the benefit of hunter 2 (Figure 4.5).

What will the outcome be now? On the face of it, the players should both stick to the agreement and cooperate. After all, their payout is highest in quadrant I. However, if one player doubts whether the other player is actually devoting himself to stag hunting, he will also decide to hunt rabbits and defect. The smaller the difference is between the utility values a and b, the lower the doubt threshold is about the behavior of the other player sufficient to cause one player to defect. Likewise, a player who wants to maximize his lowest possible payout in the course of a maximin solution plays it safe by choosing the rabbit-hunt defection strategy.

The stag hunt is therefore another example of a dilemma structure that can lead to the prevention of mutually beneficial cooperation. This is the case, even though the parameters of the situation of the cooperation solution are not as hostile as in the situation of the prisoner's dilemma. Rousseau's parable embodies a situation in which rational agents are torn between risk considerations, on the one hand, and return considerations, on the other. Defection is the low-risk but also low-yield option, while cooperation is the riskier but also potentially higher-return option.

4.2.5.4 The battle of the sexes

This game models the incentives of a couple who would like to spend the evening together. At the moment, this is their most important concern. Both know about only two possible dating spots: the cinema or the football stadium. But they forgot to agree on where they were meeting when they said goodbye. The woman prefers the cinema, the man the stadium. The payout matrix thus takes the following form, where a > b > c. To the left of the comma is the benefit of the woman, to the right of the comma is the benefit of the man (Figure 4.6).

In the present case, there are two Nash equilibria in pure strategies:[3] the quadrants I and IV. If the man goes to the stadium, it is also best for the

		Player 2	
		Stag hunt	Hare hunt
Player 1	Stag hunt	I a, a	II c, b
	Hare hunt	III b, c	IV b, b

Figure 4.5 The stag hunt

		Man	
		Cinema	Station
Woman	Cinema	I a, b	II c, c
	Station	III c, c	IV b, a

Figure 4.6 The battle of the sexes

woman to go to the stadium. The same applies in reverse. If the woman goes to the cinema, it is also best for the man to go to the cinema. Unlike the prisoner's dilemma and similar to the stag hunt, there is no dominant strategy in this game. Both players go to their preferred date spot, miss each other, and spend a very sad evening alone. On the other hand, if they decide to do their partner a favor (putting the other's preference first), they also miss each other—the woman goes to the stadium and the man goes to the cinema.

The battle of the sexes is a coordination game, whose dilemmatic feature comes through the additional presence of a distribution conflict. It therefore does not fall into the class of pure coordination games: The players certainly have a clear and contradictory preference for a particular coordination solution. Accordingly, converging and diverging interests combine in the struggle of the sexes. This gives the game an incentive structure that corresponds to the real conditions: Often we want to get together with others in some way but have different ideas about the specific nature of this get-together.

4.2.5.5 Overcoming dilemma structures

The analysis of dilemma structures is highly important for economic ethics, for it draws attention to the situational conditions. The specific aim is to identify those factors that prevent cooperation from failing to achieve a mutually beneficial result.

From a constitutional perspective, Buchanan here sees the state as a social institution that is established through a collective act of exchange. The possibility of social cooperation is purchased, insofar as individuals renounce their own behavioral options which would be detrimental to this cooperation due to impending sanctions. To illustrate this: It makes little sense to ask a traffic offender if he prefers to abide by the traffic rules. He has already shown through his conduct that he prefers to break the rules.

Let us now image the decision of the traffic offender with the help of the prisoner's dilemma. He himself is Player 1, while "Player 2" now represents all other road users. The traffic offender is currently in quadrant III: a situation in which he breaks the traffic rules, while the other road users abide by them. A change in behavior would now mean that he would adapt his own behavior if the behavior of the others remained constant. This would involve a movement into quadrant I. The utility of Player 1 in quadrant III, the status quo, is higher than in quadrant I ($a > b$). A consensus on a behavioral change of the traffic offender because of the fact that he drives better if he exceeds the rules, while everyone else sticks to them, would therefore fail.

This means that individual changes in behavior cannot be sensibly subjected to a consensus test. The constitutional consensus test consequently questions the ability of rules to be approved. The question, then, is whether the traffic offender prefers a general transgression of the rules to a general observance of the rules. This is not the case: If all road users were to break the rules, it would be worse than in a situation where all road users abide by the rules. The benefit of Player 1 in quadrant IV is lower than his benefit in quadrant I ($c < b$). The decisive comparison is therefore the one between the general defection in quadrant IV and the general cooperation in quadrant I. It is a comparison between the so-called minor status quo and a Pareto-better alternative. This Pareto-better alternative is certain to gain consensus. The distinction between the interest in behavior and the interest in the rules outlined here clearly shows why it is so important to distinguish between hypothetical and empirical consent. The reason for this is that there are no revealed preferences in the described dilemma situation. The situations, on the other hand, are characterized by the existence of structures that cause the individuals to produce a Pareto-worse result. And this would occur, even though they would have preferred a different result individually: the Pareto-better result.

4.2.5.6 Incomplete contracts

In the previous section, it became clear that there are interactions in which both sides have an interest in a common institution that helps them to overcome the dilemma structure of the situation. In this sense, institutions are systems of rules that define rights and obligations, i.e. allow, prescribe, or prohibit certain actions by the actors. An important characteristic of these control systems, however, is that they can never be entirely comprehensive. That is, they will never be able to regulate every eventuality. Performance and consideration are not exactly determined. One therefore speaks of incomplete contracts.

Why are contracts incomplete? There are two main reasons for this: They cannot be, and they should not be. Let us first turn to the factual limitations. First of all, there is an information problem. It is simply not possible to anticipate and contractually specify all future environmental conditions. However, even if possible environmental conditions can in principle be foreseen and included in the contract, the performance of the service is often not objectively ascertainable and therefore also not justiciable, i.e. capable of being settled by law or by the action of a court. In cases where there is objective evidence, enforcement in court is often associated with high costs.

Now let us look at the reasons why completeness of contracts is not desired at all. The core idea is that the contracting parties should be given the freedom to react to new information, which then allows them to realize gains in cooperation in the course of a directed openness (Homann and Suchanek, 2005). New information is available, for example, if unforeseeable coincidences lead to an increase in the production costs of an agreed service. An important reason for the deliberate incompleteness of a contract is that the actors want to keep their implicit local knowledge usable, which allows them to productively deal with changes that occur. This would no longer be possible if their behavior were wholly determined by the contract.

A well-known example of an incomplete contract is the employment contract. Here, the employee's responsibilities are described only in the context of a general area of activity (Homann and Suchanek, 2005). Numerous details concerning the exact execution of his work are left to the employee himself. This allows the employee to develop his knowledge and skills as optimally as possible in line with the respective situation. He should thus be able to use his local information advantage for the benefit of the company. Overregulation would make this local information advantage worthless.

However, employees can also use the resulting scope for action for their own benefit without placing the interests of the company first. Indeed, it should be noted that within the framework of so-called formal contract theory, which also includes the theory of incomplete contracts, it is assumed that the participants are motivated by self-interest. This means that moral imperatives are used only so long as the corresponding behavior is considered more profitable than the opposite (Richter and Furubotn, 2010, p. 290). For the model theorist, then, opportunism before and after the conclusion of the contract is of central importance. The anticipation of this potential behavior by the company may under certain circumstances lead to a lack cooperation for the mutual benefit of both parties.

The conclusion of a contract requires an external sanctioning body that ensures that both parties remain loyal to the contract. In this context, contracts are always embedded in a rule hierarchy: Higher-order rules, such as constitutional rules, cannot simply be ignored when closing individual contracts.

The theory of incomplete contracts plays a significant role in corporate ethics. An independent "moral" action of the actors becomes necessary where the systematic incompleteness of contracts needs to be compensated for (Homann and Lütge, 2013). Morality in the sense of integrity, fairness, and trust is intended to offset the uncertainties arising from incomplete contracts and thus reduce the transaction costs of interactions. Since the realization of mutual cooperation gains is at stake, the moral behavior of individual actors can, in this sense, be reconstructed self-interestedly.

An important concept of moral action is the self-binding of the actors. Self-binding is understood to mean that an actor voluntarily deprives himself of future behavioral options. However, this in turn presupposes that at the time of self-restriction there is a behavioral option, namely the option of limiting oneself. Ulysses' option to be tied to the mast of his ship is one alternative from his current set of behavioral options. If selected, it leads to a limitation of his set of behavioral options tomorrow. In the context of rational actors who do not suffer from weakness of will, consenting to self-binding may sound odd. Why deprive oneself of future options? After all, by definition, options are merely possibilities for action—which do not necessarily have to be taken but allow an actor to react to new information.

The way that behavioral freedom can only arise through the curtailment of future actions may be illustrated by means of a simple game of trust with a self-binding option. Consider two actors who are thinking about doing business together. Player 1 promises to provide a certain, though not clearly specified service, if Player 2 pays in advance. The performance of Player 1 is therefore not justiciable. Player 1 now has the option to voluntarily limit himself in advance about how he will behave if Player 2 makes the payment. Figure 4.7 shows this sequential game in the form of a game tree.

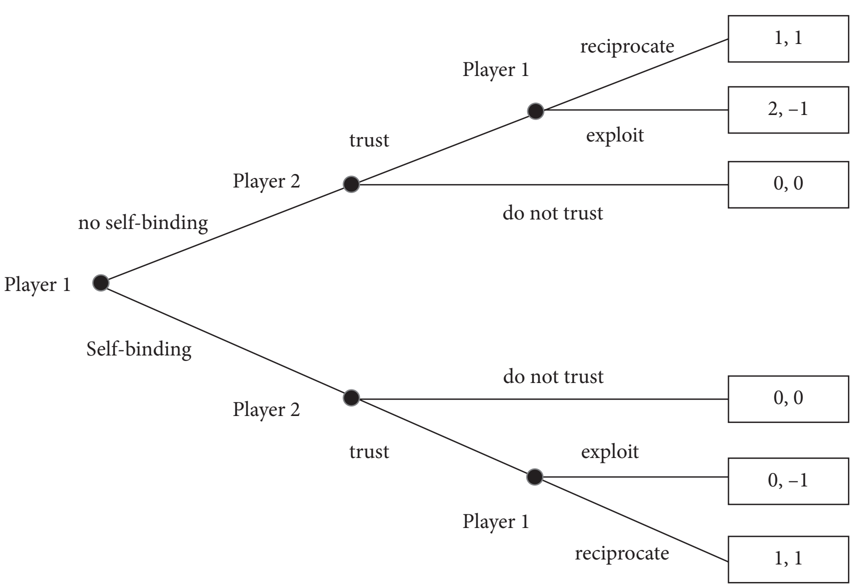


Figure 4.7 Trust game with self-binding option

The circles of the game tree represent decision nodes. Here the respective player (marked "1" or "2" in the tree) has to make a decision. The decision that is made then leads over the branches of the game tree to a new decision node. If Player 1, who is first to act, decides not to bind himself, then Player 2, who is next to act, finds himself in the upper-decision node. If Player 1 decides to make a self-binding decision, Player 2 finds himself in the lower-decision node. He now has the option to trust Player 1 in each point or not. If Player 2 does not extend his trust, the game ends and both players receive the correspondingly framed payout. Again, the value before the comma represents the benefit of Player 1 and the one behind the comma of Player 2. On the other hand, If Player 2 trusts Player 1, both payouts depend on the behavior of Player 1. The latter can either reciprocate or exploit the trust. As becomes clear, the payouts for Player 1 in the event of an exploitation of the trust differ depending on whether he himself has decided in favor of self-binding in the first case or not: The exploitation of trust in the case of self-binding leads to a lower payout for Player 1 than in the case of non-self-binding.

In the modeled situation, will Player 1 now opt for self-binding? Let us first consider the case where he does not. He therefore chooses the upper first branch of the game tree. Player 2 now considers whether, starting from his decision node, he should select the "trust" branch or the "do not trust" branch." What if he goes with the "trust" branch? Since both players are assumed to be fully informed about the game tree, Player 2 knows that Player 1 will take advantage of his trust in this case.

In doing this, Player 1 eventually receives the higher payout. Player 2 will leave the game with a payout of -1 in this situation, which is very unpleasant for him. Given this fact, Player 2 will select the "do not trust" branch, thereby securing a relatively better payout of 0. If Player 1 decides against self-binding in the first decision node, he will ultimately receive a payout of 0 as well. What happens if Player 1 voluntarily downgrades his own payout in the case of a breach of trust and chooses self-binding? Player 2—now in the lower decision node—will consider whether to choose "trust" or "do not trust." If he chooses "do not trust," he again secures a payout of 0. If he goes with "trust," the outcome depends on Player 1's decision. At the same time, he will now reciprocate the trust, since his payout is higher in this case than in the case of the exploited trust. This, in turn, implies a higher payout for Player 2 than in a situation where he did not trust. Through self-binding, Player 1 ultimately realizes a payout of 1 for himself, whereas he realizes a benefit of 0 if he renounces self-binding. Player 1, as homo economicus, will therefore decide in favor of self-binding. This results in an improvement for both players.

Self-binding as a restriction to later behavioral freedom thus makes it possible to realize gains in cooperation and, in this way, creates freedom. It serves as a brake on opportunism—similar to the brake in the car, which only gives the driver the potential to drive fast.

4.2.6 Experimental economic research

The core idea behind economic research is the analysis of the actual behavior of actors under incentive structures. The assumption here is that selected economic situations can be investigated in isolated experiments. The validity of the obtained results is then tested by repeating the experiments and, if possible, by replicating their results. In principle, two approaches within experimental economic research can be distinguished (Tietz and Weber, 1980). First, established economic theories are subjected to a reality test. This means that their theoretical predictions are checked against the behavior of test subjects. In the course of this first approach, distinct behavioral hypotheses are derived from the established theory, which can then be falsified experimentally. Second, new, more realistic theories are developed. To a certain extent, the procedure is reversed from the first case. Within the experimental framework, economic situations are constructed. One hopes that the obtained data will lead to the development of consistent theory for the observed behavior. This rather explorative approach was propagated, for example, by Nobel Prize winner Reinhard Selten (Sauermann and Selten, 1967).

Paul Samuelson regretted in his standard work *Foundations of Economic Analysis* (1947) that economics was not an experimental science like the natural sciences. He noted that it is not possible to carry out targeted manipulations under controlled conditions to investigate their effects on certain economic variables. The reason is that the ceteris paribus condition, which is central to economic analysis, cannot be maintained in a social-scientific context. This is the condition that all other actual or potential influencing factors be kept constant. It is the only way that change in the dependent variable can also be attributed to the targeted change of the independent variable.

Although Samuelson's opinion was mainstream at the time, Edward Chamberlin (1948) was already conducting lecture-hall experiments with his students on imperfect competition. One of Chamberlin's students, Vernon L. Smith, received the Nobel Prize in economics over 50 years later for his use of laboratory experiments in economics. Since then, the number of experimental works in the leading journals has increased dramatically. In the meantime, a paradigm shift has taken place: There are few serious economists today who deny the value of experiments—at least in some areas of the discipline. In fact, there has been recent trend towards an increased use of field experiments. In contrast to field experiments, which are often highly stylized, laboratory experiments take place in a natural environment. The subjects are then often unaware that they are even participating in an experiment. The reason for the growing use of this method lies in the often higher external validity of field studies. This means that the conclusions drawn from these studies are more generalizable than in the case of laboratory studies. Here the criticism is often voiced that the results obtained in the laboratory say nothing essential about the “real” world outside the laboratory.[4]

While field experiments tend to have a higher external validity than laboratory experiments, the higher internal validity of the laboratory experiments represents their central advantage. An experiment is internally valid if the conclusions drawn directly from the experiment can be legitimately drawn for the dependent variable. This is not the case, for example, if, in addition to deliberate manipulation, a further change has imperceptibly occurred in the supposedly constant parameters, which partly or completely determine the observed change. Here, the above-mentioned ceteris paribus condition is violated. As a result of stronger monitoring, guaranteeing the constancy of the other influencing factors tends to be more achievable under laboratory conditions and field conditions.

Experimental economic research has drawn attention to a number of factors that traditional economics has so far neglected in its theory formation. The concept of fairness considerations is just one example from the large number of influential studies. In a one-period negotiation game, known as an ultimatum game, Güth et al. (1982) for the first time examined whether individuals reject other players’ financial offers to their own monetary disadvantage. The results of this first study have been replicated countless times in different countries since then. Ultimatum games are typically two-person games. The subjects are randomly divided into pairs. The identity of the other player is not known. The two players are then randomly assigned roles: the role of the proposer and the responder. A certain amount of money is available to the proposer. Let us assume it is 1,000 cents. The proposer now offers any part of this amount to the respondent. The respondent can either accept or reject the offer. If the respondent accepts the offer, the allocation takes place as proposed. If the respondent rejects the offer, both players get nothing. Renegotiations are not possible.

So what would the prediction be for the observed behavior, assuming the players are rational actors who intend to maximize their financial advantage? Non-cooperative game theory, following the concept of backward induction, would put the cart before the horse. Thus, the first question is: What will the respondent do if he is offered a certain amount of money? It is predicted that he will accept the monetary offer as soon as it is higher than zero. If the proposer offers the respondent at least one cent, the latter is financially better off if he accepts the offer. The reason is that by demonstratively rejecting such a relatively small amount, he can no longer influence the offer once it has been made. Renegotiations are not possible, and the game is only played once. The proposer will see through this incentive structure and—given that he wants to maximize his own financial benefit—offer exactly one cent.

The empirical results are drastically different from this prediction. In the original study, for example, the subjects offered approximately one-third of their initial endowment to the respondents. The latter often consistently turned down lower amounts (Güth et al., 1982). Fehr and Schmidt (2001) concluded that offers of less than one-fifth of the total amount tend to be rejected with a likelihood of approximately 50 percent.

The results suggest that, in addition to maximizing their financial benefit, the subjects are also concerned about fairness considerations. At a minimum, this can be concluded directly from the respondent's refusals. It is impossible to say at first whether the proposer makes fairness considerations the basis of his higher offers or he simply intuitively fears the respondent's rejection of offers that are too low. This has been tested, however, in the course of so-called dictator games, which function similarly to the ultimatum game, with the crucial difference that the respondent is not granted here the right to veto. As a consequence, he is simply called the receiver. The proposer, for his part, has the first and last word. He becomes the dictator.

By eliminating strategic considerations, the dictator game therefore allows clearer conclusions to be drawn about the dictators' motivation. In a meta-study evaluating 616 different dictator games, Engel (2011) calculated that the dictator relinquishes an average of 28 percent of his pie. Is it possible to infer the dictators' prosocial preferences from this behavior? In the context of this question, some results are particularly informative which manipulate the social control of the subjects. If, for example, the dictator is given the opportunity to hide from the recipient that the obolus he receives was the result of a dictatorial decision, the dictators' disbursement is systematically reduced. If dictators have to rise from their seats, they give more. If the recipients are brought into the emotional proximity of the dictators (by the presentation of stylized faces on the screens), the dictators also give more (Engel, 2011).

These compelling results exemplify the value of experimental economic research for business ethics.[5] As the manipulations of social control in the dictator games suggest, moral behavior erodes in anonymous markets where effective face-to-face control is no longer possible. The test subjects tend to maximize their own income if their actions take place at an emotional distance and if the setting becomes increasingly anonymous. Kenneth Binmore (2005) points out that the behavior of the test subjects is in line with the predictions of traditional economic behavioral models if only enough rounds are played to allow players adapt to the new environment. Binmore criticizes authors who concede that "hundreds of experiments" have proven that test subjects relinquish their own profits to provide financial benefits to others. This happens, he remarks, without any mention of the fact that there are many more experiments confirming the assumptions of orthodox game theory that subjects maximize their average payout in monetary units. Thus, test subjects do not attach the connotations of their moral surroundings at the laboratory door. Rather, they adapt quite quickly to the logic of anonymous markets if the turn-based games are repeated sufficiently often.

Putting aside the actual interpretation of the respective results,[6] experimental economic research offers a highly fruitful method for business ethics—one which allows it to examine the actual behavior of the actors within the context of economic incentives. Since there is often a gap between words and deeds in the field of morality, they offer a clear methodological advantage over purely hypothetical surveys, for here actual behavior is observed instead of mere declarations of intent. The test subjects do not pay with cheap talk, but in hard economic currency. In particular, experimental economic ethics becomes an indispensable method for the question of the implementability of desired moral action under the conditions of modern societies. It allows for the piloting of large-scale social experiments in nuce that are difficult to reverse; for a process of trial and error under protected conditions; and it can help to prevent costly failures.

4.3 Psychological foundations and tools

4.3.1 Introduction

Doris (2013) notes that research at the intersection of human mentation and human morality is flourishing as never before due to an unprecedented interdisciplinarity. It is true for philosophy and economics alike that research has become much more interdisciplinary. Especially the field of psychology had and keeps having a profound influence on both fields. Historically, the study of morality has been a special province of philosophy, while mental processes has largely been the province of psychology. Simultaneously, recent philosophy has been largely speculative or theoretical and the methods of contemporary psychology have characteristically been empirical or experimental. Thus, it has been argued that philosophy has often been light on fact, and psychology has often been light on theory (Doris, 2013).

Starting in late 1960s, increasing influence of philosophical naturalism and cognitive science, particularly in epistemology and philosophy of mind, induced an interdisciplinary study of morality in philosophy, while in psychology the demise of behaviorism opened the door to empirical investigations on an increasing variety of topics including such that had previously been exclusively philosophical topics (Doris, 2013). In this chapter, we will trace some important insights of moral psychology for ethics. After a discussion of dual process theory and Haidt's social intuitionist model, research on bounded ethicality will receive special attention. It overturns the traditional assumption that ethical intentions automatically lead to ethical action. The special role of organizations for ethical action is addressed by means of examples. Finally, the importance of greater self-awareness to align our ethical conduct with our ethical values is emphasized.

4.3.2 The behavioral approach to ethics

Traditional ethics ascribes a central role to intentions. Taking a prescriptive or normative approach, its focus is on how people should act when resolving ethical dilemmas. Consequently, business ethics usually focuses on the moral evaluation of practices of people within corporations (Bazerman and Gino, 2012). Usually, it is assumed in traditional ethics that once people have understood what is right and what is wrong, they act accordingly. This view is pointedly challenged by the findings of Schwitzgebel (2009) who provides evidence from 31 leading academic libraries across the United States and United Kingdom that ethics books were more likely to be stolen than other philosophical books of similar popularity and age. Additionally, advanced texts that were more likely to be of interest to graduate students and ethics professors were missing even more frequently.

The central role of deliberation for ethics is exemplified by Lawrence Kohlberg's (1969) stages of moral development. According to this theory, individuals progress in moral reasoning from a pre-conventional stage of obedience and self-interest via a conventional stage of social consensus to a post-conventional stage in which they elevate their own abstract principles over social conventions. When an individual encounters an ethical dilemma and finds their current level of moral reasoning unsatisfactory, they will constructively strive for the next level (Colby et al., 1983). This moral development approach to ethics suggests that morality develops through different stages and then becomes a stable character trait. Bazerman and Gino (2012) emphasize that educators in traditional ethics courses commonly highlight the distinction between cases and have students discuss and argue for their own ethical view. They criticize this approach for being insufficient if we want to understand how we actually solve ethical dilemmas and if we are really interested in improving ethicality in organizations.

In Section 4.1, we already mentioned the famous trolley problem (Foot, 1967) where respondents are asked whether they would be willing to offset lives against another. Recent research on the trolley problem gives some intriguing insights on the subtle factors that actually drive ethical decisions and the contradictions that this implies. In the classic version of the problem, called “switch,” a bystander can hit a switch to divert a runaway trolley that is about to run over five railway workmen onto a sidetrack where it will only run over one workman instead of five. When respondents are asked whether it is morally permissible to hit the switch, the clear majority feels that this is the case. In another version of the trolley problem, called “footbridge,” a bystander can push a railway worker with a backpack onto the tracks below and use his body to stop the trolley from running over five railway workers. Respondents are then asked whether it is morally permissible to push the man off the bridge. There is comprehensive evidence that the clear majority vote of sacrificing one person for the sake of five in “switch” drops to a clear minority vote in “footbridge.”

While many utilitarians insist on the inconsistency of these judgments, deontological ethics might provide a rationale for this pattern. The normative “doctrine of double effect” that is essentially the “doctrine of side effect” draws an important line between harm that is caused as a means to an end and harm that is caused as a side effect. One way to think about this is to imagine that the victim would miraculously disappear. What would this imply for “footbridge” and “switch”? In footbridge, there would be no trolley-stopper, while in switch the disappearance would be a godsend. Kant’s categorical imperative demands that humans should never be regarded as means to an end but always as ends in themselves. In other words, humans should never be instrumentalized. What could be a more brutal instrumentalization of a human than to use him or her as a trolley-stopper? So, does this mean that the different responses in switch and in footbridge are morally justified?

Greene (2014) presents an interesting challenge to this conclusion by introducing an ingenious hybrid of the switch and the footbridge version of the trolley problem: the "remote footbridge."

In the remote footbridge, a railway worker with a backpack stands again on the footbridge under which a runaway trolley rushes along the rails. However, now the bystander is standing at some distance from the footbridge at a switch. Hitting the switch will open a trapdoor through which the railway worker falls onto the rails to stop the train. Greene (2014) reports that the approval rate of hitting the switch rises from 31 percent in footbridge to 63 percent in remote footbridge. He criticizes these emotions as misleading by asking one to assume that a friend calls from a footbridge seeking moral advice and asks whether he or she should kill one to save five. It seems bizarre that one would say: "Well, that depends . . . Will you be pushing this person, or can you drop 'em with a switch?" (Greene, 2014, p. 217). Although the physical mechanism should not matter ethically, it matters psychologically. It seems that our intuitions in these dilemmas are not only influenced by the ethically relevant means/side-effect distinction that many of us may find reasonable, but also by a distinction of physical distance that most of us probably find rather dubious.

Most of us dramatically underestimate how strongly our behavior is prone to incentives and other situational factors. Behavioral ethics studies how people actually behave and assumes that people often act contrary to their best ethical intentions. It focuses on the psychological and often subconscious factors that influence moral decision-making and which are highly situational. This means that specific aspects of the situational context in which the respective choice takes place and that should be ethically irrelevant shape our actual moral behavior. For business ethics, the interplay between different people in organizations is of particular interest. We will specifically look at the effects of this interplay in Section 4.3.7.

People are good at behaving very inconsistently in the moral domain and still keeping up their favorable self-image. In this sense, we are not only good at deceiving others but also at deceiving ourselves. Traditional approaches to ethics fundamentally lack an understanding of the unintentional cognitive drivers of unethical behavior (Bazerman and Tenbrunsel, 2011). It is important to subject these cognitive drivers to scientific examination, because they are not idiosyncratic behavioral "noise" but predictable patterns that can be understood and accordingly addressed. Ultimately, behavioral ethics is concerned with how people actually take moral decisions and not with how they are supposed to behave in an ideal world.

Most approaches to ethics assume that people identify an ethical dilemma as what it is and then respond intentionally to it. Bounded ethicality analyzes unethical behavior that arises without intentionality. It is a research program that describes the systematic and predictable psychological processes underlying ethically problematic behavior that is inconsistent with the ethics that the people engaging in this behavior prefer for themselves. It is thus according to the decision-maker's own standards, and not the standards of some external ethical observer, that the ethical behavior is bounded. Bounded ethicality is therefore an instance of Herbert Simon's (1997) concept of bounded rationality in the domain of ethics.

4.3.3 Dual process theory

An important distinction is the dichotomy between "System 1" and "System 2" thinking that has been made popular by Daniel Kahneman and his long-term collaborator Amos Tversky. System 1 operates automatically, quickly, effortlessly, and without sense of voluntary control. System 2 allocates attention to the effortful mental activities that demand it. Operations of Systems 2 are often associated with subjective experiences of agency, choice, and concentration (Kahneman, 2011). Given that we have to make thousands of decisions every day, we have to take shortcuts to solve most of the problems we encounter. These shortcuts are called heuristics. Kahneman argues that because System 1 operates automatically and cannot be turned off at will, it is very difficult to prevent errors of intuitive thought. System 1 often has no clue of the errors and these can only be avoided by the monitoring and effortful activity of System 2. However, constantly questioning our own thinking would be tedious and System 2 is simply too slow and inefficient to serve a substitute for System 1. According to Kahneman, the best we can do is to learn to recognize situations in which mistakes are likely to occur and try harder to avoid substantial mistakes when stakes are high (Kahneman, 2011).

A main function of System 2 is to monitor and control the thoughts and actions that are "suggested" by System 1. The laziness of System 2 is exemplified nicely by the bat-and-ball problem: "A bat and ball cost $1.10. The bat costs one dollar more than the ball. How much does the ball cost?" (Kahneman, 2011, p. 44). The number that immediately comes to mind is 10¢. The usefulness of the problem lies in the fact that it evokes an answer that is appealing, intuitive, and wrong, because the correct answer is 5¢. Kahneman (2011) argues that it is safe to assume that the intuitive answer also came to the mind of those people who managed to give the right answer, but they were able to resist the temptation. People who say 10¢ appear to be followers of the rule of least effort and people who avoid this answer appear to have more active minds. Several thousands of students have answered the bat-and-ball problem and more than 50 percent of students at Harvard, MIT, and Princeton gave the intuitive and wrong answer. At less selective universities, the failure to check was in excess of 80 percent (Kahneman, 2011). This is despite the fact that they could have become suspicious that a cognitive test included a question that would contain such an obvious answer. Kahneman concludes that people place too much faith in their intuitions and find cognitive effort more than just mildly unpleasant. Understanding the relevance of System 1 for our thinking can not only sensitize us for logical errors but also for ethical errors, because it is not unusual that people have System 1 responses that could be called moral heuristics to ethical problems. Acknowledging the role of our intuitive responses for moral judgment is one of the central premises of behavioral ethics.

4.3.4 The social intuitionist model to moral judgment

Kohlberg (1969), Piaget (1965), and Turiel (1983) are proponents of rationalist approaches in moral psychology which assume that moral judgments are reached by processes of reasoning and reflection. They do not deny that moral emotions may feed into the reasoning process but reject the idea that they are the direct causes of moral judgments. In rationalist models, people weigh right and wrong, benefit and harm, fairness and unfairness and then arrive at a well-calibrated judgment. If they find no condemning evidence, the plaintiff is not condemned. Intuitionist psychologists argue that our emotional reactions precede moral reasoning. Haidt (2001) presents the social intuitionist model as an alternative to rationalist models. The model is social in emphasizing the importance of social and cultural influences on moral judgments while deemphasizing the role of private reasoning done by individuals (Haidt, 2001). It is intuitionist in stating that moral judgments are generally the result of intuitions, i.e. quick and automatic evaluations. These moral judgments are then followed by slow ex post facto moral reasoning.

Figure 4.8 contrasts the rationalist model and the social intuitionist model. The core of the social intuitionist model is characterized by four links (Haidt, 2001). The intuitive judgment link posits that moral judgments are the automatic and effortless result of moral intuitions. The post

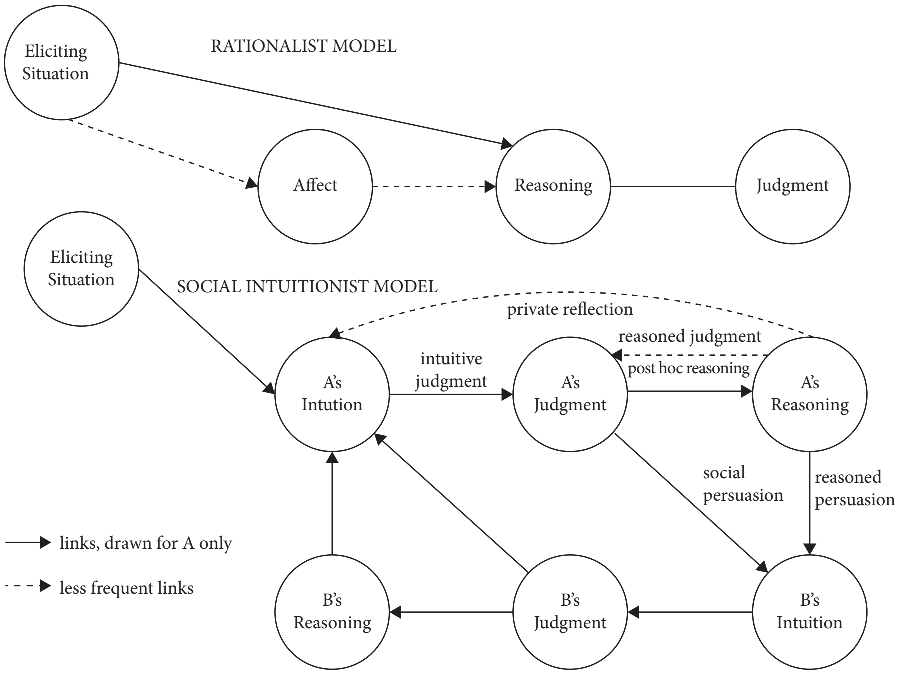


Figure 4.8 The rationalist model and the social intuitionist model of moral judgment
Source: Own representation according to Haidt (2001, p. 815)

hoc reasoning link proposes that moral reasoning is an effortful process where one searches for reasons to support one's already made hypothesis. The reasoned persuasion link captures the idea that moral reasoning is sent forth verbally to justify one's already-made moral judgment to others by triggering affective intuitions in the listener. The social persuasion link posits that the mere fact that a member of one's own social group has made a moral judgment exerts an influence on others even in the absence of reasoned persuasion. Although these four links form the core of the social intuitionist model, the full model includes two ways in which private reasoning may shape moral judgments. The reasoned judgment link may sometimes lead to people overriding their initial intuition by force of logic, yet the intuitive judgment tends to continue to exist under the surface. Finally, the private reflection link may in the course of thinking activate a new intuition contradicting the initial one. This pathway amounts to having an inner dialogue with oneself.

Haidt concludes his seminal article by stating that rationalist models made sense in the 1960s and 1970s when the cognitive revolution created advances to think about moral judgment as a form of information processing. Since then, however, evidence has reaffirmed us that most of cognition occurs automatically and moral judgments happen outside of our consciousness. People usually cannot explain how they really arrived at a particular moral judgment. He suggests that the time may be ripe for a revolution in our theorizing by considering the possibility that moral emotions are the dog that wags the tail of moral reasoning (Haidt, 2001).

4.3.5 The limits of reason for moral judgments

Haidt acknowledges that philosophy has worshipped reason for most of its history. It was only in the eighteenth century that English and Scottish philosophers discussed alternative approaches to rationalism. Especially Hume explicitly suggested that moral judgments and aesthetic judgments were alike. They are both derived from a sentiment and not from reason. This is highlighted in Hume's famous claim that "Reason is, and ought only to be the slave of the passions, and can never pretend to any other office than to serve and obey them" (Hume, 1739).

According to Haidt (2001), four reasons can be given to doubt the causal importance of reason for moral behavior. The first reason is the evidence supporting dual process models of judgment making that carry over to the domain of moral judgments that typically involve complex social stimuli. The literature on attitude formation suggests that it is rather based on automatic processes than on deliberation and that people form impressions at first sight (Albright et al., 1988) that are almost identical to their attitudes after much longer observation (Ambady and Rosenthal, 1992).

The second reason is the problem of motivated reasoning which suggests that the post hoc reasoning link in Figure 4.8 is more important than the reasoned judgment and private reflection links. People are more likely to arrive at conclusions that they want to arrive at, while this ability is constrained by their ability to come up with seemingly reasonable justifications for these conclusions (Kunda, 1990). Haidt (2001) states that the reasoning process is better compared to a lawyer defending a client than to a scientist seeking truth.

The third reason refers to the post hoc problem where people generate causal explanations out of a priori causal theories. A priori causal theories are norms for evaluating others' behavior that are culturally transmitted. The post hoc problem implies that our moral life is plagued by two illusions. Haidt (2001) calls the first on the "wag-the-dog illusion": We believe that the tail of moral reasoning wags the dog of our moral judgment. He calls the second one the "wag-the-other-dog's-tail illusion": This is the belief that the successful rebuttal of our opponent's argument in a moral debate will make him change his mind. The expectation is similar to the belief that wagging a dog's tail with our hand, will make the dog happy.

The fourth and final reason is the action problem that focuses on moral behavior instead of moral judgment. Strong evidence that moral reasoning matters less for moral action than moral emotions comes from the study of psychopaths who understand the harmful consequences of their actions but simply do not care about them. Several studies conclude that psychopaths and people with antisocial personality disorder differ from normal people in the operation of their prefrontal cortex (Haidt, 2001). Damasio and his coauthors have studied the importance of the ventromedial area of the prefrontal cortex (VMPFC, the area behind the bridge of the nose) for moral action. Patients with damages that are restricted to this area show no reduction in logical reasoning abilities and retain full knowledge of moral rules and social conventions and even have no difficulties in solving hypothetical moral dilemmas. Yet, when shown pictures of mutilation or dying people that arouse strong skin conductance responses in people without damage to the VMPFC, individuals with VMPFC damage show no response and report that they feel nothing, although they know that the images should affect them (Damasio et al., 1990).

4.3.6 Boundedly ethical decision-making

Bazerman and Tenbrunsel describe a vivid example for a person acting against her own ethical values. As professors at prestigious universities, they tend to get calls from long-lost friends as one of their children's eighteenth birthday approaches and are asked for an introduction of their child to the director of admissions (Bazerman and Tenbrunsel, 2011). Although these calls are awkward for them, because they cannot give much useful input, they usually follow through with the process of making arrangements, because it would be unpleasant to tell a friend that they can offer little help. Most of us are intuitively comfortable with doing favors for those with whom we identify. These are usually those who are a lot like us with respect to religion, race, or gender. With respect to race, the authors suggest that the resulting in-group favoritism leads to Caucasians making phone calls to Caucasians to request special favors for Caucasians. Of course, this is not the result of an immoral intention to leave minorities out in the cold, but the result of focusing on being "nice" by putting in a good word to the dean of admissions for a long-lost friend. However, in a world of scarce resources, favoring those who are like us is equivalent to punishing those who do not share our demographic traits. We tend to fail to recognize this.

To gain a deeper understanding of boundedly ethical decision-making, it is helpful to divide the decision-making process into three stages: before, during, and after a moral decision is made. This helps us to identify the psychological factors that contribute to making our decisions boundedly ethical. Misprediction and misremembrance are two kinds of misperceptions, one happening before the decision is made and one happening after it is made, that help to explain the gap between how ethical we think we are and how ethical we actually are. Bounded ethicality arises from the temporal inconsistencies between the contextual trichotomy of our "should"-driven predictions and recollections and our "want"-driven actions. The "want/should" distinction was proposed by Bazerman et al. (1998) to explicitly capture the intra-personal conflicts that exist within the human mind. This theory provides an operational specification to issues that are known as "multiple selves" problems. The respective literature argues that the self-system is best described as a multitude of self-conceptions that are triggered in different contexts (Kivetz and Tyler, 2007).

4.3.6.1 Before the decision: prediction errors

Before the moral decision is made, prediction errors about one's own behavior play an important role. The human tendency to make inaccurate predictions about how one will behave in a future situation is well established. In his research on intra-personal empathy gaps, George Loewenstein has shown that people tend to underestimate the impact that visceral factors, i.e. emotions, drives, and cravings, have on our future behavior. The hot-to-cold empathy gap describes our tendency to consider our transient desires in emotional states as being more stable than they actually are. An intense desire to retaliate in the heat of the moment may evaporate in a few days or even hours. This is one reason why the waiting period to get a firearm in the USA is called a "cool-off phase." When we consider a future ethical decision on a purely theoretical level and have the luxury of carefully deliberating about a future choice, we are likely to predict a decision that is most compatible with our ethics. However, if the decision becomes reality, many ethical considerations shift out of focus. The prediction turns into a prediction error. It is noteworthy that while we tend to predict our future behavior in a very favorable manner, this does not carry over to other individuals. Epley and Dunning (2000) have investigated people's typical tendency to believe that they are more likely to engage in selfless and generous behaviors than their peers, although this is statistically suspect. They tested whether people feel "holier than thou" because they have overly cynical views of their peers but accurate impressions of themselves or overly charitable views of themselves and accurate impressions of their peers. In support of the latter explanation the authors found that people overestimated their own likelihood of behaving ethically, while their beliefs about others' behavior were more accurate. According to Epley and Dunning, this divergence in accuracy is partly based on people's neglect of population base rates when predicting their own as opposed to others' behavior (Epley and Dunning, 2000).

4.3.6.2 During the decision: ethical fading

When we are in the phase of predicting our decision-making, we are preoccupied with thoughts of what we should do. Social science research suggests that when a decision is made, our thoughts are dominated by considerations of how we want to behave, while the thoughts of how we ought to behave tend to disappear. Tenbrunsel and Messick (2004) have coined the term "ethical fading" to account for the dominance of the "want" self during the time of the decision. Ethical fading describes a process by which a decision-maker is unaware of the ethical implications of her decision which leads to the neglect of ethical criteria for the decision. The "should" self has no reason to be activated and the "want" self rules. This also has implications for how we judge others' ethical behavior. When we consider the behavior of managers who were involved in recent scandals, we are usually convinced that we never would have engaged in these sorts of behavior and would not have supported but reported it. Considering others' behavior, our "should" self gets activated. Behavioral ethics research, however, shows that very often, when we are actually facing a decision with an ethical dimension, our "want" self wins out. When we predict our future behavior, it is very difficult for us to anticipate the specifics of the actual decision situation that we will face. Our prediction is driven by abstract principles and attitudes. When taking the specific decision, however, our behavior is driven by the details of the situation. When facing ethical dilemmas, our actions precede moral reasoning and we make quick decisions that are based on our visceral responses. It is only later that we engage again in moral reason and try to realign our actions with our ethics.

4.3.6.3 After the decision: selective memory

As we gain distance from our visceral responses, the ethical implications of our actions come back into focus. In this sense, the recollection phase is once more dominated by should considerations. We are now confronted with a mismatch between our favorable self-image and our unethical behavior that is perceived as very inconvenient. When thinking about our own past unethical, we become "revisionist historians" (Bazerman and Tenbrunsel, 2011). Our memory is selective and we tend to remember behaviors that support our self-image and tend to forget those that do not. The goal is not to arrive at an accurate self-depiction but at a picture that reflects who we desire to be. Because self-serving biases are not completely foolproof, we may see our unethical behavior in a given situation. Usually, we find ways to "spin" the behavior by rationalizing our role in a given situation, interpreting our unethical actions in a more favorable light or simply redefining what is ethical. A person who follows the principle to abstain from lying, may justify her lies in a negotiation by telling herself that it is not really a lie, but actually what one is expected to do in a negotiation. Mitchell et al. (1997) have shown that the "rosy view" is not exclusively limited to one's own ethical behavior, but a more general tendency that lets us misremember past experiences as more positive than we perceived them at the time of experience. Tenbrunsel et al. (2010) argue that the so-called omission bias, which describes the tendency to believe acts of omission to be morally superior to acts of commission, reinforces people's egocentric adaptations of ethical standards when they recollect past behavior. The temporal nature of ethical decision-making explains how the omission bias influences the recollection process. We often predict that we will have the courage to speak up against injustice. Yet, when the time comes, we often remain silent. When the time for recollection arrives, we adopt an understanding of ethics that reflects the omission bias. We allow ourselves to believe that were not unethical because we did not create additional harm. The focus of assessment shifts from an act of commission, namely the silence in the midst of an ethical dilemma, to an act of omission, because the latter is considered "less unethical" (Tenbrunsel et al., 2010).

4.3.7 Bounded ethicality in organizations

The standard approach to the study of business ethics has been a normative approach which focuses on what managers and employees "should" do in order to act as morally responsible actors. According to De Cremer and Tenbrunsel (2011), the prescriptive tone that is inherent in this literature is clearly reflected in the popularity of companies' codes of conduct and moral guidelines. This approach rests on the assumption that individuals are rationally and purposively acting in line with their intentions and are fully aware of their actions' implications. This view leads to the intuitively compelling but simplistic conclusion that most business scandals are the result of a few bad apples. Behavioral business ethics reminds us that some contexts may be sufficiently attractive for almost anyone to engage in unethical behavior (De Cremer and Tenbrunsel, 2011). It is the understanding of these circumstances that could enable business leaders to create more ethical organizations. This makes it necessary to not only look at the behavior itself but also to understand the psychological processes underlying the behavior.

Business ethics courses that have become increasingly popular at business schools usually teach students how to use ethical principles to discriminate behaviors that are and are not ethical. The assumption is that by highlighting a decision's moral component, executives will be more likely to choose the moral path (Tenbrunsel and Messick, 2004). Behavioral business ethics can provide usefulness beyond this traditional approach by providing insights into how institutions can be designed that make it easier for people to behave in conformity to their own ethical principles (Dana et al., 2011). Organizational contexts have important implications for ethical behavior. That is because people tend to avoid holding themselves ethically accountable and organizations may allow them to do this more easily. In the following, three examples of how organizational contexts may promote unethical behavior will be discussed. The first example deals with the diffusion of responsibility, the second example is concerned with the influence of unethical others and the third example deals with crowding-out effects through organizational measures.

4.3.7.1 Diffusion of responsibility

The diffusion of responsibility describes people's preference to share responsibility for an ethically difficult decision. From the design of the respective experiments, it should once more become clear here that the resulting unethical behavior does not occur because people decide to behave unethical, but precisely because people are ethical, or at least truly want to be ethical. Otherwise, they would not have to go through the costly contortions that they do to allow themselves to behave in an unethical way when in fact no one would punish them except for themselves (Dana et al., 2011). Diffusion of responsibility makes it possible for people to take actions that they themselves would eschew if they were acting unilaterally. Dana et al. (2011) distinguish between diffusion of responsibility that occurs vertically, i.e. when intermediaries exist that may take over the "dirty work," and horizontally, i.e. when people fail to behave ethically, because they count on others to do so on their behalf. An example for vertical diffusion of responsibility may be the outsourcing of certain functions to a subcontractor that pays its employees wages that are below the standards of the firm. A famous example for horizontal diffusion of responsibility is the so-called "bystander effect" in which people fail to help another person when others are present but do not do so when alone (Dana et al., 2011).

Hamman et al. (2010) report the results of three laboratory experiments that analyze principal-agent relationships. In their studies, principals repeatedly either decide how much money to share with a recipient or hire agents to make sharing decisions on their behalf. The authors conclude that principal-agent relationships can serve functions beyond those usually attributed to them. In the baseline condition, principals made the allocation decision in a dictator game themselves by specifying an amount they wished to share with the recipient. Sharing decreases considerably when decisions are made through agents, and those agents who are willing to act most self-interestedly on behalf of their principals were able to attract most of the principals' business. Most notably, however, acting through the agents allowed the principals to maintain their positive self-image. Hamman et al. (2010) argue that agents serve this function through a complex interplay of psychological factors. Principals do not feel that they take unethical decisions, because they are simply hiring agents. Agents tend to behave more self-interestedly on their principals' behalf than they would tend to behave if they were dictators themselves. After all, they were just doing their job. It is important to keep in mind here that agents were drawn randomly from the same population as baseline dictators. At a practical level, the studies point to potential institutional arrangements that could reduce unethical behavior in hierarchical situations such as, for instance, regulations with regard to the kinds of advertising employed by agents in some contexts (Hamman et al., 2010). Although not explicitly tested in their study, the authors also suggest that a principal could be forced to see the decision made on her behalf and have the option of overriding it or certifying that they want to see the action implemented. This behavior could potentially reintroduce the social pressure or obligation to behavior ethically. In fact, a similar procedure was implemented by the Sarbanes-Oxley Act that requires CEOs to personally vouch for the accuracy of the books undermining the common excuse of the top management that they were unaware of malfeasance that was implemented on their behalf (Hamman et al., 2010).

Dana et al. (2007) report the results of a study on horizontal diffusion of responsibility. In their game, two decision-makers made a binary choice between a fair outcome for themselves and a passive bystander and an inequitable outcome that benefited the two decision-makers but harmed the third party. The inequitable outcome, however, was only implemented if both decision-makers chose it. This structure ensured that any decision-maker who had an ethical preference for the fair outcome could guarantee its emergence unilaterally, but could also evade accountability for choosing the unfair option because it would only be implemented if the other decision-maker also chose it. Decision-makers who shared their responsibility for the outcome chose the unfair option almost twice as often as decision-makers in a baseline who did not have the option to diffuse responsibility (Dana et al., 2007). The experiment provides a nice illustration for the importance of testing the effects of potential institutional solutions in isolated experiments before they are rolled out on a larger scale. This is even the case for institutional settings that may seem like "no brainers" to many, because these institutions may interact with people's preferences. Reckoning that each representative decision-maker has an exogenously given probability $p < 1$ to choose the unfair allocation, one would expect that implementing the decision only if both decision-makers will choose it would reduce the overall probability of the unfair allocation being implemented to $p^2 < p < 1$. Therefore, intuitively, one might assume that an institution which implements a four-eyes principle would mitigate tendencies for unethical behavior. This intuition, however, does not account for the possibility that preferences for ethical behavior might be endogenous. In the worst case, the diffusion of responsibility between both decision-makers could lead to an increase in each decision-maker's probability to engage in unethical behavior that overcompensates for the institutional hurdle of needing dual consent for the unethical action.

4.3.7.2 The influence of unethical others

Behavioral ethics posits that our environment strongly shapes our behavior. In social contexts, we frequently observe other people's behavior which will then influence our own ethical conduct (Shu et al., 2011). Organizations are one instance of such social contexts. Gino et al. (2009) disentangled three different ways in which the unethical behavior of others can influence our own ethical behavior. First, when we observe unethical behavior, we may change the cost–benefit analysis of the behavior. In "Crime and Punishment: An Economic Approach," Gary Becker develops a rational choice model of crime that considers crime merely as a choice, just like any other choice (Becker, 1968). Becker summarizes that theories about the determinants of the number of offenses differ greatly, but that practically all of these diverse theories agree that, ceteris paribus, increasing a person's probability of conviction or punishment or punishment if convicted would generally decrease the number of offenses the person commits. He adds that a change in the probability has a greater effect on the number of offenses than a change in the punishment. In observing other people get away with their unethical conduct, we may update our belief about the likelihood of getting caught and correct the presumed costs of the unethical act downward. Assuming constant benefits, this makes the respective behavior more attractive according to rational crime theory.

Second, observing people's dishonesty can also have the opposite effect on our own behavior. When we see someone act unethically, this may increase the salience of morality and accordingly the relevance of ethics for one's behavior. Mazar et al. (2008) present the findings of an experiment in which subjects were randomly assigned to two different kinds of priming. One group of subjects was asked to write down the Ten Commandments, while the other group was asked to write down the names of ten books that they had read in high school. The first group therefore underwent a moral priming and the second group received no moral reminder. The authors hypothesized that thinking about the Ten Commandments would be enough to increase attention to people's own moral standards, regardless of people's religiosity and their ability to remember the exact content of the commandments. The group of subjects who had written down the Ten Commandments as a moral reminder subsequently reduced their level of cheating for financial gain as compared to the group who had not been morally primed. The authors indeed found no correlation between the number of commandments recalled and the level of cheating. If the number of commandments recalled can be seen as a proxy for religiosity, the lacking relationship between religiosity and the magnitude of cheating suggests that the efficacy of the Ten Commandments is based on increasing the attention to internal standards of honesty (Mazar et al., 2008).

Third, the behavior of others can also affect our own moral conduct by affecting our understanding of the norms that underlie a given situation. According to norm-focus theory, observing the same behavior in different environments can induce different sets of norms. A study by Cialdini et al. (1990) found that subjects were more likely to litter into a fully littered environment than into an unlittered one. Moreover, subjects were less likely to litter into an environment that contained a single and salient piece of litter than into an unlittered environment. The authors emphasize the importance of distinguishing between two separate types of norms thought to be acting in a given situation and about the condition under which it is likely to act. The two different types of norms are injunctive and descriptive ones. Injunctive norms make specifications of how one ought to behave, while descriptive norms specify what is actually done. Both types can exist simultaneously in a setting and can have congruent or contradictory behavioral implications (Cialdini et al., 1990). The differing descriptive norms that are observed in an unlittered and a littered environment have a profound effect on people's propensity to follow the injunctive norm not to litter. The increased salience of the injunctive norm that is induced by a single piece of litter in an otherwise unlittered environment, however, also has a positive effect on people's latency to add litter to the environment.

4.3.7.3 Crowding-out effects through organizational measures

Organizational theories often put an emphasis on monitoring and controlling employees to foster ethical behavior. The implementation of such systems, however, may have an influence on the decision frame that people adopt and therefore change an ethical frame in which ethical behavior tends to be the salient choice to a business frame in which unethical behavior might be considered less problematic. Tenbrunsel and Messick (1999) report the results of experiments that show that weak sanctions that are intended to increase ethical behavior actually reduce it. The ethical behavior is crowded out. The authors conclude that organizations should think twice before implementing weak sanctioning systems, because they will not only incur the cost of the system but potentially also the costs of decreased ethical behavior (Tenbrunsel and Messick, 1999). A related effect has been shown by Falk and Kosfeld (2006), where the principal's choice of implementing a minimum performance requirement induces the agent to reduce her performance. The detrimental effect has entered the literature as the "hidden costs of control."

Crowding-out has been shown in several ethical contexts to play an important role. The most famous study documenting this effect was a field experiment by Gneezy and Rustichini (2000) who studied the effect of fines on the frequency with which parents arrive late to collect their children from daycare centers. After the introduction of the fine, the authors observed an increase in the number of parents coming late and this number remained at a higher rate than in the no fine period. Apparently, the introduction of the fine changed parents' decision frame from an ethical decision to a mere business transaction. Similar counterintuitive effects have been documented with monetary rewards instead of fines. Richard Titmuss famously claimed in *The Gift Relationship* of 1970 that monetary compensation may undermine an individual's sense of civic duty (Titmuss, 2018), while economists would tend to assume that the effect of the reward can be added to an individual's altruistic motivations. A field experiment with blood donors showed that while the introduction of monetary rewards had little effect on men's supply of blood donors, women were much less likely to donate blood in the presence of monetary compensations (Mellström and Johannesson, 2008).

In this sense, Samuel Bowles (2016) argues that assuming that people's preferences are always stable and exogenously given is one of the cardinal faults of economics. Institutions may interact with people's preferences and crowding-out effects are probably the most prominent example of this phenomenon. Bowles emphasizes that it may be important to provide institutions with a narrative that explains the ethical rationale behind its extrinsic incentives. If this is successful, incentives may even lead to a crowding-in of ethical behavior. In any case, behavioral ethics teaches us that one has to be careful with the design of institutions and properly test them before rolling them out. While institutions play a huge role for our behavior, the influence that they exercise is not always straightforward. It is therefore crucial to carefully test the effects of institutions and to empirically understand whether and how they shape people's preferences. Organizations may pay a high price for simply trying something out that then turns out to be counterproductive, because returning to the status quo ante may not always be possible, as the study by Gneezy and Rustichini (2000) demonstrated: After the fine for coming late was removed, no reduction of the number of late-coming parents was achieved. The perception of the decision frame turned out to be sticky.

4.3.8 Fighting our unethical behavior

Bazerman and Tenbrunsel (2011) summarize some recommendations on how to remove our blind spots to improve our ethical behavior by reflecting realistically on it. Our more emotional and intuitive System 1 responses are more likely to be immoral than our reflective System 2 reasoning. Learning to think in more analytical ways before we act, would help us to close the gap between our "should" and our "want" self. It would prepare us for the hidden psychological forces that influence our ethical decisions. One way is to increase your accuracy in the planning stage. Anticipating that our "want" selves will exert pressure at the time of the decision and increase the chance that short-term self-interest will prevail in these situations can help us to use self-control strategies to curb that influence (Bazerman and Tenbrunsel, 2011). One such strategy is the use of commitment devices to keep our "want" self from dominating our decision-making. Research demonstrates that those who publicly commit to a decision in advance are more likely to follow through with a decision than those who do not make such commitments. Committing to one's intended ethical choice by sharing it with an unbiased individual may increase the likelihood that decisions will be executed as planned.

In addition to preparing for the power that the "want" self will exercise at the moment of the decision, training our abstract thinking may be another way to increase the influence of the "should" self. Focusing on the high-level aspects of a situation at the time when the decision is made may be one way to do this. In Walter Mischel's famous "marshmallow experiments," children could either eat the marshmallow in front of them immediately or wait and be rewarded with a second marshmallow for their patience. The level of thinking seemed to partially predict the success to resist the temptation of eating the sweet right away. Children who were encouraged to think about the marshmallow in more abstract terms, for instance, to image that it was a puffy cloud, were more likely to exercise patience and wait for the reward (Bazerman and Tenbrunsel, 2011).

Another option would be to construe the decision that one is taking as involving more than one option. Bazerman et al. (1998) reinterpret evidence on the importance of preference elicitation procedures in light of the "want"/"should" self distinction. They refer to an experiment by Kahneman et al. (1993) in which a variety of item pairs pitted the existence of animal species against human health. One group of subjects proved their willingness to pay for each item in the pair separately, whereas another group selected between the two items. Across seven paired items, a solid preference reversal was found: people valued the animal/environment item more in the willingness-to-pay measure but selected the human health item more in choice. Bazerman et al.'s interpretation of this finding is that single options involving animals triggered immediate and emotional responses (cute panda bears versus statistical data on sunscreen for farmers) leading to a dominating preference for the want option. Having more than one option, however, induced a reasoned response that human health should take precedence over the well-being of animals, thus resulting more often in the should response. Thinking abstractly about our decisions and construing them as involving more than one option require of course an awareness that the decision is ethical which in turn would make these recommendations superfluous. Ethical decision-making therefore requires that we apply these recommendations to all our important decisions.

Because uncertainty, time pressure, and short-term horizons serve as catalysts for the process of ethical fading, identifying the areas in an organization that are characterized by these features is a good starting point for changing it (Bazerman and Tenbrunsel, 2011). In environments characterized by high uncertainty, people will find it easier to downplay the ethical aspects of decisions which may trigger the "want" self and increase the probability that unethical choices will be made. The frantic pace of managerial life suggests that executives often have to rely on System 1 thinking. Experiments have shown that people under cognitive load are more likely to give in to their "wants" and discard what they think they should do. The likelihood of taking a "should" choice can be increased by analyzing ethical dilemmas in an environment free of distractions and time pressures. Greater self-awareness is the key to more ethical decision-making at the individual and organizational level. Applying the lens of behavioral ethics should help us to think less romantically about our own ethical choices, see the ethical implications of our actions more clearly, and help to make choices that better align with our values (Bazerman and Tenbrunsel, 2011).

Notes

1. How a decision-maker then actually decides between two alternatives about which she is indifferent is not considered. The parable of Buridan's ass illustrates that this is a philosophical problem. As it is impossible for a donkey to choose between two haystacks of exactly the same size, it is unable to decide which one to eat first and eventually starves to death.
2. It has been related about the philosopher Sidney Morgenbesser that when he was faced with the choice between apple and blueberry pie, he chose apple. But, then, when he found out that there was also strawberry cake on offer, he went with blueberry.
3. Mixed strategies, in which the player does not directly decide for a particular action, but chooses a random mechanism, which, in turn, determines a pure strategy, are neglected here for reasons of simplicity.
4. If the laboratory is obviously not part of the "real world," however, the question arises as to which world the laboratory belongs.
5. For the role of experiments for ethics in general, see also Lütge et al. (2014).
6. See, for example, the article by Falk and Szech (2013) and the commentary by Lütge and Rusch (2013).

References to Chapter 4

Section 4.1

Birnbacher, Dieter (2013). *Analytische Einführung in die Ethik* (3rd Ed.). Berlin/New York: Walter de Gruyter.

Bowie, Norman E. (1999). *Business Ethics: A Kantian Perspective*. New York: Wiley.

Foot, Philippa (1967). The Problem of Abortion and the Doctrine of the Double Effect. *Oxford Review*, 5, 1–7.

Habermas, Jürgen (1990). *Moral Consciousness and Communicative Action* (Translated by Christian Lenhardt and Shierry Weber Nicholson). Cambridge, MA: MIT Press.

Homann, Karl (2002). *Vorteile und Anreize: zur Grundlegung einer Ethik der Zukunft* (Edited by Christoph Lütge). Tübingen: Mohr Siebeck.

Homann, Karl and Kirchner, Christian (1995). Ordnungsethik. *Jahrbuch für Neue Politische Ökonomie*, 14, 189–211.

Homann, Karl and Lütge, Christoph (2013). *Einführung in die Wirtschaftsethik* (3rd Ed.). Münster: LIT.

Johnson, Robert and Cureton, Adam (2016). Kant's Moral Philosophy. In: E. Zalta (Ed.), *The Stanford Encyclopedia of Philosophy*. Last accessed August 4, 2020 at: https://plato.stanford.edu/entries/kant-moral/

Kant, Immanuel (1785/1998). *Groundwork of the Metaphysics of Morals*. Cambridge: Cambridge University Press.

Kant, Immanuel (1902 ff.). *Kants gesammelte Schriften*, Ed. von der Konigl. Preus. (later Dt.) Akademie der Wissenschaften. Berlin: de Gruyter.

Kant, Immanuel (1976). *Werkausgabe* (12 vols.) (Edited by W. Weischedel). Frankfurt am Main: Suhrkamp.

Lütge, Christoph (2007). *Was hält eine Gesellschaft zusammen? Ethik im Zeitalter der Globalisierung*. Tübingen: Mohr Siebeck.

Lütge, Christoph (2012a). *Wirtschaftsethik ohne Illusionen: Ordnungstheoretische Reflexionen*. Tübingen: Mohr Siebeck.

Lütge, Christoph (2012b). Fundamentals of Order Ethics: Law, Business Ethics and the Financial Crisis. *Archiv für Rechts- und Sozialphilosophie Beihefte*, 130, 11–21.

Lütge, Christoph (Ed.) (2013). *Handbook of the Philosophical Foundations of Business Ethics* (Vol. 3). Heidelberg/New York: Springer.

Lütge, Christoph (2015). *Order Ethics or Moral Surplus: What Holds a Society Together?* Lanham, MD: Lexington Books.

Lütge, Christoph (2016). Order Ethics and the Problem of Social Glue. *University of St. Thomas Law Journal*, 12(2), 339–59.

Lütge, Christoph (2019). *The Ethics of Competition: How a Competitive Society is Good for All*. Cheltenham, UK and Northampton, MA, USA: Edward Elgar Publishing.

Lütge, Christoph, Armbruster, Thomas, and Muller, Julian (2016). Order Ethics: Bridging the Gap between Contractarianism and Business Ethics. *Journal of Business Ethics*, 136(4), 687–97.

Lütge, Christoph and Mukerji, Nikil (Eds.) (2016). *Order Ethics: An Ethical Framework for the Social Market Economy*. Heidelberg: Springer.

Pies, Ingo (1996). Theoretische Grundlagen demokratischer Wirtschafts- und Gesellschaftspolitik—Der Beitrag James Buchanans. In: I. Pies and M. Leschke (Eds.), *James Buchanans konstitutionelle Ökonomik*. Tübingen: Mohr Sieber.

Pies, Ingo (2012). *Regelkonsens statt Wertekonsens: Ordonomische Schriften zum politischen Liberalismus*. Berlin: Wvb.

Rawls, John (1971). *A Theory of Justice*. Cambridge, MA: The Belknap Press of Harvard University Press.

Suchanek, Andreas (2001). *Ökonomische Ethik*. Tübingen: Mohr Siebeck.

Ulrich, Peter (2008). *Integrative Wirtschaftsethik, Grundlagen einer lebensdienlichen Ökonomie* (4th Ed.). Bern/Stuttgart/Wien: Haupt Verlag.

Section 4.2

Binmore, Ken (2005). Economic Man—or Straw Man? *Behavioral and Brain Sciences*, 28(6), 817–18.

Binmore, Ken (2011). *Natural Justice*. Oxford: Oxford University Press.

Brennan, Geoffrey and Buchanan, James M. (1985). *The Reason of Rules: Constitutional Political Economy* (The Collected Works of James M. Buchanan). Cambridge and New York: Cambridge University Press.

Breyer, Friedrich and Kolmar, Martin (2014). *Grundlagen der Wirtschaftspolitik*. Tübingen: Mohr Siebeck.

Chamberlin, Edward (1948). An Experimental Imperfect Market. *Journal of Political Economy*, 56(2), 95–108.

Engel, Christoph (2011). Dictator Games: A Meta Study. *Experimental Economics*, 14(4), 583–610.

Falk, Armin and Szech, Nora (2013). Morals and Markets. *Science*, 340(6133), 707–11.

Fehr, Ernst and Schmidt, Klaus (2001). Theories of Fairness and Reciprocity: Evidence and Economic Applications. Working Paper No. 75, Institute for Empirical Research in Economics, Universität Zürich.

Güth, Werner, Schmittberger, Rolf, and Schwarze, Bernd (1982). An Experimental Analysis of Ultimatum Bargaining. *Journal of Economic Behavior & Organization*, 3(4), 367–88.

Hardin, Garrett (1968). The Tragedy of the Commons. *Science*, 162(3859), 1243–8.

Hayek, Friedrich August von (1963). Arten der Ordnung. *Ordo: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft*, 14, 3–20.

Hayek, Friedrich August von (1967). Rechtsordnung und Handelsordnung. In: E. Streißler (Ed.), *Zur Einheit der Rechts- und Staatswissenschaften* (pp. 195–230). Heidelberg: C. F. Müller.

Heath, Joseph (2015). Methodological Individualism. In E. Zalta (Ed.), *Stanford Encyclopedia of Philosophy*. Last accessed February 6, 2017 at: plato.stanford.edu/entries/methodological-individualism

Homann, Karl (1980). *Die Interdependenz von Zielen und Mitteln*. Tübingen: Mohr Siebeck.

Homann, Karl (1994). *Homo oeconomics und Dilemmastrukturen*. Tübingen: Mohr Siebeck.

Homann, Karl and Lütge, Christoph (2013). *Einführung in die Wirtschaftsethik* (3rd Ed.). Münster: LIT.

Homann, Karl and Suchanek, Andreas (2005). *Ökonomik: Eine Einführung* (2nd Ed.). Tübingen: Mohr Siebeck.

Kirste, Stephan and Tschentscher, Axel (1999). *Prozedurale Theorien der Gerechtigkeit: Rationales Entscheiden, Diskursethik und prozedurales Recht, Studien zur Rechtsphilosophie und Rechtstheorie*, Vol. 24. Baden-Baden: Nomos Verlagsgesellschaft.

Laband, David N. and Beil, Richard O. (1999). Are Economists More Selfish than Other 'Social' Scientists? *Public Choice*, 100(1), 85–101.

Law, John (1705). *Money and Trade Considered: With a Proposal for Supplying the Nation with Money*. Edinburgh: Heirs and Successors of Andrew Anderson, Printer to the Queen's most Excellent Majesty. Accessible at: http://avalon.law.yale.edu/18th_century/mon.asp

Lütge, Christoph (2001). *Ökonomische Wissenschaftstheorie*. Würzburg: Königshausen & Neumann.

Lütge, Christoph and Rusch, Hannes (2013). The Systematic Place of Morals in Markets: Comment on Armin Falk & Nora Szech "Morals and Markets." *Science*, 341(6147), 714.

Lütge, Christoph, Rusch, Hannes, and Uhl, Matthias (Eds.) (2014). *Experimental Ethics*. Basingstoke: Palgrave Macmillan.

Mantzavinos, Chrysostomos (2001). *Individuals, Institutions and Markets*. Cambridge: Cambridge University Press.

Nozick, Robert (1974). *Anarchy, State, and Utopia*. New York: Basic Books.

Olson, Mancur (1965). *The Logic of Collective Action: Public Goods and the Theory of Groups*. Cambridge, MA: Harvard Economic Studies.

Richter, Rudolf and Furubotn, Eirik (2010). *Neue Institutionenökonomik: Eine Einführung und kritische Würdigung* (4th Ed.). Tübingen: Mohr Siebeck.

Samuelson, Paul (1947). *Foundations of Economic Analysis*. Cambridge, MA: Harvard University Press.

Samuelson, Paul A. (1954). The Pure Theory of Public Expenditure. *The Review of Economics and Statistics*, 36, 387–9.

Sauermann, Heinz and Selten, Reinhard (1967). Zur Entwicklung der experimentellen Wirtschaftsforschung. In: H. Sauermann (Ed.), *Beiträge zur experimentellen Wirtschaftsforschung* (pp. 1–8). Tübingen: Mohr Siebeck.

Schumpeter, Joseph (1908). *Das Wesen und der Hauptinhalt der theoretischen Nationalökonomie*. Munich: Duncker & Humblot.

Stigler, George and Becker, Gary S. (1977). De gustibus non est disputandum. *The American Economic Review*, 67(2), 76–90.

Tietz, Reinhard and W. Weber (1980). Experimentelle Wirtschaftsforschung. In: W. Albers et al. (Eds.), *Handwörterbuch der Wirtschaftswissenschaften* (pp. 518–24). Stuttgart: Fischer.

Weber, Max (1922/1978). *Economy and Society: An Outline of Interpretive Sociology*. Berkeley/Los Angeles/London: University of California Press.

Weimann, Joachim (2009). *Wirtschaftspolitik: Allokation und kollektive Entscheidung*. Heidelberg: Springer.

Williamson, Oliver E. (2000). The New Institutional Economics: Taking Stock, Looking Ahead. *Journal of Economic Literature*, 38(3), 595–613.

Section 4.3

Albright, Linda; Kenny, David A.; Malloy, Thomas E. (1988): Consensus in personality judgments at zero acquaintance. *Journal of Personality and Social Psychology*, 55(3), pp. 387–395. DOI: 10.1037/0022-3514.55.3.387.

Ambady, Nalini; Rosenthal, Robert (1992): Thin slices of expressive behavior as predictors of interpersonal consequences: A meta-analysis. *Psychological Bulletin*, 111(2), pp. 256–274. DOI: 10.1037/0033-2909.111.2.256.

Bazerman, Max H. and Gino, Francesca (2012). Behavior Ethics: Toward a Deeper Understanding of Moral Judgment and Dishonesty. *Annual Review of Law and Social Science*, 8, 85–104.

Bazerman, Max H. and Tenbrunsel, Ann E. (2011). *Blind Spots: Why We Fail to Do What's Right and What to Do about It*. Princeton, NJ: Princeton University Press.

Bazerman, Max H., Tenbrunsel, Ann E., and Wade-Benzoni, Kimberly (1998). Negotiating With Yourself and Losing: Making Decisions With Competing Internal Preferences. *Academy of Management Review*, 23(2), 225–41.

Becker, Gary S. (1968). Crime and Punishment: An Economic Approach. *Journal of Political Economy*, 76(2), 169–217.

Bowles, Samuel (2016). *The Moral Economy: Why Good Incentives Are No Substitute for Good Citizens*. New Haven, CT: Yale University Press.

Cialdini, Robert B., Reno, Raymond R., and Kallgren, Carl A. (1990). A Focus Theory of Normative Conduct: Recycling the Concept of Norms to Reduce Littering in Public Places. *Journal of Personality and Social Psychology*, 58(6), 1015–26.

Colby, Anne, Gibbs, John, Lieberman, Marcus A., and Kohlberg, Lawrence (1983). *A Longitudinal Study of Moral Judgment: A Monograph for the Society of Research in Child Development*. Chicago, IL: University of Chicago Press.

Damasio, Antonio R., Tranel, Daniel, and Damasio, Hanna (1990). Individuals with Sociopathic Behavior Caused by Frontal Damage Fail to Respond Automatically to Social Stimuli, *Behavioral Brain Research*, 41, 81–94.

Dana, Jason, Loewenstein, George, and Weber, Roberto A. (2011). Ethical Immunity: How People Violate Their Own Moral Standards Without Feeling They Are Doing So. In: David De Cremer and Anne E. Tenbrunsel (Eds.), *Behavioral Business Ethics: Shaping an Emerging Field* (pp. 201–19). New York: Routledge.

Dana, Jason, Weber, Roberto A., and Kuang, Jason Xi (2007). Exploiting Moral Wiggle Room: Experiments Demonstrating an Illusory Preference for Fairness. *Economic Theory*, 33(1), 67–80.

De Cremer, David and Tenbrunsel, Ann E. (Eds.) (2011). *Behavioral Business Ethics: Shaping an Emerging Field*. New York: Routledge.

Doris, John M. (2013). Introduction. In: John M. Doris and the Moral Psychology Research Group (Eds.), *The Moral Psychology Handbook* (pp. 1–2). Oxford: Oxford University Press.

Epley, Nicholas and Dunning, David (2000). Feeling "Holier than Thou": Are Self-Serving Assessments Produced by Errors in Self- or Social Prediction? *Journal of Personality and Social Psychology*, 79(6), 861–75.

Falk, Armin and Kosfeld, Michael (2006). The Hidden Costs of Control. *American Economic Review*, 96(5), 1611–30.

Gino, Francesca; Ayal, Shahar; Ariely, Dan (2009): Contagion and differentiation in unethical behavior: the effect of one bad apple on the barrel. *Psychological Science*, 20(3), pp. 393–398. DOI: 10.1111/j.1467-9280.2009.02306.x.

Gneezy, Uri and Rustichini, Aldo (2000). A Fine is a Price. *The Journal of Legal Studies*, 29(1), 1–17.

Greene, Joshua (2014). *Moral Tribes: Emotion, Reason, and the Gap Between Us and Them*. New York: Penguin Books.

Haidt, Jonathan (2001). The Emotional Dog and Its Rational Tail: A Social Intuitionist Approach to Moral Judgment. *Psychological Review*, 198(4), 814–34.

Hamman, John R., Loewenstein, George, and Weber, Roberto A. (2010). Self-Interest through Delegation: An Additional Rationale for the Principal-Agent Relationship. *American Economic Review*, 100(4), 1826–46.

Hume, David (1739). *A Treatise on Human Nature* (Edited by Selby-Bigge and Lewis Amherst). Available online at: https://oll.libertyfund.org/titles/hume-a-treatise-of-human-nature

Kahneman, Daniel (2011). *Thinking, Fast and Slow*. New York: Penguin Books.

Kahneman, Daniel, Ritov, Ilana, Jacowitz, Karen E., and Grant, Paul (1993). Stated Willingness to Pay for Public Goods: A Psychological Perspective. *Psychological Science*, 4, 310–15.

Kivetz, Yifat and Tyler, Tom R. (2007). Tomorrow I'll Be Me: The Effect of Time Perspective on the Activation of Idealistic Versus Pragmatic Selves. *Organizational Behavior and Human Decision Processes*, 102(2), 193–211.

Kohlberg, Lawrence (1969). Stage and Sequence: The Cognitive-Developmental Approach to Socialization. In: D. A. Goslin (Ed.), *Handbook of Socialization Theory and Research* (pp. 347–380). Chicago: Rand McNally.

Kunda, Ziva (1990). The Case for Motivated Reasoning. *Psychological Bulletin*, 108(3), 480–98.

Mazar, Nina, Amir, On, and Ariely, Dan (2008). The Dishonesty of Honest People: A Theory of Self-Concept Maintenance. *Journal of Marketing Research*, 45(6), 633–44.

Mellström, Carl and Johannesson, Magnus (2008). Crowding Out in Blood Donation: Was Titmuss Right? *Journal of the European Economic Association*, 6(4), 845–63.

Mitchell, Terence C., Thompson, Leigh, Peterson, Erika, and Cronk, Randy (1997). Temporal Adjustments in the Evaluation of Events: The "Rosy View." *Journal of Experimental Social Psychology*, 33(4), 421–48.

Piaget, Jean (1965). *The Moral Judgement of the Child*. New York: Free Press.

Schwitzgebel, Eric (2009). Do Ethicists Steal More Books? *Philosophical Psychology*, 22, 711–25.

Shu, Lisa L., Gino, Francesca, and Bazerman, Max H. (2011). Ethical Discrepancy: Changing Our Attitudes to Resolve Moral Dissonance. In: David De Cremer and Ann E. Tenbrunsel (Eds.), *Behavioral Business Ethics: Shaping an Emerging Field* (pp. 221–39). New York: Routledge.

Simon, Herbert A. (1997). *Models of Bounded Rationality: Empirically Grounded Economic Reason*, Vol. 3. Boston, MA: MIT Press.

Tenbrunsel, Ann E., Diekmann, Kristina A., Wade-Benzoni, Kimberly A., and Bazerman, Max H. (2010). The Ethical Mirage: A Temporal Explanation as to Why We Aren't as Ethical as We Think We Are. *Research in Organizational Behavior*, 30, 153–73.

Tenbrunsel, Ann E.; Messick, David M. (1999): Sanctioning Systems, Decision Frames, and Cooperation. *Administrative Science Quarterly*, 44 (4), p. 684. DOI: 10.2307/2667052

Tenbrunsel, Ann E. and Messick, David M. (2004). Ethical Fading: The Role of Self-Deception in Unethical Behavior. *Social Justice Research*, 17(2), 223–36.

Titmuss, Richard (2018). *The Gift Relationship: From Human Blood to Social Policy*. Bristol: Policy Press.

Turiel, Elliot (1983). *The Development of Social Knowledge: Morality and Convention*. Cambridge: Cambridge University Press.

5

Problem areas of business ethics

> **Selected learning objectives**
>
> After reading this chapter, you will be able to:
> - distinguish absolute and relative poverty and to question the goal of equality from the point of view of ethics
> - understand the relationship between human dignity and human rights, to name specific rights, to classify them, and to discuss their normative status
> - operationalize the concept of sustainability and understand the concept of discounting in this context.

Chapter overview

5.1 Poverty and inequality

Business ethics is especially concerned with the question of how equitable different distributions of resources and wealth are. Financial assets are often a stumbling block, as some believe they are too unevenly distributed. Public outrage is piqued above all when it comes to "executive salaries." Vociferous appeals are accordingly made for government measures to limit or eliminate these monetary differences. Demands range from laws to cap manager bonuses to a wealth tax to reduce a society's internal inequities, to actions on behalf of "fair trade" and developmental aid to reduce disparities between the countries and regions of the world. Interestingly, high compensation is

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).

 DOI: 10.1093/oso/9780198864776.003.0006

tolerated among certain professional groups or at least seen as less problematic (athletes, actors, musicians), while other professional groups are scrutinized much more critically (bankers, CEOs, entrepreneurs).

When it comes to poverty and inequality, two sets of questions can be distinguished:

> First, does a market economy really produce greater inequality than other forms of economic order? Are the poor always made poorer and the rich richer, and to a greater extent than in other economic systems?
>
> Second, what degree of inequality is defensible or even necessary to enable prosperity for broad strata of society?

To be able to answer these questions, we will first discuss the two classifications of poverty—absolute and relative poverty. Then, the historical development of human poverty will be traced over recent decades in order to assess whether the introduction of competition and market economy processes has an impact on the poorest part of the human population.

Finally, the implications of the concept of (distributive) justice will be examined, and whether a distribution of resources that does not correspond to the principle distributive justice can be morally justified.

5.1.1 Poverty—absolute and relative

In looking at relevant statistics, such as the World Bank (www.worldbank.org), one sees that the distribution of wealth around the world is very uneven. Rich regions in the West and partly in the East are compared with poorer regions of Africa and some parts of Asia. However, to measure poverty, it is first and foremost necessary to define when a person is considered poor. In some cases, the definitions of the concept of poverty can vary widely. Nevertheless, it is possible to identify two distinct approaches:

The first type of measurement—absolute poverty—recognizes a certain threshold with regard to various essential goods (shelter, food, access to medical care, etc.), below which a person is classified as poor. A minimum level of resources is therefore determined here that a person should have at his or her disposal in order to meet their basic needs. The World Bank has set this threshold in monetary terms at USD 1.90 per day of disposable income since October 2015. If a person does not have this level of income, he or she is classified as poor.

In contrast, measurements based on the principle of relative poverty classify people as poor when they have fewer resources relative to their socio-economic group. Relative poverty is therefore always oriented towards the distribution of income and resources within a country. For example, if a person's income is significantly lower than their country's average per capita income, then he or she is considered relatively poor or at risk of poverty. While most countries and global organizations mainly use the first definition, measurements based on the principle of relative poverty are generally found in Europe.

5.1.1.1 Absolute poverty

Former World Bank President Robert McNamara (1916–2009), who introduced the concept of absolute poverty, defines it as follows:

> Poverty at the absolute level . . . is life at the very margin of existence. The absolute poor are severely deprived human beings struggling to survive in a set of squalid and degraded circumstances almost beyond the power of our sophisticated imaginations and privileged circumstances to conceive.
>
> (McNamara, 1973; cited in Singer, 1993, p. 219)

The poverty line thus denotes an income below which the acquisition of all essential resources is not possible, i.e. absolute poverty exists. If a person falls into the realm of absolute poverty, he or she is no longer able to secure their daily nutrition and to acquire other necessities. People who live on less than USD 1.90 a day are therefore often at risk of starvation or forced to increase their income by begging. It should be noted that the limit of USD 1.90 per day is already economically adjusted to local conditions (purchasing power parity), i.e. the amount refers to a possible shopping basket that can be purchased in the United States for USD 1.90. The structure of lower prices in poorer countries is determined accordingly. The International Development Association (IDA), a World Bank development organization, lists some indicators that classify a person as absolutely poor:

- An income of less than $150 per year
- Infant mortality higher than 3.3 percent
- Life expectancy under 55 years
- Daily available calorie intake (depending on the country) below 2160–2670 kcal
- A birth rate of over 25 per 1000 people.

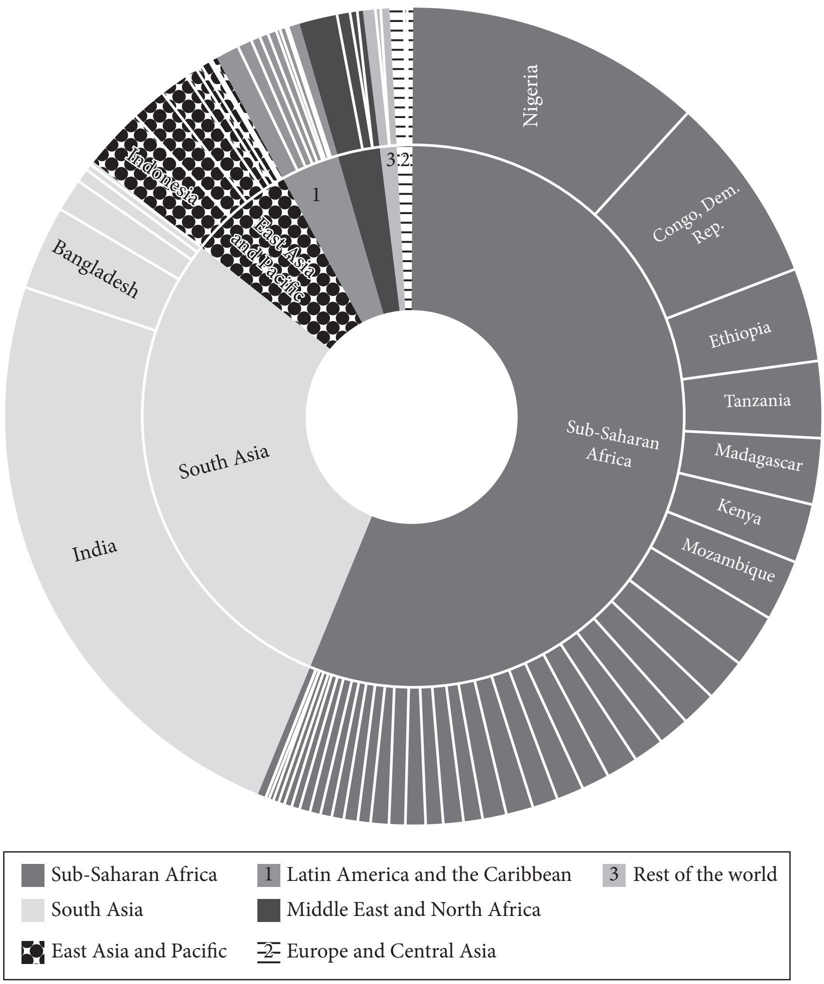


Figure 5.1 Global distribution of extreme poverty by region and country, 2018
Source: World Bank (2018, p. 30).

Figure 5.1 shows in which countries and regions most of the people who fall into the realm of absolute poverty live.

The indicators of the IDA usually point in the same direction. One of the most important indicators of absolute poverty is infant mortality, because it combines many factors and effects of poverty, including malnutrition of the mother, lack of hygiene at birth due to a lack of resources, etc. The summary of the countries with the highest infant mortality rates is therefore very similar to that of disposable income (Figure 5.2).

Looking at the development of poverty in the world, it can be seen that poverty is declining almost everywhere, especially in those regions that have been able to create prosperity through market economy reforms. Total

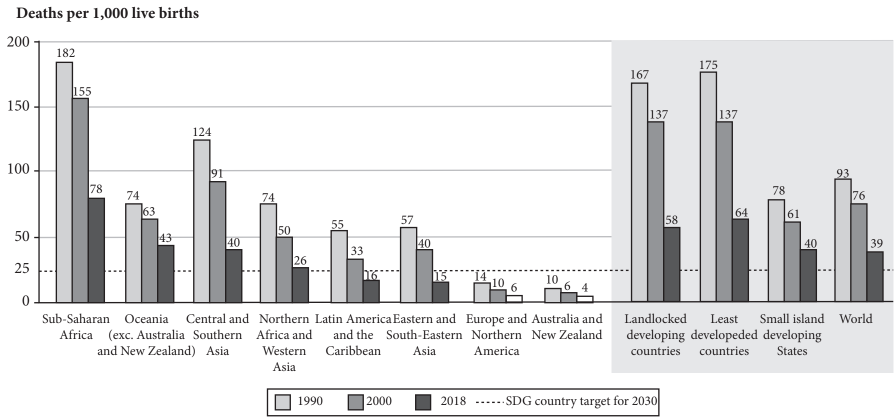


Figure 5.2 Under-five mortality rate by Sustainable Development Goal region, 1990, 2000, and 2018

Source: United Nations Inter-agency Group for Child Mortality Estimation (2019, p. 11).

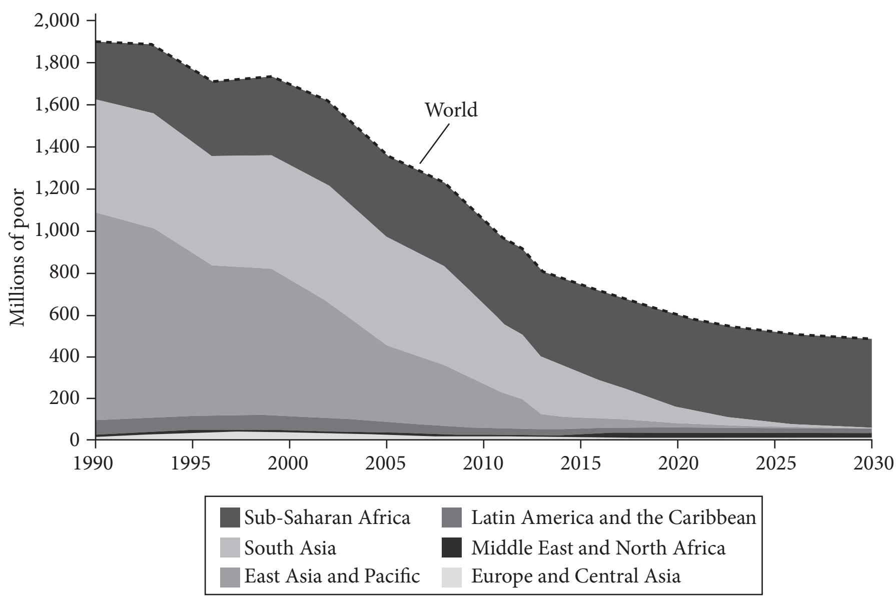


Figure 5.3 Development of extreme poverty per region between 1990 and 2030

Source: World Bank (2018, p. 25).

absolute poverty has declined significantly since the 1980s (Figure 5.3). The same development can be observed in infant mortality, which has been reduced by about two-thirds within half a century.

In addition to infant mortality, malnutrition due to a lack of resources is an important indicator of poverty. This is also declining worldwide, although here too, certain regions and countries are ahead of others. In some cases, the “Millennium Development Goals” of the United Nations from the year 2000 have clearly been surpassed. Since then, the regions of East Asia, South-East Asia, and Latin America in particular have witnessed exceptional progress in combating malnutrition.

5.1.1.2 Relative poverty

Unlike the concept of absolute poverty, the concept of relative poverty always refers to a person’s socio-economic environment. Poverty is thus defined in relation to the prosperity of others and not by an absolute standard.

The relative concept of poverty is usually ascertained and published in developed industrial nations, especially in European countries. For Third World countries, the concept of relative poverty makes little sense. It is quite possible, for instance, for someone to be considered at once relatively and extremely poor, i.e. he or she has less than USD 1.90 dollars per day. This is not the case in developed industrial countries, however, since absolute poverty does not exist there.

The concept of relative poverty thus places the focus elsewhere. Equally difficult is to find a suitable definition of goods in developed countries that everyone must possess in order not to be considered absolutely poor. While it makes sense in poor countries to determine the minimum level of goods for ensuring a person’s survival, such a definition has little meaning in industrial nations.

In practice, the concept of relative poverty is usually based on the median income of all the inhabitants of a country. The threshold from which a person can be regarded as relatively poor is controversial and varied. That said, it is usually a disposable income of less than 40, 50, or 60 percent of the median income, i.e. exactly the disposable income of the person who occupies the middle position on the income ladder of a society. The median income divides society into two parts: One half has a higher income, the other has a lower income. The disposable income of a person or household is the portion of income that is mainly available for private consumption. The assessment takes into account the transfer payments within the society: Support services such as unemployment benefits, social assistance, or family allowances are thus accounted for when estimating relative poverty.

The following thresholds are specifically used in the European Union to classify poverty and the risk of poverty:

Persons, who have less than

- 70 percent of the median of the net equivalized income are threatened by poverty and living in at-risk social situations
- 60 percent are threatened by poverty

- 50 percent are relatively low-income
- 40 percent are poor.

For Germany, this estimate results in a poverty rate of around 20 percent, which corresponds to approximately 16 million citizens.

The statisticians of the Organisation for Economic Co-operation and Development (OECD) and the WHO (World Health Organization), on the other hand, only use the threshold of 50 percent of net equivalized income to classify a person as poor.

The concept of relative poverty is therefore above all a measure of a society's material equality or inequality in terms of disposable income. As early as 1776, Adam Smith showed that poverty can be reasonably regarded as a phenomenon that occurs even when absolute poverty has already been overcome (in the sense of literally life-essential resources being at everyone's disposal):

> By necessaries I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without. A linen shirt, for example, is, strictly speaking, not a necessary of life. The Greeks and Romans lived, I suppose, very comfortably though they had no linen. But in the present times, through the greater part of Europe, a creditable day-laborer would be ashamed to appear in public without a linen shirt, the want of which would be supposed to denote that disgraceful degree of poverty […] Custom, in the same manner, has rendered leather shoes a necessary of life in England. The poorest creditable person of either sex would be ashamed to appear in public without them.
>
> (Smith, 1776, p. 682)

The examples mentioned here illustrate the problem of the absolute poverty line in countries that already provide for the basic welfare of their population. For developing regions, a different approach would therefore seem to make sense. Two main options present themselves:

First, a new and adjusted "absolute" poverty line could be developed that includes, for example, the ownership of a smartphone or a refrigerator. The problem here, however, is the requisite arbitrariness, which must go hand in hand with such a determination. In contrast to an approach based on the physically necessary caloric intake, a threshold in developed nations seems to depend heavily on political beliefs that entail different judgments of what a person needs to lead a "dignified" and "self-determined" life.

Second, the concept of relative poverty described above could be used, but with some reservations.

5.1.1.3 Problems with the concept of relative poverty

To be able to assess the problems of the concept of relative poverty, it is necessary to take a brief look at the underlying statistical calculation and, in particular, the statistical concept of the median. In statistics, the median is the value that divides a certain distribution (here: disposable income) into two equal halves. In contrast to the arithmetic mean (commonly known as the average), it is less susceptible to outliers.

This means, for example, that a small group of exceptionally wealthy people hardly influences the median, as only the position within society counts and the actual worth has no direct influence. The European Union, the WHO, and the OECD use the median of disposable income as a measure of relative poverty and the risk of poverty. Due to the mathematical properties of the distributions and the median, there are sometimes counterintuitive and also unwanted effects that undermine the significance of poverty statistics and in some cases make them appear nonsensical. Six points can be made here:

1. With a given distribution of income and a certain number of households classified as poor or at risk of poverty, an additional income per household of 50 percent of the previous income would not change the number of households classified as poor.
2. Upward income movements of those who were already above the median do not change the number of people classified as poor either. The same applies to declines in income, which were already below the 60 percent threshold. If people classified as poor become poorer in absolute terms, it is not reflected in the number of households classified as poor.
3. Moreover, if the incomes of the middle class around the median increase, the number of households classified as poor will increase as long as the incomes of poorer households remain constant or rise less sharply.
4. On the other hand, rich countries, which are characterized by greater material inequality, can be classified as poorer than economically weaker, but less differentiated countries in terms of disposable income. According to OECD data, for example, the number of poor households in the United States is higher than in obviously economically less-developed countries such as Turkey, Poland, or the Czech Republic (see Figure 5.4).
5. If the incomes of upper households decline while those below the median remain the same, the number of households classified as poor will decrease, even though there has been no change to their living

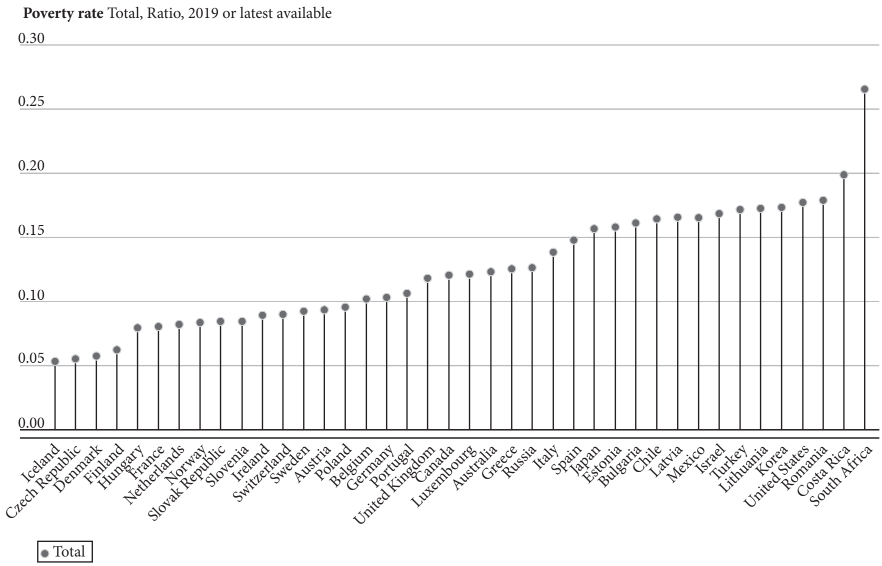


Figure 5.4 Percentage of poor households by country
Source: OECD (2019).

situation. Thus, in Romania, not only did disposable incomes fall during the 2008/2009 financial and economic crisis, but so did the number of households classified as poor (World Bank, 2014). This development may be understandable mathematically, but it seems pointless to suggest that a loss of income can lead to a reduction of poverty.

6. A further criticism is only indirectly linked to the concept of relative poverty. Specifically, the empirical data basis for the determination of disposable income is flawed because the data are obtained by self-disclosure. Since people with higher incomes are less forthcoming with their information, incomes of only up to 18,000 euros are included. The retained earnings of entrepreneurs, among other things, are also not taken into account.

5.1.2 The problem of inequality

The concept of relative poverty is often used as a measure of inequality. In fact, poverty in a country like Germany normally does not mean that people are starving or homeless, but that they have less money than their fellow citizens in relative terms. Relative poverty can therefore be minimized in a variety of ways:

Since relative poverty is lowest when all inhabitants of a country have the respective median income at their disposal, a minimization of relative poverty can be achieved both by increasing the income of the lower classes and by lowering the income of the upper classes. The issue of redistribution and the state regulation of disposable income is thus inextricably linked to the problem of poverty. As mentioned above, relative poverty is ascertained in Europe and Germany after transfer payments have been made. This means that all the benefits have already been taken into account that usually flow from the wealthier to the socially weaker classes. Without these transfers, inequality would be correspondingly higher.

The fact that poverty in Europe is determined on the basis of relative income is by and large understandable. Economic inequality has always played a significant role in the public discourse of Western European societies. The question of whether inequality is justified or desired, and if so, how much, has a high priority in regulatory debates. Some authors see the inequality of income or available monetary means as a threat to the basic democratic order. More recently, the work of the French economist Thomas Piketty (2014) has attracted a great deal of attention. His main thesis is that capitalism in its present form necessarily increases inequality. Rising inequality and the associated increase in relative poverty, in turn, have the potential to destroy the existing legal system and democracy, for inequality that is perceived as "unjust" erodes the citizenry's sense of justice. There is also the danger that a concentration of wealth will be accompanied by a concentration of power, so that poorer classes will be permanently excluded from a meaningful participation in the political process. Only a restriction of capitalism could prevent such a development. It would mean keeping the inequality of the citizens of a society in check, for inequality is inherent to the capitalistic system.

Piketty's main thesis is this: Since returns on capital gains increased faster than economic growth, certain groups in society became richer and richer in relation to others, whose incomes were primarily based on wages. His claim can be summed up in the following formula:

$r > g$ (where r is the return on investment and g is economic growth)

In the public debate, the salaries of top managers have received particular scrutiny. Piketty, however, regards the inequality caused by high wages as relatively insignificant—especially in view of the fact that investment income rose more strongly than the overall economy and wages, which are often linked to economic development. Piketty recommends counteracting this development by introducing a wealth tax, maintaining the progressive income tax, and increasing the top tax rate.

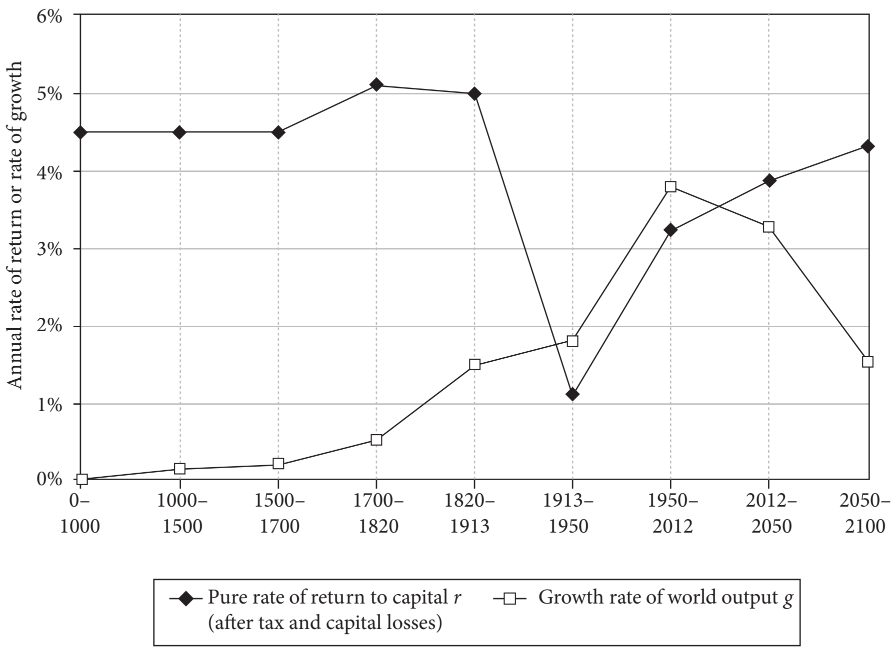


Figure 5.5 Return on investment after taxes and global economic growth
Source: Piketty (2014, p. 448).

Just the same, the question of whether inequality is actually increasing and has risen sharply in the past is controversial. Critics accuse Piketty of errors in his empirical analysis. For example, Piketty includes real estate prices as capital assets, which have actually risen sharply in the past. However, it is debatable whether the purchase or sale price of a house should be classified as a capital-generating asset. In fact, any rental income should be regarded as a return on real estate. Based on the development of rental income, the ratio of income to return on investment is fairly constant for many Western countries (Figure 5.5).

Other critics (such as Giles, 2014) accuse Piketty of having insufficient data or misinterpreting data. A detailed analysis of his critics, however, is not possible here. We would do well instead to address the fundamental problem: Is inequality per se to be avoided? Or must a certain degree of inequality be accepted in order to continue with the indisputable success story of the market economy (or even because other ethical reasons speak in favor of it)?

5.1.3 Equality as a goal?

The desire for material equality seems to be firmly embedded in Western and Northern European countries.[1] While in the United States, for example, there is generally a greater tolerance for material inequality, in Western Europe the widening of the "social scissors" is often evoked. It is to be closed again through redistribution (mainly with the help of state intervention). Far-reaching material equality among citizens is thereby raised to a normative goal, whose realization is the task of social policy. The desire for equality seems plausible to many. Nonetheless, a policy that aims to bring it about can quickly come into conflict with other important values such as equality before the law and individual freedom. Hayek succinctly expresses this problem when he writes:

> From the fact that people are very different it follows that, if we treat them equally, the result must be inequality in their actual position, and that the only way to place them in an equal position would be to treat them differently. Equality before the law and material equality are therefore not only different but are in conflict with each other; and we can achieve either the one or the other, but not both at the same time. The equality before the law which freedom requires leads to material inequality. Our argument will be that, though where the state must use coercion for other reasons, it should treat all people alike, the desire of making people more alike in their condition cannot be accepted in a free society as a justification for further and discriminatory coercion. (Hayek, 2006, pp. 76–7)

In order to reduce a society's relative poverty, the equality of citizens must be increased in material terms. While a general increase in the prosperity of a society—which favors some more, some less—combats the problem of absolute poverty, this is not necessarily the case when measuring relative poverty. Even if every single member of a society benefits from an economic upturn, it does not mean by any means that a society's relative poverty decreases. If different groups benefit to varying degrees from economic growth, relative poverty may even increase, although everyone is in effect better off materially (in absolute terms).

A brief example sheds some light on the differences and consequences of focusing on material equality:

Suppose two people start out with wealth of 10 euros each. While the assets of the one (person A) increase tenfold, the assets of the other (person B) increase a thousand-fold. In this example, a person needs 20 euros to feed a family. Before that, neither of them was able to feed a family. But, after their salaries increased due to economic growth, both could. In this small society, absolute poverty has fallen from 2 (all) to 0 (none). Relative poverty, on the other hand, rises from 0, and a situation where no one could feed a family, to 1, although both are now able to meet basic needs such as food and shelter.

If we want to achieve material equality at all costs through political intervention, it can only be produced through strong interference in the individual freedoms of citizens. There are basically two ways to achieve material equality: the improvement of the situation of the worse-off or the worsening of the situation of the better-off in a society. The latter would theoretically be possible through expropriations and enormous taxes. Such a strategy, though, usually leads to a decline in both the income of richer households and that of the poorer ones. The capital flight resulting from such a policy, the lack of incentives for entrepreneurship and innovation, and the far-reaching abandonment of property rights would affect the entire economy—especially the poorer households, which, for instance, have fewer opportunities to transfer their assets abroad. These evasive actions, which are virtually unavoidable in an open society, accordingly, lead to a reduction in the size of the overall pie. Everyone then receives a roughly equal, but comparatively much smaller, piece. It is dangerous to focus on a concept of relative poverty, for it ignores the absolute improvements that the market economy has produced around the world for decades.

Ultimately this means: It does not make sense to construct a fundamental trade-off between freedom and equality. Rather, there should be a search for win-win opportunities that improve all parts of society so that no group feels systematically left behind.

We conclude this section with an example from a developing country that shows how experimental studies can be used to identify good practices in the fight against poverty (see practice box 5.1: More industrial jobs for Africa?). Poverty reduction through either developmental aid or economic development instruments relates almost exclusively to the reduction of absolute poverty in particularly poverty-stricken countries and regions of the world. As people below the poverty line have difficulties satisfying their essential basic needs, it is all the more important that the effectiveness of instruments to improve living conditions plays a decisive role.

Practice box 5.1 More industrial jobs for Africa? An experimental study in Ethiopia

The authors: The economist and political scientist Christopher Blattman and the economic policy expert Stefan Dercon headed up a field experiment in Ethiopia. They investigated the influence of different employment situations on the economic situation of workers.

Subjects: 947 Ethiopian job seekers with relatively similar qualifications, all of whom had applied for a job at five different companies.

Experimental setup: The subjects were randomly assigned to one of three groups. The participants in group one got one of the jobs in the industry for which everyone had applied (employment group). The participants in group two each received 300 dollars for their free use after taking part in a 5-day entrepreneur coaching to stimulate entrepreneurial activity (entrepreneurial group). The third group received neither money nor jobs and thus acted as a control group.

What was measured: The living conditions of the participants were surveyed in interviews at the beginning of the study and about one year later.

Results: Compared to the starting point, after one year the economic situation had improved for the entrepreneurial group, but not for the employment group; 77 percent of the participants in the employment group had quit their jobs within the year, most of whom left the industrial sector. In addition, the health risks of the employees (e.g. from toxic vapors) increased by one percentage point with each month of employment. In the entrepreneurial group, on the other hand, the participants earned on average one dollar more per week than the participants in the control group. When they also took on industrial jobs, it was doing skilled work. Despite the impacts on occupational choice, income, and health in the first year, after five years the authors find nearly complete convergence across all groups and outcomes. Short-run increases in productivity and earnings from the grant dissipate as recipients exit their micro-enterprises. Adverse effects of factory work on health found after one year also appear to be temporary. The authors' results suggest that one-time and one-dimensional interventions may struggle to overcome barriers to wage- or self-employment.

Source: Blattman, Chris, Franklin, Simon, and Dercon, Stefan (2019). Impacts of Industrial and Entrepreneurial Jobs on Youth: 5-Year Experimental Evidence on Factory Job Offers and Cash Grants in Ethiopia. SocArXiv Papers. Accessed July 21, 2020 at: https://osf.io/preprints/socarxiv/zrqe4/

5.2 Human dignity and human rights

5.2.1 On the concept of human dignity and human rights

The idea of human dignity has its origins in ancient Greek philosophy and the Judeo-Christian tradition. Whereas in antiquity the concept of dignity primarily referred to the prestige of exceptional individuals, Judaism and

Christianity extended the concept to all human beings due to human beings' special status (having been created in "the image and likeness of God") (Bayertz, 1995; Huber, 1992). Philosophy since the time of the Renaissance, and especially the Enlightenment, hearkens back to these older views, but interprets the concept of dignity differently. In particular, in contrast to Christian doctrine, our worldly existence should not simply be recognized as a litmus test for the hereafter, but as valuable in itself (Bayertz, 1995). Concerns about human dignity figure prominently in many different contexts: from inhumane prison conditions in many countries to social-welfare payments that are considered inhumanely low.

It is striking that the term human dignity may be invoked by both opponents and supporters of a particular practice. This can be observed, for example, in the field of euthanasia. When asked about assisted suicide, Vice President of the Bundestag Peter Hintze said in 2014 that a person had to decide for himself what he was prepared to endure, and that it is a "violation of human dignity if the protection of human life becomes a state-imposed compulsion to suffer" (Gajevic, 2014). Church representatives, conversely, spoke out against assisted suicide in the debate about a dignified end to life. Thus, the Catholic psychotherapist Manfred Lütz warned of the inhumane pressure that a corresponding law would exercise on sick and disabled people: "It would be terrible, lowering the temperature of society's humanity to the freezing point" (EKD, 2014).

An attempt to define human dignity proceeds from the idea of human rights. Human rights are innate rights, which are neither acquired nor bestowed, but are inextricably linked to a person's humanity. They cannot be lost or forfeited. For all intents and purposes, however, it is only possible to assume a single innate human right, namely that of having human rights at all (Fritzsche, 2016). In this context, the actual rights that a person has are the result of contingent historical and political developments. Human rights are also universal, i.e. they should apply to all people in accordance with the United Nations Universal Declaration of Human Rights (1948) (see practice box 5.2: The Universal Declaration of Human Rights).

Various reasons have been cited to establish human rights. For example, they have been attributed to divine commandments. From the perspective of social contract theory, human rights are reconstructed as an agreement in a (mostly fictitious) original state, in which people granted each other these rights through voluntary exchange.

Fritzsche (2016) divides human rights into rights of defense, participation, and benefits:

- Rights of defense refer to the protection of the individual from the arbitrary power of the state and other authorities.
- Rights of participation refer to the participation in the state, which must be kept in check.
- Rights to benefits refer to the guarantee of living conditions that make it possible to exercise the other rights in the first place.

Another distinction is made between civil and political rights and between social, economic, and cultural rights (Fritzsche, 2016) Civil and political rights deter the state and entitle citizens to do something. As a rule, civil rights mean liberal rights of defense, such as freedom of conscience or freedom of opinion. Political rights, on the other hand, reflect the idea of democratic participation, such as equal access to public offices or freedom of assembly. Social, economic, and cultural rights oblige the state to take measures that create decent living conditions for its citizens, such as the right to health or education (Figure 5.6).

Practice box 5.2 The Universal Declaration of Human Rights

Article 1: All human beings are born free and equal in dignity and rights. [...]

Article 2: Everyone is entitled to all the rights and freedoms set forth in this Declaration, without distinction of any kind, [...]

Article 3: Everyone has the right to life, liberty and security of person.

Article 4: No one shall be held in slavery or servitude [...]

Article 5: No one shall be subjected to torture [...]

Article 6: Everyone has the right to recognition everywhere as a person before the law.

Article 7: All are equal before the law [...]

Article 8: Everyone has the right to an effective remedy [...]

Article 9: No one shall be subjected to arbitrary arrest, detention or exile.

Article 10: Everyone is entitled in full equality to a fair and public hearing by an independent and impartial tribunal [...]

Article 11: Everyone [...] has the right to be presumed innocent until proved guilty according to law in a public trial [...]

Article 12: No one shall be subjected to arbitrary interference with his privacy [...] nor to attacks upon his honor and reputation. [...]

Continued

Practice box 5.2 Continued

Article 13: Everyone has the right to freedom of movement [. . .] within the borders of each state. Everyone has the right to leave any country [. . .] and to return to his country.

Article 14: Everyone has the right to seek and to enjoy in other countries asylum from persecution. [. . .]

Article 15: Everyone has the right to a nationality. [. . .]

Article 16: Men and women of full age, without any limitation [. . .] have the right to marry and to found a family. They are entitled to equal rights [. . .]

Article 17: Everyone has the right [. . .] to own property. No one shall be arbitrarily deprived of his property.

Article 18: Everyone has the right to freedom of thought, conscience and religion [. . .]

Article 19: Everyone has the right to freedom of opinion and expression [. . .]

Article 20: Everyone has the right to freedom of peaceful assembly [. . .]

Article 21: Everyone has the right to take part in the government of his country, directly or through freely chosen representatives. [. . .]

Article 22: Everyone, as a member of society, has the right to social security and is entitled to realization [. . .] of the economic, social and cultural rights indispensable for his dignity and the free development of his personality.

Article 23: Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment. [. . .]

Article 24: Everyone has the right to rest and leisure, including reasonable limitation of working hours and periodic holidays with pay.

Article 25: Everyone has the right to a standard of living adequate for the health and well-being [. . .]

Article 26: Everyone has the right to education. [. . .]

Article 27: Everyone has the right freely to participate in the cultural life of the community [. . .]

Article 28: Everyone is entitled to a social and international order in which the rights and freedoms set forth in this Declaration can be fully realized.

Article 29: Everyone has duties to the community in which alone the free and full development of his personality is possible. [. . .]

Article 30: Nothing in this Declaration may be interpreted as implying for any State, group or person any right to engage in any activity or to perform any act aimed at the destruction of any of the rights and freedoms set forth herein.

Source: UN General Assembly (1948). Universal Declaration of Human Rights (217 [III] A). Paris. Last accessed April 23, 2020 at: http://www.un.org/en/universal-declaration-human-rights/

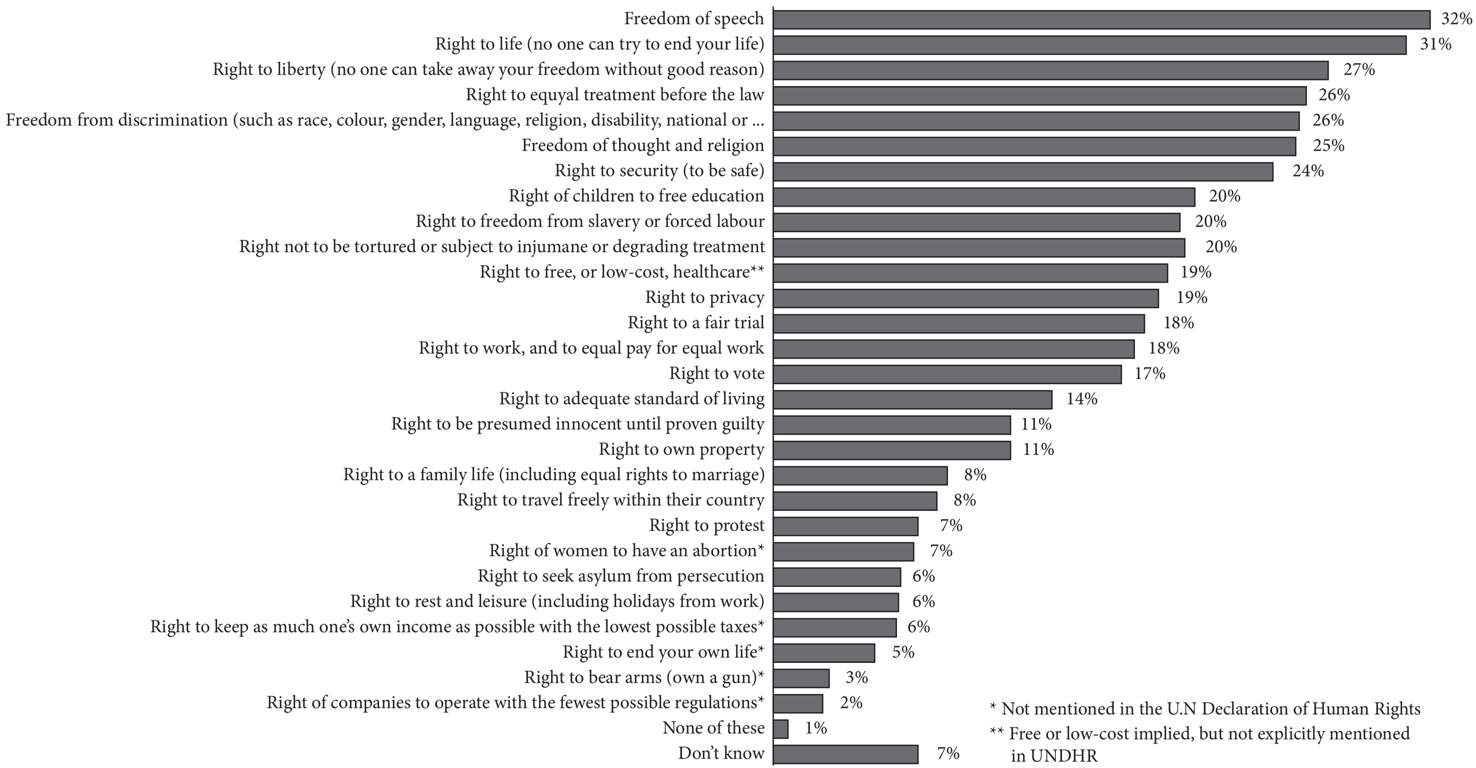


Figure 5.6 The most important human rights to be protected from a global perspective

Source: Bardon et al. (2018, p. 26).

5.2.2 Negative and positive liberties

Human rights should ensure that a person is able to live in freedom. The concept of freedom is based on two different concepts: “negative” and “positive” liberty.

Negative liberty defines what should not happen to a person. My liberty ends where the liberty of my fellow human beings begins. I am therefore not allowed to coerce another person. Negative liberty is usually propagated by liberal thinkers. Accordingly, John Stuart Mill postulates with his harm principle that the only reason to interfere with a person’s freedom of action is to prevent harm to others (Mill, 1859). This is why negative liberty is also understood as freedom from. Article 4 of the Universal Declaration of Human Rights, which says no one shall be held in slavery or servitude, is a typical example of a negative right of liberty.

Positive liberty means the freedom to do something. Positive liberty is therefore also understood as freedom to. While negative liberties oblige a person to refrain from doing something, the positive liberties oblige him or her to do something. Behind the idea of positive liberty is therefore the idea that people should be enabled to make the most of their abilities.

Article 26 of the Universal Declaration of Human Rights, which guarantees people a right to education, is a typical example of a positive liberty. A prominent representative of the concept of positive liberty is the economist Amartya Sen. His capability approach understands freedom above all as the ability to act according to one’s own wishes (Sen, 1999). According to Sen, the more opportunities there are for self-realization in a society, the fairer it is. As a welfare criterion, he suggests measuring the degree of opportunities for self-realization in terms of the existing possibilities.

The distinction between negative and positive liberty goes back, at the latest, to Kant. However, it was expanded on and popularized in the 1950s and 1960s by Isaiah Berlin (1909–1997). Berlin showed that negative and positive liberty can be understood not only as two different types of freedom, but as two rival interpretations of a single political ideal (Berlin, 2002; Carter, 2016).

Berlin sees the danger of the positive concept of liberty in the fact that it has a certain proximity to authoritarianism. Since positive liberty implies coercion, it is much more difficult to justify than negative liberty. Berlin himself was shaped by the experiences of the Cold War and the impressions of Soviet autocracy. In the name of the noble idea of self-determination, the latter imposed its own idea of a truly free life on individuals it perceived to be less than rational (Carter, 2016). Thus, political liberalism prefers a negative interpretation of liberty and views state coercive measures with great skepticism. The critics of liberalism, on the other hand, permit state coercive measures to promote the self-realization or self-determination of individuals or groups.

Advocates of the concept of negative liberty usually limit the obstacles to freedom to obstacles emanating from other people. For example, although a serious illness essentially makes it impossible for me to do certain things, I am not inhibited from doing them in the sense of negative liberty. The situation is different, however, when people forcefully hinder me from doing something (Carter, 2016). Some liberal thinkers are even more restrictive in their understanding of the obstacles caused by other people that are considered restrictions on freedom. Friedrich A. von Hayek thus did not consider impersonal economic constraints as restrictions on freedom. Although ultimately caused by other people, they did not arise from the arbitrary will of others (Hayek, 2006).

5.2.3 Universalism and relativism

The terms “universalism” and “relativism” refer to meta-theoretical views and refer to the normative status of theories:

- Universalism assumes that certain theories or categories have general validity. Applied to ethics, this means that a principle applies irrespective of special conditions, such as geographical, religious, or ethnic circumstances.
- According to relativism, however, ethics specifically cannot be justified without reference to particular conditions (Engelhard and Heidemann, 2005). Ethical relativism, therefore, can be understood as the assertion that the truth of ethical value judgments—if this truth exists—is relative to context or culture (Baghramian and Carter, 2015).

Questions concerning the universalism or relativism of ethics have gained in importance in recent years. Karl-Otto Apel already pointed out in the 1970s that the need for a universalistic, orientation-providing ethics has never been greater. At the same time, he noted that it has never been so difficult to implement in the age of “scientism, i.e. a time oriented towards a certain ideal of (natural) scientificity. Apel contends that this is due to the ubiquitous “scientistic” tendency towards value-free objectivity, on the one hand, and the persistent tendencies of group morals, on the other (Engelhard and Heidemann, 2005).

Ethical relativism is probably the most influential and controversial form of relativism. While its proponents see it as a sign of tolerance, cosmopolitanism, and anti-authoritarianism, its opponents condemn it as morally depraved and as a tendency that undermines ethics. Edvard Westermarck (1862–1939) thus regarded relativism in ethics as a guarantor of more tolerance and, simultaneously, of more self-criticism regarding one's own value judgments. Walter T. Stace (1886–1967), conversely, opposed relativism, arguing that this approach could not even condemn the most despicable practices such as sati (the traditional self-immolation of widows), slavery, or cannibalism (Baghramian and Carter, 2015).

The question of ethical universalism or relativism is especially relevant in the context of human rights. Even though human rights claim universal validity in accordance with the United Nations Universal Declaration of Human Rights, they are nonetheless violated in many countries. Often a justification of these violations occurs by taking recourse to the respective culture. As a consequence, there is great disagreement as to whether human rights really are universal or whether they can be relativized by culture.

The weighing of universalism and relativism plays a decisive role in particular for multinational corporations. Following an ethnocentric approach, should they defend their values from corporate headquarters against local customs and practices in their various subsidiaries? Or should they, following a polycentric approach, accept the respective moral systems of their countries of activity and thereby demonstrate their "ethical flexibility"? Indeed, it is not clear what path might be derived from the well-worn management rule of thumb: "think global, act local" (see also practice box 5.3: Gao Feng and Chrysler).

Practice box 5.3 Gao Feng and Chrysler

The case: In May 1994, Gao Feng, an employee of Chrysler's joint venture with the Chinese government, was arrested for violating Chinese law. The devout Christian had planned to organize a private memorial service for the fifth anniversary of the Tiananmen massacre. Gao remained under arrest for five weeks but was never formally charged. When he returned to work, his superiors at Chrysler demanded proof that he had been locked up for over a month. The Chinese police issued him a document stating that he had been locked up for three days and then released without a hearing. Chrysler management faced a difficult decision. On the one hand, the Chinese joint-venture partner put considerable pressure on Chrysler to dismiss Gao from the company. If the company failed to do so, it would put at risk millions of dollars in investment in China. Furthermore, if Chrysler chose to ignore the requests of its Chinese partners, it could be seen as a sign of "cultural imperialism." After all, the employee appeared to have violated Chinese law. At the same time, if they fired Gao, Chrysler would be complicit in the infringement of his religious freedom and freedom to express his political views. Chrysler would, then, be violating the basic universal values of its own country.

The decision: Since Gao Feng did not have a document officially certifying his week-long arrest, Chrysler dismissed him for unexcused absenteeism. His case became world famous when Human Rights Watch—an American and internationally active non-governmental organization—took up his cause. Gao was finally reinstated following the personal intervention of then Chrysler CEO, Robert J. Eaton. However, several months after his reinstatement, when public attention had subsided, he was arrested again and sent to a labor camp for re-education. He was released again in 1998 when a group of interdenominational clergymen appointed by US President Bill Clinton visited China to examine the question of religious freedom.

Source: Santoro, Michael A. (2009). Case Study—Chrysler and Gao Feng: Corporate Responsibility for Religious and Political Freedom in China. In Al Gini and Alexei M. Marcoux (Eds.), *Case Studies in Business Ethics* (6th Ed.) (pp. 237–9). Upper Saddle River, NJ: Pearson/Prentice Hall.

According to figures from non-governmental organizations, US companies empirically lead the group of companies most often accused of human rights violations: Between 2005 and 2014, Kamminga (2016) recorded and evaluated 1,877 human rights complaints. Of these, 511 concern US companies, corresponding to the first place in the negative ranking of the countries that faced the most accusations. This is followed at a considerable distance by the United Kingdom (198 complaints), Canada (110 complaints), China (94 complaints), and Germany (87 complaints).

The Business & Human Rights Resource Centre gives the respective companies that have been accused by civil society the opportunity to comment on the allegations. Although the rate varies greatly from country to country, the average response rate is 70 percent. US and UK companies, for instance, have a response rate of 72 and 71 percent respectively, which is slightly above average. The top respondents are Sweden and South Africa (93 percent each). Four countries have response rates well below 50 percent: China, India, Israel, and Russia. The complaints against Chinese companies mainly concern working conditions, environmental and health problems, and forced relocation. Complaints against Indian companies are primarily aimed at child labor, environmental and health problems, workers' rights, and forced relocations. Israeli companies are mainly accused of supporting illegal

Table 5.1 Allegations of human rights violations and response rate by country of origin

Country of origin	Complaints	Response rate (%)
Australia	43	77
Brazil	22	86
Canada	110	74
China	94	40
Colombia	20	80
France	79	80
Germany	87	86
India	56	41
Israel	20	45
Italy	29	62
Japan	29	66
Malaysia	15	80
Mexico	23	65
Netherlands	69	90
Republic of Korea	32	75
Russia	18	39
South Africa	40	93
Spain	25	60
Sweden	29	93
Switzerland	46	78
Taiwan	29	66
United Kingdom	198	71
United States of America	511	72

Source: Kamminga (2016, pp. 101f.).

settlements. And the complaints against Russian companies usually concern environmental and health problems as well as workers' rights (Kamminga, 2016). Table 5.1 shows the complete list of countries with the number of complaints and the corresponding response rate.

5.2.4 Human dignity and institutional design: the example of defaults

The choice of the so-called default figures prominently in current behavioral economics discussion. A default is the pre-selection of a certain choice. If the decision-maker does not take action and change the default, the default option is used automatically. Such a situation can be imagined with a particular software in which one of two alternatives is already pre-selected. One then accepts the correspondingly chosen alternative by clicking on "Next."

In a number of domains, changing the default can have significant economic implications. For example, in Germany the church tax is between 8 percent and 9 percent of the income tax. The obligation to pay church tax, however, applies only to those who belong to a church or religious community that levies a church tax. In Germany, these are above all the Roman Catholic and Protestant churches. When leaving the respective religious community, the church-tax liability ends at the end of the month or the following month in which the withdrawal takes place. The departure must be declared to a state authority (registry office, district court). The default in Germany is therefore the payment of the church tax, whereby action must be taken to initiate the withdrawal. In most cases, there is a state-specific withdrawal fee of around 30 euros. In relation to tax savings, the fee associated with the withdrawal and the transaction costs of a visit to the authorities play a rather minor economic role. Traditional economics would therefore assume that leaving the church is a matter of clear religious preferences. Following this argument, then, one would expect that an inverted default would more or less result in the same number of church members. Whereas in the present process atheists have to consciously decide to withdraw, in a differently designed process believers would have to decide to opt in. Agnostics, too, are unlikely to be indifferent to the question of having to pay a fee to belong to a church.

Empirical studies suggest, however, that the default has a far greater influence on the individual's decision than traditional economics would predict. Johnson and Goldstein (2003), for instance, examined which effect an opt-in versus an opt-out solution has on the rate of organ donation. In an experimental online study, they asked their US participants whether they would be willing to donate their organs based on three different questions. The questions differed in the hypothetical default. In a first question, a case was described in which the participants move to another country where the default is not to be an organ donor. They were then asked whether they wanted to confirm or change this status. Therefore, they had to explicitly agree to become an organ donor (consent solution). The second question was identical, apart from the fact that the default was now to become an organ donor. In this case, organ donation had to be explicitly rejected (objection solution). In a third question, no default was set so that the participants had to make a decision. The nature of the question had a dramatic effect on the participants' decision-making. In the case of a consent solution, only 42 percent of participants declared their willingness to donate, whereas in the case of an objection solution, it was 82 percent. When the participants were asked without any pre-selected default, 79 percent declared their willingness to donate their organs. This last question shows that a clear majority of participants had a preference for organ donation. This willingness erodes drastically when they are confronted with a consent solution. In the event of a consent solution, the switching costs are therefore imposed on the majority.

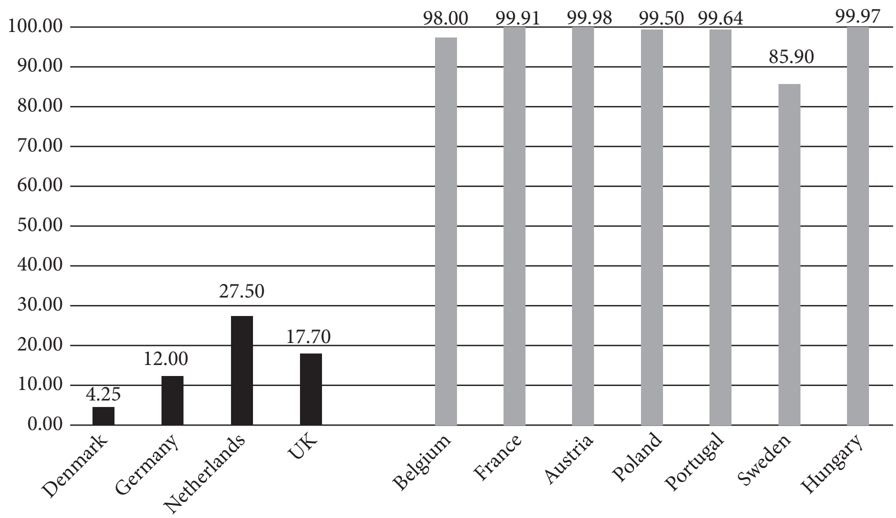


Figure 5.7 Effects of consent on organ donation per country
Source: Johnson and Goldstein (2003, p. 1338).

Johnson and Goldstein (2003) further compared organ donor rates in different EU countries, depending on whether a consent or objection rule applied to organ donation in each country. As Figure 5.7 shows, the proportion of organ donors in countries that had implemented an objection rule at the time of the study (gray bars) was dramatically higher than the proportion of organ donors in countries that had implemented a consent rule (black bars).

The question now arises as to whether the different institutional choices of the default represent a commitment to negative or positive liberties. This is important because empirically it is shown that the pre-selected default has a clear effect on the donor behavior due to the stickiness of the pre-selection. One could argue in balancing the legal interests that the right to physical integrity, which even goes beyond death, outweighs the right to health—or vice versa. While physical integrity represents a negative liberty, i.e. freedom from interventions against one's own body, the right to health represents a positive liberty, i.e. a claim to the solidarity community.

Of course, it can be argued that an objection rule, though obviously highly effective, continues to give people de jure the option to decide against the default with little effort. Of course, what arrangement should be made with respect to human dignity lies in the eye of the beholder.

Thaler and Sunstein point out that there is no such thing as a default-free environment, for it is always necessary to implement some form of pre-selection. Since the default strongly influences people, it makes sense then to choose the right one (see, for example, Thaler and Sunstein, 2008). Against this, however, it can be argued that the institutionally deliberate randomization of the default represents a liberal alternative to pre-selecting a certain default. For example, if one does not want to give any party an advantage in elections by naming it first on people's ballots, it makes perfect sense to randomize the ordering. Thus, if in the light of empirical studies, a cautious institutional designer is aware of his inevitable influence on the choice of the default, he might deliberately choose the least invasive solution to minimize the impact overall on decentralized decisions. In some cases, as in the one of organ donation, a default could be dispensed with entirely. The citizen could be asked instead to make a decision, for example, upon the issuance of a driving license or identity card. This is called a decision-making solution.

5.3 Sustainability

5.3.1 On the concept of sustainability

The term sustainability was coined in the eighteenth century by the mining administrator at the court of Kursachsen in Freiberg, Hans Carl von Carlowitz. In the course of an impending raw material crisis, he thus named a principle for forestry according to which only as much wood could be felled as could grow again through planned reforestation. Even today, "sustainability" is often primarily understood as the conservation of natural resources to secure the existence for future generations (Springer Gabler Verlag, 2018).

Probably the best-known definition of sustainability is taken from the 1987 report *Our Common Future* published by the United Nations World Commission on Environment and Development. The Commission that drafted this report was headed by the former Norwegian Prime Minister Brundtland, which is why it is also referred to as the "Brundtland Report." The definition of sustainability published there reads:

> Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.
>
> (United Nations, 1987)

The report had a major impact on the international discourse on developmental and environmental policy. For the first time, problem areas usually regarded in isolation were seen as interconnected. They included environmental pollution in the industrialized countries, the debt crisis, and desertification in the Third World. The Commission argued that poverty must be overcome in developing countries, while in the industrialized countries material prosperity must be reconciled with the preservation of the natural environment (Thomsen, 2013).

The importance of the term, which has grown tremendously over recent decades, is due to the emergence of global problems in the social, economic, and environmental spheres. Specht (2017) points out that the concept of sustainability loses precision the more it is appropriated. Sustainability therefore must be seen more as a regulative idea for securing the future than as an operational objective. In particular, the question is raised here about the conditions under which individuals would be prepared to invest in basic social capital goods.

5.3.2 The triple-bottom-line approach

The "triple-bottom-line approach" goes back to John Elkington, who introduced it in an article in 1994 and further elaborated on it in 1997 in his book *Cannibals with Forks*. The "bottom line" is the netting of income and expenses under which the profit is shown. It is proposed that this purely financial consideration be extended to include the dimensions of the environment and society (Elkington, 1997). Another prevalent, yet less incisive, approach, the "three-pillar model" employs three interconnected "pillars" or sometimes also called "stool legs." In this tripartite conception, the dimensions of economy, ecology, and society ("profit, planet, people") stand side by side as equal bearers of sustainable development (Purvis et al., 2019).

5.3.2.1 Economic sustainability

Economic sustainability requires that a society not live beyond its means and that its actions should not endanger the underlying basis of an economy. If it does, it will take resources reserved for future generations. Sustainable farming must therefore be effective over the long term.

Rogall (2004) presents several economic management rules of sustainability:

1. Human needs should be met as efficiently as possible within the framework of the environment.
2. Prices should serve as scarcity indicators in order to optimally understand their directional impulse. If externalities occur, prices are to be increased accordingly by the state-authorized decision-makers.

3. The general parameters must be designed in such a way that they induce innovations with regard to sustainable development.
4. The human and social capital of society should be constantly improved. In this context, there must be a sufficient amount of public and merit goods.

5.3.2.2 Ecological sustainability

Ecological sustainability is the requirement that a society not over-exploit natural resources. Nature must be given the opportunity to regenerate. In this pillar, the importance of sustainability, which began with forestry, is most obvious.

The environmental management rules of sustainability (Rogall, 2004) are as follows:

1. The use of a resource must not permanently exceed the rate of its renewal.
2. The release of emissions must not permanently exceed the absorption capacity of the environment.
3. Risks to people and the environment must be avoided.
4. The timing of human intervention must stand in an appropriate relationship to the time it takes the environment to stabilize itself.

5.3.2.3 Social sustainability

Social sustainability refers to the harmonious coexistence of social groups in a society. Conflicts should be resolved in a civilized way. In this context, political issues are discussed such as basic income, equal opportunities, or equality. The much-cited intergenerational justice can also be understood against this background.

Rogall (2004) finally proposes the following management rules for social sustainability:

1. Each member of the society receives benefits from the solidarity community according to the contributions he/she has made or according to his/her needs. Benefits can only grow along with a person's economic performance.
2. Human rights, the rule of law, the participation of citizens in decision-making processes and their internal security must be guaranteed.

Structures and policies that threaten international security must be avoided.
3. The overall conditions must be designed in such a way as to ensure a fair distribution of life opportunities for present and future generations.
4. Members of society must make financial and non-material contributions commensurate with their capability.

5.3.3 The preference for the present

Sustainability can be seen as an investment in the future that requires actors to forgo short-term profits. This is not easy, because impatience is a decidedly human trait. The preference for the short-term realization of profits or benefits is reflected in the economic concept of discounting. Discounting explicitly takes into account the present preference of economic actors as a component of their utility calculation. A distinction must be made here, however, between exponential and hyperbolic discounting. While exponential discounting captures the basic idea of "the sooner, the better," hyperbolic discounting describes a reversal of decisions caused by the proximity of events. While exponential discounting justifies temporally consistent action, hyperbolic discounting leads to temporally inconsistent action.

5.3.3.1 Temporally consistent behavior

Traditional economics assumes that people are impatient when it comes to realizing profits or benefits. Accordingly, a surplus of USD 1 million in one year, for example, will typically be preferred to an equally high surplus in ten years. These reasons for this impatience are at least twofold: First, the risk is logically higher that an economic actor will not see the payment in ten years than in one. Second, a payment in just one year can lead to a profitable investment nine years earlier than the same payment in ten years. The payment in one year can thus earn interest nine years longer than the payment in ten years. Exponential discounting illustrates this basic human tendency towards impatience.

The intertemporal preferences of the actor at time t are represented by the utility function U_t. The utility values t_t of the forthcoming individual periods $\tau \geq t$ are multiplied by a discount factor δ^τ. The intertemporal preferences are thus determined as follows:

$$U_t(u_t, u_{t+1}, \cdots, u_T) = \sum_{\tau=t}^{T} \delta^\tau u_\tau.$$

The decisive factor is $0 < \delta < 1$. This technically represents the intuition of impatience. From today's perspective, the further off in the future the payment is, the less value it has. The current preferences are temporally consistent. As a result, once a decision has been made to prefer intertemporal alternative A to intertemporal alternative B, it will not change over time. For example, if an actor decides at the start of the planning horizon to have a higher payment surplus in a later period at the expense of a lower payment surplus in an earlier period, he will maintain this choice even after the earlier period begins and the lower payment surplus comes within reach.

This phenomenon can be illustrated using Figure 5.8. Here, the passage of time is on the abscissa and the discounted benefit is on the ordinate. Option A requires a higher accrual of benefits than Option B. However, this higher accrual of benefits from Option A occurs later than that from Option B. Although the higher accrual of benefits occurs later, it is—as the figure shows—sufficiently high at the beginning of the planning horizon to allow the actor to choose Option A over Option B with the lower, but earlier benefit. As the figure demonstrates, the first preferred Option A is permanently preferred to Option B. This means that even when Option B, whose benefits can be realized earlier, is within reach, the actor still sticks with Option A. As we will see in the following chapter, this is not the case with temporally inconsistent preferences.

The smaller the discount factor δ, the less the future is weighted and the greater the importance of the current gains for the actor. In this context, a large part of the debate on sustainability can ultimately be understood as a discussion of appropriate discount factors. A conflict arises here, for example, when the shareholders of a company pursue a longer-term goal for the

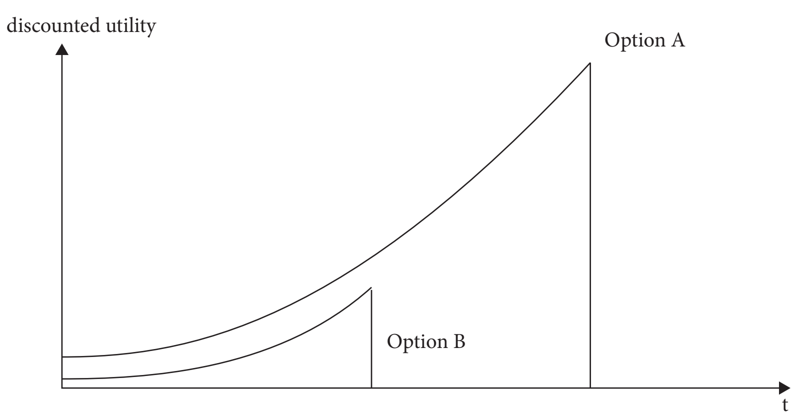


Figure 5.8 Exponential discounting

sake of economic sustainability than the company's managers. The managers, in other words, discount the future more than the shareholders. Calls to link the compensation of the managers to the company's long-term value creation underscore the different points of view. The Hans-Böckler-Stiftung, for instance, stipulates in a brochure on the subject of "Executive Board Compensation" that one criterion for the remuneration of management should be that existing stock options have a retention period of at least five years (Hans-Böckler-Stiftung, 2006).

5.3.3.2 Temporally inconsistent behavior

As we have seen, differences of opinion might exist between economic actors over the right discount factor in the context of temporally consistent behavior. Temporally inconsistent behavior, on the other hand, reveals a problem in which this difference of opinion is effectively shifted to one and the same person. Temporally inconsistent behavior is therefore often interpreted as irrationality or bias, of which the individual is either conscious or unconscious. In the first case, the person will try to impose their plan on a later alter ego. If the person is not aware of this bias, many authors argue that it is the duty of the state to take corrective action.

Breaking resolutions is a human trait that many of us can relate to. It is also closely linked to sustainability issues. In the context of economic theory, however, the phenomenon of breaking a resolution is difficult to explain. One apparently resolves to do something on the basis that it would be advantageous to do it. Following the idea of revealed preferences presented earlier, the subsequent breaking of a resolution also justifies the advantageousness of this act from the individual's point of view. Otherwise, it would not have been carried out. Now it is easy to understand how the resolution to drink less wine next year, for example, can become obsolete when scientific findings are published on the health benefits of wine consumption. Or how the resolution to study for an exam over the weekend can dissipate when it turns out that the test will not be held for another month. In both cases, "belief updating" occurs as new convictions emerge. The formation and breaking of a resolution are always rational in the light of existing beliefs. That said, it is typical for human beings to break resolutions even without any new information and reason to revise their point of view. The resolution is broken, although the information remains constant and only time has passed.

Some philosophers attribute this caprice to the fact that most people are weak-willed, that they tend to succumb to temptations. This problem has been discussed by philosophers since antiquity as "akrasia." Plato, for example, addressed it in *Protagoras*, and Aristotle did likewise in his *Nicomachean Ethics*. David Hume sums up the problem in his *Treatise on Human Nature*:

> But on my nearer approach, those circumstances, which I at first over-look'd, begin to appear, and have an influence on my conduct and affections. A new inclination to the present good springs up, and makes it difficult for me to adhere inflexibly to my first purpose and resolution. (Hume, 1739, p. 137)

This temporal inconsistency is usually modeled by hyperbolic discounting. Hyperbolic discounting requires that the temporal approximation of the event leads to the revision of a decision. In contrast to exponential discounting, where the actor upholds his initial decision, here the actor overturns his plans.

In this case, the intertemporal preferences of the actor are represented at time t by the utility function U_t. The utility values u_t of the forthcoming individual periods $\tau \geq t$ are multiplied by a discount factor δ^τ. The intertemporal preferences are thus determined as follows:

$$U_t(u_t, u_{t+1}, \ldots, u_T) = u_t + \beta \sum_{\tau=t+1}^{T} \delta^\tau u_\tau.$$

In this case, $0 < \beta < 1$ and $0 < \delta < 1$. This modeling leads to a temporal inconsistency of the actors since the utility of the current period receives a disproportionately strong weight.

This becomes clear in Figure 5.9. Option A, which requires a higher, but later, accrual of benefits compared to Option B, is preferred at the start of the planning horizon. However, as soon as time R is reached, the actor changes his decision ad now prefers Option B to Option A. As can be seen from the figure, this result is determined. An important question is therefore whether the actor in question reflects this behavioral pattern or is naïve.

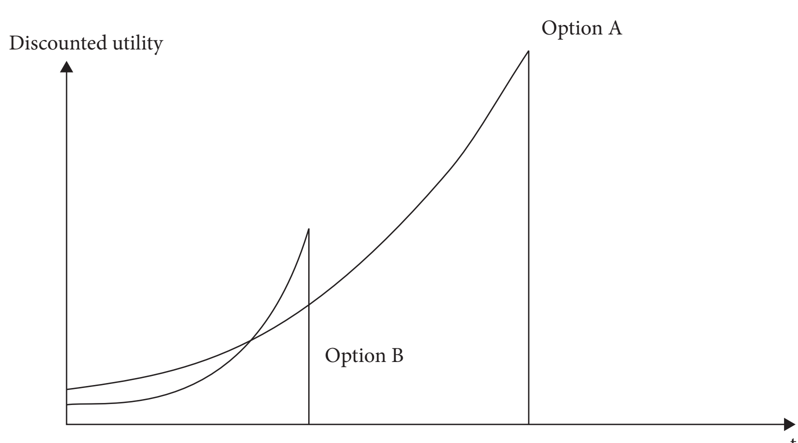


Figure 5.9 Hyperbolic discounting

If the actor is not naïve about his own behavior, he will—if possible—take appropriate action to put a stop to this temporally inconsistent behavior. He commits himself through an act of voluntary self-binding to the initially formed plan. The famous literary example from Homer, which is considered paradigmatic, is the self-binding of the cunning Ulysses to the mast of his ship in order not to succumb to the songs of the sirens. Ulysses commits himself to the long-term plan to return to Ithaca at the expense of his short-term impulse to yield to the temptations of the sirens. Modern and less heroic variants of this action include placing an alarm clock out of reach to force yourself to get out of bed, or consciously leaving behind a credit card before you head into town to prevent a spending spree.

Temporally inconsistent behavior poses a particular challenge to the problem of sustainability, as it describes a tendency to adopt plans in the face of short-term temptations. Institutional self-binding mechanisms have been gaining in importance in this context (see also practice box 5.4: Self-binding of bank customers in the Philippines). If the actors are unable to accept the need for self-binding, the question arises as to whether intervention is necessary to promote the long-term interests of the actors for the purpose of sustainability.

Practice box 5.4 Self-binding of bank customers in the Philippines

The authors Nava Ashraf, Dean Karlan, and Wesley Yin have launched a savings product in the Philippines with an aspect of self-binding. It was offered to a randomly selected group of 710 current and former clients of a bank. The savings product was marked by limiting customers' access to liquidity without giving them a financial advantage, for example through an interest rate premium. Using a hypothetical questionnaire, the authors first identified individuals' tendencies towards hyperbolic discounting and weakness of will. The participants were then randomly assigned to one of three treatments: a self-binding treatment in which the customer was offered the special product; an advertising treatment in which the customer received a separate promotional visit to promote savings but was not offered the special product; and a control treatment.

Of all the customers in the self-binding treatment, 28 percent opened the corresponding liquidity-restricting account. After six months the savings of this group had increased by 47 percent compared to the control group, and after twelve months by 82 percent. This long-term effect suggests that the observed phenomenon was not just a one-time response to a new product. As it turned out, it was above all those individuals with a high temporal inconsistency who decided in favor of the product. The effect was particularly evident in women. The authors attribute this to the fact that in the Philippines women are traditionally responsible for household finances.

Source: Ashraf, Nava, Karlan, Dean, and Yin, Wesley (2006). Tying Odysseus to the Mast: Evidence from a Commitment Savings Product in the Philippines. *Quarterly Journal of Economics*, 121(2), 635–72.

5.3.4 Two solution strategies: efficiency and sufficiency

The idea of efficiency describes the productive use of resources to achieve goals. Efficiency is established as the relationship between yield and expenditure. The lever for achieving efficiency gains is accordingly technical progress.

Economic efficiency can be distinguished from ecological efficiency:

> Economic efficiency requires that the most economical instrument be chosen among those with identical ecological effectiveness. This requires, for example, that companies save different amounts of emissions. These should be saved in such a way that the marginal abatement costs of all companies are identical. If Company A has higher marginal abatement costs than Company B, it would be desirable from a macroeconomic point of view if Company B were to avoid the corresponding emissions instead of Company A. Here, cost-effectiveness is ensured to the extent that a given reduction in emissions is achieved by those companies that can avoid emissions at the lowest cost. Emissions trading is a tool to realize this principle. Ecological efficiency, on the other hand, strives for a sustainable use of resources. This is manifested in improved technical processes which, for example, avoid waste or recycle used products. Here, then, ecological effectiveness is to be increased.

One criticism of the demand for efficiency concerns the so-called "rebound effects." Rebound effects refer to the fact that savings made possible by efficiency gains are not realized in full or in part due to secondary effects. If the overall effect of the efficiency gains is even negative, i.e. if even more resources are used than before, we speak of a "backfire." The idea of the rebound effect goes back to the economist William Stanley Jevons (1835–1882). In his work *The Coal Question*, he observed that English energy consumption had increased after the introduction of Watt's coal-fired steam engine, even though it was significantly more efficient than Newcomen's atmospheric steam engine (Jevons, 1866). Less coal consumption per use resulted in a rise in coal consumption overall. Similar issues have been discussed in the context of cars, where it has also been observed that the lower fuel consumption per vehicle leads to an overall higher total consumption due to more cars on the road and more miles driven.

In the context of the demand for resource conservation and as an alternative to efficiency, recourse is often taken to the term sufficiency. Efficiency is based on the idea of doing things right, while sufficiency is aimed at consuming fewer resources. Sufficiency means an adequate level has been reached. Within the scope of sustainable consumption, the term usually connotes self-limitation through non-consumption. The idea of sufficiency, it should be noted, requires here that people change their previous lifestyle. They are required to moderate their behavior. This idea is represented, for example, in the book *Change Everything: Creating an Economy for the Common Good* by the co-founder of the alter-globalization NGO Attac, Christian Felber (Felber, 2015). He thus calls for the standard work week to be reduced to 20 to 30 hours per week in order to allow for a more "balanced" management of time. As a result, a person's lifestyle would become less centered on consumption, more sufficient, and more sustainable.

Wolfgang Sachs has commented extensively on the idea of sufficiency. A sustainable society can only be achieved in his view by combining an intelligent rationalization of resources with a sensible limitation of objectives. Sachs has defined a moderate lifestyle with what he calls in German the "4 E's"—or what one might refer to in English as the "4 D's": Deceleration, decartelization, decommercialization, and decluttering (Sachs, 1993).

According to Sachs, deceleration refers to an attempt to escape linear thinking and to rediscover the leisureliness of the nineteenth century. This was lost, among other things, due to the advent of the railroad. Decartelization is the fight against a "planetary economy." Sachs criticizes, for example, the widening distances between producer and consumer, in which flowers are imported from Kenya or shoes from Taiwan. Decommercialization is based on the idea that the gross national product of an economy systematically excludes numerous services provided outside the market (voluntary work, bringing up children, etc.). This calls for a return to the "true" sources of prosperity. Finally, decluttering is the demand for a simpler lifestyle. Sachs warns: "The danger of abundance is the fragmentation of the mind." The approach insists that buying options not be methodically exercised.

Aspects of efficiency and sufficiency can go hand in hand in some measures. Fischer and Grießhammer (2013) illustrate this with the example of car sharing. Here, the total number of vehicles per mile driven may be reduced, so that a constant transport performance is achieved with fewer vehicles. This is an efficiency effect. At the same time, however, it can be assumed that the total number of miles driven will also decline as cars are less available. This is a sufficiency effect.

The question that naturally arises in connection with sufficiency is:

> "How much is actually enough?" Nonetheless, this may be difficult or even impossible to decide in a market economy without a planning authority. In contrast to efficiency, sufficiency requires a fundamental change in the lifestyle of each individual. The idea of sufficiency stems from pre-modern thinking, in which economic life was characterized by playing zero-sum games. (Lütge, 2013)

It therefore needs to be asked whether in the fierce competition of modern society, which is based on positive sum games, the concept of sufficiency is in keeping with the times. It certainly makes sense to save resources. But this must not be thought and demanded in opposition to economic logic and competition. What's more: Expansion is a fundamental aspect of human nature. It is therefore empirically doubtful that an appeal for the individual to practice a temperate lifestyle could even work.

Note

1. In Denmark, for example, it is associated with the term "Janteloven" (Law of Jante), see Rendtorff (2019).

References to Chapter 5

Section 5.1

Giles, Chris (2014). Data Problems with Capital in the 21st Century. *Financial Times*, May 23.

Hayek, Friedrich August von (2006). *The Constitution of Liberty*. London and New York: Routledge.

OECD (2019). Poverty Rate. Last accessed July 27, 2020 at: https://data.oecd.org/inequality/poverty-rate.htm

Piketty, Thomas (2014). *Capital in the Twenty-First Century*. Cambridge, MA: Harvard University Press.

Rendtorff Jacob, Dahl (2019). The Honest Businessperson: Cosmopolitan Theory and Cultural Praxis (The Example of Denmark and Scandinavia). In: C. Lütge and C. Strosetzki (Eds.), *The Honorable Merchant: Between Modesty and Risk-Taking* (pp. 41–54). Cham: Springer.

Singer, Peter (1993). Practical Ethics (2nd Ed.). Cambridge: Cambridge University Press.

Smith, Adam (1776). *An Enquiry into the Nature and Causes of the Wealth of Nations*. Raleigh, NC: Generic NL Freebook Publisher.

United Nations Inter-agency Group for Child Mortality Estimation (UN IGME) (2019). *Levels & Trends in Child Mortality: Report 2019*. New York: United Nations Children's Fund. Last accessed April 23, 2020 at: https://www.unicef.org/media/60561/file/UN-IGME-child-mortality-report-2019.pdf

World Bank (2014). The Data Blog: Relative versus Absolute Poverty Headcount Ratios: The Full Breakdown. Last accessed June 2, 2017 at: https://blogs.worldbank.org/opendata/relative-versus-absolute-poverty-headcount-ratios-full-breakdown

World Bank (2018). *Poverty and Shared Prosperity 2018: Piecing Together the Poverty Puzzle*. Washington, DC: World Bank. Last accessed April 22, 2020 at: https://openknowledge.worldbank.org/bitstream/handle/10986/30418/9781464813306.pdf

Section 5.2

Baghramian, Maria and Carter, Adam J. (2015). Relativism. In: E. Zalta (Ed.), *The Stanford Encyclopedia of Philosophy*. Last accessed June 2, 2017 at: https://plato.stanford.edu/entries/relativism

Bardon, Yves, Morin, Chloé, and Boyon, Nicolas (2018). Human Rights in 2018: A Global Advisor Survey. Ipsos. Last accessed April 30, 2020 at: https://www.ipsos.com/sites/default/files/ct/news/documents/2018-07/human_rights_in_2018_-_global_advisor_survey_graphic_report_0.pdf

Bayertz, Kurt (1995). Die Idee der Menschenwürde: Probleme und Paradoxien. *Archiv für Rechts- und Sozialphilosophie/Archives for Philosophy of Law and Social Philosophy*, 81(4), 465–81.

Berlin, Isaiah (2002). Two Concepts of Liberty. In I. Berlin (Ed.), *Four Essays on Liberty*. Oxford: Oxford University Press.

Carter, Ian (2016). Positive and Negative Liberty. In: E. Zalta (Ed.), *The Stanford Encyclopedia of Philosophy*. Last accessed June 2, 2017 at: https://plato.stanford.edu/entries/liberty-positive-negative

Engelhard, Kristina and Heidemann, Dietmar H. (2005). Einleitung—Grundprobleme der Ethik- begründungen. In: K. Engelhard and D. Heidemann (Eds.), *Ethikbegründungen zwischen Universalismus und Relativismus* (pp. 1–10). Berlin: Walter de Gruyter.

Evangelische Kirche in Deutschland (EKD) (2014). Kirchen gegen aktive Sterbehilfe, May 9. Last accessed June 2, 2017 at: https://www.ekd.de/aktuell_presse/news_2014_05_09_2_jung_sterbehilfe.html

Fritzsche, Karl Peter (2016). *Menschenrechte: Eine Einführung mit Dokumenten* (3rd Ed.). Paderborn: Ferdinand Schöningh (UTB).

Gajevic, Mira (2014). Debatte um Sterbehilfe: Ärzte und Kirchenvertreter üben Kritik. *Berliner Zeitung*, October 16. Last accessed June 2, 2017 at: http://www.berliner-zeitung.de/debatte-um-sterbehilfe-aerzte-und-kirchenvertreter-ueben-kritik-228960

Huber, Wolfgang (1992). Menschenrechte/Menschenwürde. In: *Theologische Realenzyklopädie* (TRE) (Vol. XXII) (pp. 577–602). Berlin and New York: Walter de Gruyter.

Johnson, Eric J. and Goldstein, Daniel (2003). Do Defaults Save Lives? *Science*, 302(5649), 1338–9.

Kamminga, Menno T. (2016). Company Responses to Human Rights Reports: An Empirical Analysis. *Business and Human Rights Journal*, 1(1), 95–110.

Mill, John Stuart (1859). *On Liberty*. Oxford: Oxford University Press.

Sen, Amartya (1999). *Development as Freedom*. New York: Oxford University Press.

Thaler, Richard H. and Sunstein, Cass R. (2008). *Nudge: Improving Decisions About Health, Wealth, and Happiness*. New Haven, CT: Yale University Press.

UN General Assembly (1948). Universal Declaration of Human Rights (217 [III] A). Paris. Last accessed April 23, 2020 at: http://www.un.org/en/universal-declaration-human-rights/

Section 5.3

Elkington, John (1997). *Cannibals with Forks. The Triple Bottom Line of 21st Century Business*. Oxford: Capstone.

Felber, Christian (2015). *Change Everything: Creating an Economy for the Common Good*. London: Zed Books.

Fischer, Corinna and Grießhammer, Rainer (2013). Mehr als nur weniger. Suffizienz: Begriff, Begründung und Potenziale. Öko-Institut Working Paper, 2/2013. Last accessed June 2, 2017 at: https://www.oeko.de/oekodoc/1836/2013-505-de.pdf

Hans-Böckler-Stiftung (2006). *Vorstandsvergütung: Informationen zur Bemessung der Vorstandvergütungen durch den Aufsichtsrat*. Arbeitshilfe für Aufsichtsräte 14. Düsseldorf: Hans-Böckler-Stiftung.

Hume, David (1739). *A Treatise on Human Nature* (Edited by Selby-Bigge and Lewis Amherst). Available online at: https://oll.libertyfund.org/titles/hume-a-treatise-of-human-nature

Jevons, William Stanley (1866). *The Coal Question: An Enquiry Concerning the Progress of the Nation, and the Probable Exhaustion of our Coal-Mines*. London: Macmillan.

Lütge, Christoph (2013). Keine sinnvolle Idee: Suffizienz aus Sicht einer modernen Ethik. *Politische Ökologie*, 135, 33–8.

Purvis, Ben, Mao, Yong, and Robinson, Darren (2019). Three Pillars of Sustainability: In Search of Conceptual Origins. *Sustainability Science*, 14, 681–95.

Rogall, Holger (2004). *Ökonomie der Nachhaltigkeit*. Wiesbaden: Springer.

Sachs, Wolfgang (1993). Die vier E's: Merkposten für einen maßvollen Wirtschaftsstil. *Politische Ökologie*, 33, 69–72.

Specht, Dieter (2017). Nachhaltigkeit. In: Springer Gabler Verlag (Ed.), Gabler Wirtschaftslexikon. Last accessed June 2, 2017 at: http://wirtschaftslexikon.gabler.de/Archiv/55232/nachhaltigkeit-v9.html

Thomsen, Christa (2013). Sustainability (World Commission on Environment and Development Definition). In: S. O. Idowu, N. Capaldi, L. Zu, and A. D. Gupta (Eds), *Encyclopedia of Corporate Social Responsibility*. Berlin: Springer. Last accessed April 24, 2020 at: https://link.springer.com/referenceworkentry/10.1007/978-3-642-28036-8_531

United Nations (1987). *Report of the World Commission on Environment and Development: Our Common Future*. Oxford: Oxford University Press. Last accessed on April 24, 2020 at: http://www.un-documents.net/wced-ocf.htm

6

Corporate ethics

Selected learning objectives

After reading this chapter, you will be able to:

- classify relevant compliance risks, explain the main tasks and tools of compliance and discuss its limits
- distinguish the three possible perspectives on corporate ethics from each other
- discuss the idea of corporate social responsibility against the background of different theories
- formulate theoretical and practical criticism of the presented concepts.

Chapter overview

6.1 Compliance as a minimum ethical requirement

6.1.1 On the term compliance

Compliance generally refers to an organization's conformity with certain rules. In the following, however, we want to interpret the term compliance in a broad sense. It connotes not only compliance with legal rules or regulations, but also the observance of self-imposed principles. This self-imposition can take place as part of a collective or company-specific self-binding. In order to lend substance to the term, it seems appropriate to clearly distinguish compliance from other ambiguous concepts of corporate ethics such as

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).
 DOI: 10.1093/oso/9780198864776.003.0007

corporate social responsibility (CSR). In the following, therefore, compliance should be understood as meaning all those processes which serve to ensure compliance with rules regarded as exogenous. Any processes aimed at changing existing rules or self-imposed new rules are therefore not covered by this term.

Conformity with codified law is the minimum requirement for compliance. A substantive restriction of the term definition is prohibited. The responsibility of the management of the company extends to anti-corruption law, competition law, data protection law, foreign trade law, and provisions on labor law and environmental protection (Moosmayer, 2015).

The first question is whether or not compliance with legal requirements and industry or self-imposed guidelines is self-evident. Is compliance not a function that companies have always had to fulfill? In this context, it should be noted that in the age of the Internet and social media companies have lost control over their messaging. Under the conditions of symmetrical communication, the misconduct of companies today reaches the public much faster and with a higher probability than before. The reputational risk for companies is therefore greater. Furthermore, new technologies have also increased the transparency requirements for companies (Schach and Christoph, 2015).

Once the company has identified the relevant compliance risks, management has three main tasks in the area of compliance: the prevention of misconduct, its detection, and the response to it (Moosmayer, 2015). After an initial discussion on how to identify relevant risks, we will address these three main tasks individually.

6.1.2 Compliance risks

6.1.2.1 Consequences of compliance violations

If violations of the law occur in the course of business operations, the companies concerned may be subject to substantial fines. This is regulated in Germany within the framework of §30 para. 4 of the Act on Administrative Offenses (OWiG). In this context, guilt might be attributed to the authorized representative bodies, authorized signatories, and other authorized representatives. According to §30 (3) in conjunction with §17 (4) OWiG, a penalty may be imposed which consequently skims off the economic advantage of the company arising from the unlawful act. There is a great deal of legal uncertainty with regard to the scope of the forfeiture, because the 1st Criminal Division of the Federal Court of Justice (BGH)—in contrast to the 5th Criminal Division—represents a gross principle of disgorgement. Thus, any expenses incurred in committing the illegality may not be taken into account and deducted (Moosmayer, 2015).

If there is a violation of the company's supervisory duty pursuant to §130 OWiG, the members of its management and, if applicable, other company representatives may be held criminally liable. In accordance with the management-level liability under criminal law, the overall responsibility and complete jurisdiction of the company management applies here. For example, if it can be shown that the company management did not carry out any analysis of the compliance risks before the legal infringement became public, this will likely trigger the management's liability in accordance with §130 OWiG. A worst-case scenario would be one in which the company management had demonstrably carried out an analysis of the compliance risks, but then decided against implementing suitable prevention measures, for example, for cost reasons (Moosmayer, 2015). In a sense, then, ignorance can clearly protect a company against punishment. It is at first irrelevant whether a certain manager was personally involved as the perpetrator of a particular legal violation. From a legal point of view, this must be decided separately. It is sufficient, in the opinion of the court, for a member of the management to simply accept crimes without having had any active personal involvement. The question of personal criminal liability arises even if it cannot be proven that a member of management was informed of the specific use of payoffs. Under criminal law, it is irrelevant whether he or she benefited privately from the transactions in question or whether they were carried out in the alleged interest of the company (Moosmayer, 2015).

If sanctions are imposed on a company in the context of criminal or fine proceedings, this can also have serious consequences in terms of public procurement law. According to §97 para. 4 of the Act against Restraints of Competition (GWB), a company must be law-abiding and trustworthy for it to be considered in the awarding of public contracts. The public can view legal convictions of company members or fines in the company's central trade register. Once a company is exempted from public procurement, it can quickly spiral downward into a vicious cycle. This especially true if competitors consequently become more active in their pursuit of the awarding bodies (Moosmayer, 2015). For a company that has already been excluded from public procurement, clear confidence-building measures are necessary for it to become an approved bidder again.

A category that is more difficult to quantify in terms of its impact is the reputational risk that a company suffers as a result of disclosed rules violations. The legal violations of companies tend to garner a great deal of attention in the national and international press. This can have negative effects on a company at various levels. Stigmatized companies, for instance, have a hard time winning out in the fight for top talent. The motivation of existing employees is also likely to suffer if they are frequently asked about their employer's misconduct in a social context. In Germany, the fact that the values of one's own company are becoming increasingly important for employees is demonstrated by regular management surveys conducted by the non-profit Wertekommission (2015). Investors and analysts are also increasingly examining the effectiveness of compliance structures of companies as part of a credit assessment, for example, using indices such as the Dow Jones Sustainability Index. This applies in particular to institutional investors such as sovereign wealth funds and pension funds, which often threaten to withdraw their participation in the event of regular compliance violations (Moosmayer, 2015). Finally, stigmatized companies are also threatened with an erosion of confidence in the sales market, as they have disqualified themselves for new customers and part of their existing customers' base has gone elsewhere.

Practice box 6.1 describes the relevant regulatory landscape in the United Kingdom.

Practice box 6.1 Regulatory landscape in the United Kingdom

The regulatory landscape of financial offenses in the United Kingdom was recently renewed. Until 2013, the Financial Services Authority (FSA) was responsible for banking supervision. In 2013 the FSA was dissolved, and two new authorities were created. The Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) took over the responsibility for financial supervision from 1 April 2013. The Financial Conduct Authority is responsible for consumer protection, while the Prudential Regulation Authority supervises banks, insurance companies, and investment funds. The Prudential Regulation Authority, which is responsible for banking supervision, will remain under the authority of the Bank of England. The legal basis for the newly established FCA and PRA is the Financial Services Act 2012.

The Financial Reporting Council (FRC) sets out the Corporate Governance Code of the United Kingdom. It was first published in 1992 by the Cadbury Committee. The mission of the FRC is to promote transparency and integrity in accounting procedures. With the Governance Code, the FRC aims to ensure the quality of reporting and tries to enforce the adherence to ethical standards.

Regarding consumer datwa protection, the UK's law is based on the GDPR. The Data Protection Act 2018 (DPA) can be regarded as the realization of the GDPR in Britain. The DPA tailors the application of the GDPR for the UK, extends it, and provides exemptions to it. Further, it provides four separate data protection regimes

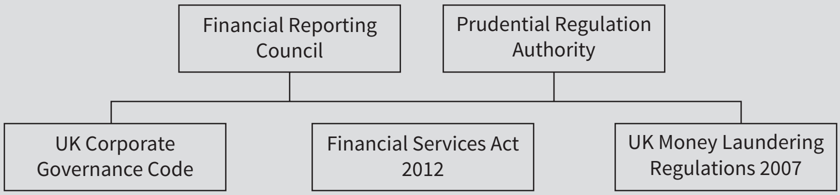


Figure: Financial offenses

that provide the law basis for different applications of the GDPR. Part 2 Chapter 2 handles general processing (GDPR). Part 2 Chapter 3 also deals with general processing but from the perspective of an applied GDPR. Part 3 is occupying law enforcement processing while Part 4 covers intelligence services processing. Part 2 Chapter 2 is the relevant law for most businesses. It supplements and tailors the GDPR to the British regulatory environment.

The oversight of the adherence to the DPA is given to the Information Commissioner. The mission of the Infowrmation Commissioner's Office (ICO, 2012) "enforces and oversees the Freedom of Information Act, the Environmental Information Regulations, the Data Protection Act and the Privacy and Electronic Communications Regulations." The Commissioner's decisions are subject to appeal to an independent tribunal and the courts.

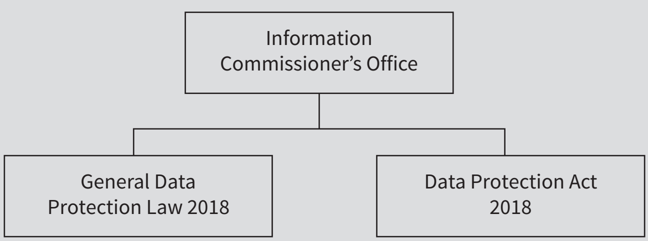


Figure: Data protection

The main institution responsible for the enforcement of antitrust violation is the Competition and Markets Authority (CMA). The formation of the CMA was enacted by the Enterprise and Regulatory Reform Act 2013. This Act aimed to reform the British regulatory environment and to make the fight against corruption and competition fraud more efficient. The major decision to achieve a more efficient enforcement of the respective regulations was the dissolution of the Office of Fair Trading and the Competition Commission. The responsibilities of those two institutions was transferred to the newly established CMA, which started operations in 2014. Having those formerly separated task areas now managed by one organization, the UK's

Continued

Practice box 6.1 Continued

competition regime was furthermore streamlined and strengthened. The CMA has the jurisdiction to carry out all market investigations and merger control laws. Further, it is the primary enforcer of civil and criminal competition law.

The main responsibilities of the CMA are first the investigation of mergers between organizations to ensure that they do not affect competition. If there is any evidence that there are competition or consumer problems, the authority can investigate entire markets. The next area of focus is the constant surveillance of companies and individuals in regard to cartels or anti-competitive behavior. Further, consumers should be protected from unfair trading practices. Apart from its enforcing duties, the CMA plays also an important role in advising the government and other regulators on how to create a regulative environment which encourages competition for the benefit of consumers.

The CMA is also responsible to enforce the Bribery Act 2010. Coming into force in 2011 it is regarded as "the toughest anti-corruption legislation in the world" (Breslin et al., 2010, p. 362). The maximum penalty for breaking the law is 10 years' imprisonment and an unlimited fine. Companies and private individuals can also expect a confiscation of property, which can be enforced by the Proceeds of Crime Act 2002. Directors may also be disqualified under the Company Directors Disqualification Act 1986. The Bribery Act is often compared to the US Foreign Corrupt Practices Act since it can be applied not only to natural persons, but also to legal entities such as companies. Critical opinions were expressed that international competitiveness is threatened by such a strict policy of bribery.

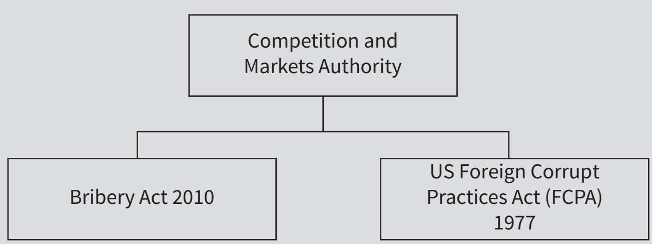


Figure: Bribery and corruption

Sources:
Breslin, Brigid, Ezickson, Doron, and Kocoras, John (2010). The Bribery Act 2010: Raising the Bar Above the US Foreign Corrupt Practices Act. *Company Lawyer*, 31(11), 362–9.

Information Commissioner's Office (ICO) (2012). Upholding Information Rights For All. Last accessed July 29, 2020 at: https://ico.org.uk/media/1042840/upholding_information_rights_for_all.pdf

Information Commissioner's Office (ICO) (2018). About the DPA 2018. Last accessed July 29, 2020 at: https://ico.org.uk/for-organisations/guide-to-data-protection/introduction-to-data-protection/about-the-dpa-2018/

6.1.2.2 Example 1: Corruption

Corruption offenses are cases for the application of fines. According to Transparency International, corruption is the abuse of entrusted power for private gain (Transparency International, 2020). Corruption is frequently associated with the bribery of government officials. For example, a company might pay money to a city official to curry favor in the awarding of a public contract. Corruption also occurs between private actors, however. Thus, a company's purchasing manager can become the preferred recipient of bribery payments, as he or she usually has a certain latitude when selecting suppliers.

Transparency International is a non-regulatory organization that was founded in Germany in 1993. It strives to curb corruption at the national and international levels by developing internationally applicable rules of conduct (Göbel, 2010). The organization publishes its "Corruption Perception Index" once a year. This index consists of a series of expert surveys and measures the perception of corruption (not actual corruption) in business, politics, and administration in 168 countries. In the aggregate, each country receives an index value that ranges between 0 (high level of perceived corruption) and 100 (no perceived corruption). Here, the United Kingdom ranked 12th in 2019 with an index score of 77 points. Table 6.1 shows a cross-section of the ranking of those countries examined in the 2019 Corruption Perception Index. The countries are listed according to the index values in descending order. As space is limited, we present here only the 20 best and the 20 worst-ranked countries.

Corruption is a difficult phenomenon to detect. The victim is often unwitting and nearly impossible to identify. Corruption can therefore go unnoticed. For this reason, wherever the existing structures—for example, the operational and structural organization of companies—promote corrupt behavior, it is necessary to create public awareness or a system of verification (Transparency International, 2020).

There are laws against corruption in many countries, but their scope varies considerably: Often only the bribery of a country's own officials is punishable, but not the bribery of foreign public officials by domestic companies. Public corruption in the sense of the bribery of public officials is frequently prohibited, while private corruption only becomes punishable indirectly if it involves a restriction on competition. In this regard, the German Corruption Section 299 of the Criminal Code was tightened, coming into effect on September 1, 2002. Since then, bribes paid by German companies to foreign business partners are also punishable by

Table 6.1 Country ranking according to the Corruption Perception Index, 2019 (excerpt)

Rank	Country	CPI score 2019	# sources	Lower CI	Upper CI	standard error	CPI score 2018	Rank 2018
1	Denmark	87	8	83	91	2.54	87	2
1	New Zealand	87	8	83	91	2.29	88	1
3	Finland	86	8	81	91	2.92	85	3
4	Singapore	85	9	82	88	2.05	85	3
4	Sweden	85	8	82	88	1.98	85	3
4	Switzerland	85	7	82	88	1.58	85	3
7	Norway	84	7	81	87	1.65	84	7
8	Netherlands	82	8	78	86	2.25	82	8
9	Germany	80	8	75	85	3.31	81	9
9	Luxembourg	80	7	77	83	1.95	80	11
11	Iceland	78	7	70	86	4.63	76	14
12	Australia	77	9	75	79	1.32	81	9
12	Austria	77	8	74	80	1.57	80	11
12	Canada	77	8	72	82	2.80	77	13
12	United Kingdom	77	8	72	82	3.34	76	14
16	Hong Kong	76	8	71	81	3.15	76	14
17	Belgium	75	7	73	77	1.09	75	17
18	Estonia	74	10	72	76	1.21	73	18
18	Ireland	74	7	68	80	3.61	73	18
20	Japan	73	9	67	79	3.51	73	18
161	Nicaragua	22	7	20	24	1.16	25	152
162	Cambodia	20	8	14	26	3.41	20	161
162	Chad	20	6	16	24	2.45	19	165
162	Iraq	20	5	15	25	2.98	18	168
165	Burundi	19	6	11	27	4.89	17	170
165	Congo	19	6	17	21	1.03	19	165
165	Turkmenistan	19	5	17	21	1.42	20	161
168	Congo	18	9	16	20	1.43	20	161
168	Guinea Bissau	18	6	13	23	2.91	20	161
168	Haiti	18	6	13	23	3.23	17	170
168	Libya	18	5	14	22	2.24	16	172
172	Korea, North	17	4	12	22	3.16	14	176
173	Afghanistan	16	5	12	20	2.55	18	168
173	Equatorial Guinea	16	4	11	21	3.00	16	172
173	Sudan	16	7	12	20	2.74	16	172
173	Venezuela	16	8	13	19	2.05	16	172
177	Yemen	15	7	12	18	1.89	14	176
178	Syria	13	5	10	16	1.92	13	178
179	South Sudan	12	5	10	14	1.26	13	178
180	Somalia	9	5	6	12	1.74	10	180

Source: Transparency International (2019) law and no longer tax-deductible. Previously, this only applied to domestic business transactions or to the bribery of foreign public officials. The tightening of corruption regulations met with fierce criticism from the business community. As the payment of bribes was still common practice in the rest of the world, companies expected significant competitive disadvantages compared to their foreign competitors. Indeed, the anti-corruption report presented by Control Risks Deutschland GmbH and the Federal Association of German Industry (BDI) in 2002 showed that 56 percent of the managers surveyed in Germany, Great Britain, the Netherlands, the USA, Singapore, and Hong Kong suspected that they had already missed out on lucrative contracts because a competitor had paid bribes (Keuchel, 2002).

According to estimates by the International Monetary Fund (IMF), bribes of 1.5 to 2 trillion US dollars are paid annually worldwide (Handelsblatt, 2016). Despite the restrictions on prosecution and the aforementioned difficulties in uncovering corruption, the Federal Criminal Police Office (BKA) has identified a considerable number of corruption offenses. Table 6.2 offers an estimate of the scale of the respective offenses for 2017 and 2018. See also practice box 6.2: Corruption scandal at Siemens AG.

Practice box 6.2 Corruption scandal at Siemens AG

In the years 2006–2008, Siemens AG was the center of public attention due to one of the biggest corporate corruption scandals in German history. In the course of this outrage, Klaus Kleinfeld, Chairman of the Management Board, and Heinrich von Pierer, Chairman of the Supervisory Board, had to leave the company. Former board member Thomas Ganswindt was remanded in custody.

Investigations revealed that Siemens AG had a system for making bribery payments for some time. Internal sources even reported that there was a method for encrypting bribes. The ten letters of the word “MAKEPROFIT” had been assigned the sequence of numbers 1234567890. For example, a note such as “Legen Sie das in der Datei APP ab” (Store this in the file APP) should have been translated with “Schmiergelder in Höhe von 2,55 Prozent des Preises sind

Continued

Practice box 6.2 Continued

genehmigt" (Bribes amounting to 2.55 percent of the price have been approved). Thus, the letter A corresponded to the number 2 and the letter P to number 5 (Buchholz, 2007).

In December 2008, Siemens AG announced that the proceedings pending in Munich and Washington on allegations of bribery had been suspended. Siemens AG paid fines of approximately 1 billion euros. In Munich, the proceedings for violation of the supervisory duty of the former Managing Board of Siemens AG were suspended against payment of 395 million euros. In October 2007, Siemens had already paid around 200 million euros for similar proceedings in the former telecommunications sector. Investigations against individuals, however, were not affected by this decision.

The US Federal Court in Washington DC found Siemens AG guilty of deliberately circumventing or failing to comply with internal controls and the United States Foreign Corrupt Practices Act (FCPA). In connection with these lawsuits, Siemens AG and three subsidiaries accepted a fine totaling 350 million euros. At the same time, civil proceedings initiated by the US Securities and Exchange Commission (SEC) against Siemens AG for violation of the FCPA were concluded. Here, the company agreed to a skimming of profits to the tune of 270 million euros.

The US Attorney's Office has acknowledged the company's cooperation with the investigating authorities and highlighted Siemens AG's extensive compliance program established after the scandal.

As part of the settlement reached in the USA, former German Finance Minister Theo Waigel was appointed as compliance monitor. He was responsible for dealing with the corruption affair for four years. In this context, he was in charge of evaluating and documenting the progress made in introducing and implementing the compliance program.

Sources:

Buchholz, Christian (2007). Der Code zum Schmiergeld. *Manager magazin*, February 8. Last accessed July 28, 2020 at: http://www.manager-magazin.de/unternehmen/artikel/a-464741.html

Siemens AG from 15 December 2008, last accessed July 28, 2020 at: https://press.siemens.com/global/en/event/press-conference-siemens-ag-reaches-resolution-german-and-us- authorities

Table 6.2 Corruption offenses 2017 and 2018

Crime	2018	2017	Delta
§ 299 StGB—Bribery/corruption in business traffic	535	1197	−662
§ 300 StGB—A particularly serious case of bribery/corruption in business traffic	48	128	−80
§ 331 StGB—Personal advantage	618	341	+277
§ 332 StGB—Corruption	994	802	+192
§ 333 StGB—Granting an advantage	446	393	+53
§ 334 StGB—Bribery	446	768	−322
§ 335 StGB—A particularly serious case of bribery/corruption	633	1097	−464
§ 108b StGB—Bribing voters	3	4	−1
§ 108e StGB—Bribing of members of parliament	8	24	−16
Law on combating international corruption	1	3	−26

Source: BKA (2019, p. 4).

6.1.2.3 Example 2: Antitrust violations

Another important reason to impose fines are agreements between companies on the same side of the market which serve to curb competition. While today the discussion around compliance primarily concerns fighting corruption, the origin of the term “Compliance Officer” and related functions in Germany can be traced back to the first major antitrust proceedings by US authorities, the EU Commission, and the Federal Cartel Office (Bundeskartellamt). At the end of the 1990s, a series of investigations began with the intensified prosecution of cartel violations in the USA, which were soon followed by the European and national cartel authorities (Volz, 2014).

The members of a cartel are often concerned with achieving the advantages of a monopoly without, however, losing any legal and economic autonomy. Certain courses of action are subject to cartel agreements. Companies that hold a dominant position are subject to special antitrust restrictions. These companies are prohibited from any conduct that could change the structure of the market, where competition is already weakened by the presence of the dominant company (Weidenbach, 2014).

A distinction is made between conduct that is primarily directed against competitors of the dominant company (“exclusionary abuse”) and conduct that affects the company’s customers and suppliers (“exploitative abuse”) (Weidenbach, 2014). An example of exclusionary abuse is the use of competitive pricing. Often competitive prices are even below the original costs to a company. Losses are therefore deliberately accepted in order to penetrate the market and crowd out other companies. An example of exploitative abuse is inappropriate and enforced business conditions that a company imposes, for example, on its dependent suppliers. These anti-competition agreements distinguish between horizontal and vertical agreements: Horizontal agreements concern the coordination of behavior between competitors. Vertical agreements concern the coordination of behavior between suppliers and their customers. Horizontal agreements include cartel agreements, e.g. price-fixing agreements or an agreement that certain customers or geographical areas will only be served by certain competitors. The exchange of confidential business information among competitors is likewise horizontal. In the vertical area, compliance violations include, for example, committing independent dealers to minimum resale prices or reselling certain products only to end customers from a specific EU member state (Weidenbach, 2014).

So-called "gentlemen's agreements" also fall under the ban on cartels. The only precondition is that the behavior of the companies participating in the competition must be coordinated on two or more sides. In the course of antitrust proceedings, it is therefore important to prove to the companies concerned that this coordination exists and that this is not "spontaneous, solidarity-based parallel behavior." For example, a cartel agreement can be identified in the following case (Volz, 2014): Three companies discuss the price development of a particular product at an association meeting. The discussion gives rise to a common desire to stop the price decline of recent years and so they then describe various scenarios to make this possible. In the end, there is a verbal agreement that each company will reduce its production by 10 percent. They also agree to maintain the status quo with regard to certain customer bases. Price increases are to be communicated in good time to those present.

In 2014, the Federal Cartel Office imposed the highest fines in its history (Figure 6.1 provides an overview of the development of the imposed fines; practice box 6.3 describes action taken against a lorry cartel in Europe in 2016). Should the European Commission initiate proceedings, the Federal Cartel Office would forfeit its jurisdiction.

Practice box 6.3 Lorry cartel

In 2016, the EU Commission levied a fine of almost 3 billion euros against four lorry manufacturers for years of price fixing. These were the German Daimler Group, the Italian company Iveco, the French-Swedish company Volvo/Renault, and the Dutch manufacturer DAF. Since German MAN AG was the whistleblower in the course of the proceedings and benefited from the leniency program, it was not fined. According to Competition Commissioner Vestager, this would have amounted to 1.2 billion euros. Daimler AG was ultimately fined the most money at about 1 billion euros. Vestager stressed the great damage caused by the corresponding agreement. In Europe, MAN, Daimler, Volvo/Renault, Iveco, and DAF together produced 90% of the medium and heavy lorries, which are used for the majority of goods transport by land.

According to the European Commission, lorry producers had coordinated sales prices for their products for a period of 14 years. They had also colluded on how the costs of meeting stricter emission regulations would be passed on to the customer. MAN also provided information leading to the premises of the accused companies being searched. Due to the ongoing investigations, Daimler had already set aside reserves in the amount of 650 million euros by 2014. The amount had to be paid within three months. The corresponding fine was paid into the EU budget and reduced the member states' contributions.

Source:
Die Zeit (2016). EU Verhängt Milliardenstrafe Gegen Lastwagenhersteller. July 19. Last accessed August 6, 2020 at: https://www.zeit.de/wirtschaft/2016-07/lkw-kartell-lastwagen-bauer-eu-kommission-rekordstrafe-preisabsprache

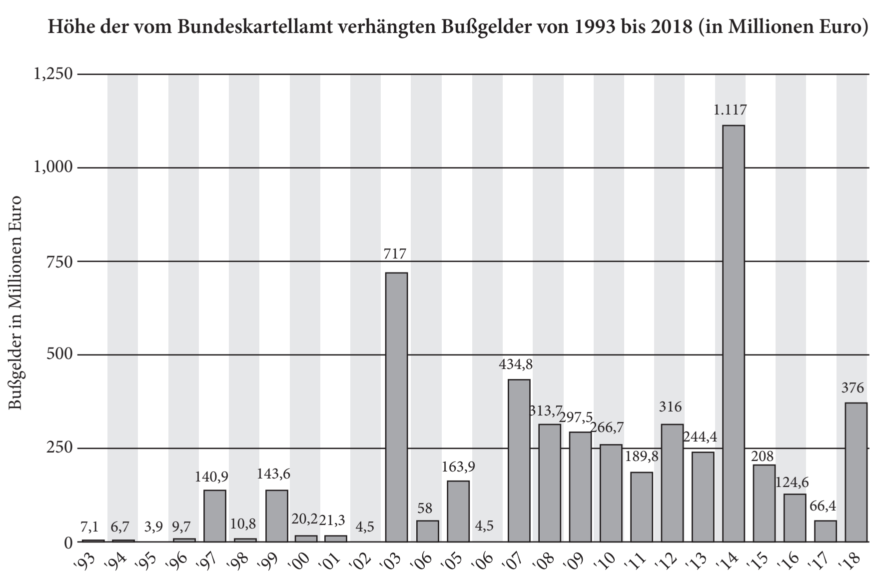


Figure 6.1 Amount of the fines imposed by the Federal Cartel Office from 1993 to 2014 (in millions of euros)
Source: Statista (2020).

6.1.2.4 Example 3: Data privacy

In the wake of data protection scandals involving German companies such as Lidl (see practice box 6.4: Spying scandal at Lidl), Aldi, Deutsche Bahn, and Deutsche Telekom, the topic of data protection continues to be hotly debated in public. Legislators used the opportunity to revise the Federal Data Protection Act (BDSG) in 2009. In general, information should be securely processed. If compliance violations occur against national or international regulations such as the BDSG, KontraG, or the Sarbanes-Oxley Act, it can result in compensatory payments and substantial fines (Bauer, 2013).

In addition to technically sound and secure data processing, companies are required to be cognizant of the fact that data may not be collected and used for just any purpose. On the one hand, companies must comply with legal requirements, for example, compliance with reporting obligations, the appointment of data protection officers, or the creation of procedural lists. On the other hand, as the responsible body, they are obliged to inform the data supervisory authorities and those affected whose data have been unlawfully shared with third parties about these “data leaks” (Bauer, 2013). According to §42a BDSG even half-page advertisements in daily newspapers published nationwide can come into question. The resulting damage to a company’s image can be considerable.

Currently, the basic principle informing the BDSG is that any collection, processing, or use of personal data requires justification. Therefore, the principles of data avoidance and data economy generally apply. Furthermore, personal data as a rule must be made anonymous or pseudonymous (Hugger and Simon, 2014). The approval of the works council (Betriebsrat) is also required for the implementation of certain measures. This includes, among other things, the introduction of technical equipment at the workplace used to monitor the behavior or performance of employees (Hugger and Simon, 2014). It is not necessary here that the facilities are actually used for monitoring, only that they have the potential to do so. Technical means could involve, for example, keyword software for monitoring emails, IP telephone systems, or online forms for logging the time worked (Hugger and Simon, 2014).

Consumer rights were further strengthened by the introduction of the General Data Protection Regulation (GDPR) in the European Union in 2018. The GDPR can be considered as the strongest set of data protection rules worldwide. On the one hand it aims to assure people the right to access and manage their personal information that was collected by companies or any other institution. On the other hand, it puts boundaries to what companies are allowed to do with the data, and how personal information must be stored securely. At the core of the GDPR there are seven principles that can be found in Article 5: lawfulness, fairness and transparency; purpose limitation; data minimization; accuracy; storage limitation; integrity and confidentiality; and accountability.

Practice box 6.4 Spying scandal at Lidl

In 2010, the German discounter Lidl was sentenced to a fine of almost 1.5 million euros for the unauthorized surveillance of its employees. The Baden-Württemberg Ministry of the Interior, which was in charge of the proceedings as the supervisory authority for data protection, criticized the low priority the company had given to data protection in the past.

In March 2010, the company had admitted to having employed detectives in 219 branches. Allegedly, the measures had served to prevent theft. In the course of overzealousness, the detectives had then obtained additional information that went beyond their actual assignment. Later, Edeka and Plus also admitted to having used video surveillance to check employees.

In total, reviews were initiated against 35 Lidl distributors. According to the information provided by the supervisory authority, between January 2006 and March 2008, around 30 Lidl sales companies had commissioned shop detectives with cameras in more than 900 cases, who in some cases prepared comprehensive audit reports, which also referred to the behavior of the employees. In approximately half of the logs that could still be found, the limits of what is legally permissible had been exceeded.

In numerous minutes, there were comments on the appearance and private life of the employees. The labor law expert Klaus Müller-Knapp classified the surveillance protocols as “highly scandalous,” as they violated Article 2 of the Basic Law, which guarantees the free development of the personality.

In the case of an employee, for example, an inspector noted: “Wednesday, 4.45 p.m.: Although Mrs. N. has still not managed to do too much in the non-food/action goods area so far, she is taking her break punctually. She sits together with Ms. L. in the break room; the staff discuss salaries, bonuses and paid overtime. Ms. N. also hopes that her salary has already been credited today, as she urgently needs money for tonight (reason = ?).”

Sources:

Der Spiegel (2008). Lidl ließ Mitarbeiter systematisch bespitzeln. March 26. Last accessed August 6, 2020 at: http://www.spiegel.de/wirtschaft/stasi-methoden-beim-discounter-lidl-liess-mitarbeiter-systematisch-bespitzeln-a-543431.html

Süddeutsche Zeitung (2010). Lidl muss zahlen: Millionen-Strafe für die Schnüffler. May 17. Last accessed August 6, 2020 at: http://www.sueddeutsche.de/wirtschaft/lidl-muss-zahlen-millionen-strafe-fuer-die-schnueffler-1.709085

6.1.2.5 Determination of company-specific compliance risks

One of the first important tasks of compliance is to determine the company-relevant compliance risks. It should first be emphasized that taking appropriate risks is an indispensable part of entrepreneurial activity. When setting up and introducing a compliance program, the aim cannot therefore be to anticipate every possible misconduct by employees, but rather to prevent systematic misconduct (Moosmayer, 2015). In addition to the risks presented in the previous section, which result from corruption, antitrust violations, and data protection violations, a large number of other risk categories play an important role. These result from the specific conditions, such as the sector affiliation and geographical reach of a company. In the course of determining these specific risks, it is necessary to subject the structure of the core business to a detailed analysis.

Using the example of corruption risk, the following shows the typical aspects that should be considered in the course of such a risk analysis. According to Moosmayer (2015, p. 25), it is generally the case that the infrastructure and industrial plant business with public clients is more prone to corruption than the product business with buyers from the private sector. In determining the risk of corruption, it should therefore be clarified whether the company receives its most important contracts from transactions with public authorities, what the relevant award procedures are, and with which authorities there is direct contact in this context. Since systematic corruption often occurs through the use of business intermediaries, business transactions via third parties must be closely examined in particular.

It should also be noted that corruption is only possible if funds can be channeled out of the company in order to make unauthorized payments. This necessitates an exact analysis of the company's payment activities (Moosmayer, 2015). Of particular concern is the monitoring and inspection of all bank accounts managed in its name as well as the question of the existence of fiduciary accounts. It must also be checked whether the company has a suitable procedure in place to ensure that new bank accounts are adequately authorized. Another important aspect is the handling of cash. It should be noted in particular that payments are recorded in full in the accounts and that there is regular control of the funds from which current expenditures are made.

6.1.3 The key tasks of compliance

The tasks of compliance can be divided into the following key areas: the prevention of compliance violations and the detection and response to misconduct (Moosmayer, 2015).

6.1.3.1 The formulation of prevention measures

An essential means of prevention is to communicate a corporate culture that adopts a clear stance when it comes to compliance issues. The company's management and its "tone from the top" play a decisive role in ensuring that compliance requirements are communicated to employees continuously and unambiguously. The cues provided here by the company management must be followed by middle management and strengthened accordingly. The "tone from the middle," which emanates from the department heads and group leaders of a company, is often especially effective due to their proximity to the employees. They therefore often have a greater role-model effect than the company management.

6.1.3.1.1 The code of ethics

An essential part of a compliance program is a code of ethics that precisely and in simple terms sets out the most important rules and requirements for employee behavior. The content of this code depends on the results of the compliance risk analysis. The aim of the code of ethics is to show employees the compliance risks they face in their daily work and to provide them with answers on how to deal with these risks. Although certain problem areas, such as provisions for preventing corruption, are likely to play a role industry wide, there will also be numerous differences in the priorities between the sectors: While sensitivity in handling customer data plays a major role for online mail-order companies, special care will be taken at a company in the food industry in the quality control.

Separate provisions apply to companies listed on a US stock exchange and thus subject to the Sarbanes-Oxley Act (see Securities and Exchange Commission, 2002). Regardless of where their headquarters are located, these companies must inform the Securities and Exchange Commission (SEC) whether they have adopted a code of ethics for those employees primarily responsible for finance and accounting. In principle, it is possible to integrate this code into the generally valid code of ethics. Nevertheless, many companies decide to adopt a separate code of ethics for the financial sector. It is therefore recommended that the current version of the code of ethics be accessible to employees at all times via the home page of the compliance organization. The compliance organization is also responsible for ensuring that outdated compliance guidelines are properly archived. This is particularly important if compliance violations have been detected and the company is obliged to prove that appropriate preventive regulations were already in place at the time of the violation (Moosmayer, 2015).

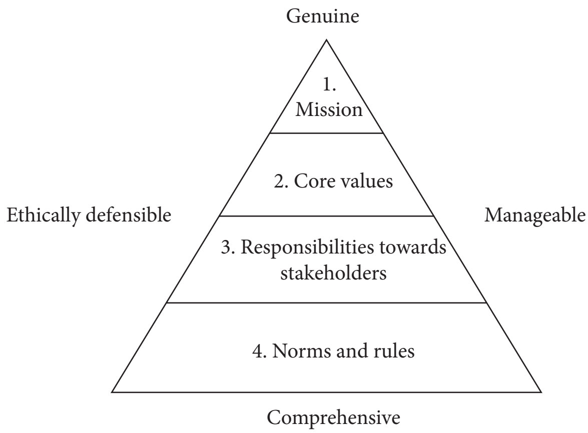


Figure 6.2 The four information layers and the four characteristics of an ethics code
Source: Kaptein (2014).

Kaptein (2014) identifies four information layers and four characteristics that characterize a good code of ethics (see Figure 6.2). The four information layers can be represented in the form of a pyramid. The lower the layer, the more detailed and technical the information. The company's mission is at the very top. Directly below is the layer of core values. Below the core values are first the responsibilities towards the stakeholders, and then come the individual rules and guidelines. The four characteristics of a good code of ethics are that it is comprehensive, morally defensible, genuine, and manageable.

Comprehensive means that the code should include all aspects for which it intercedes and is expected to address. It is important that the company determines the expectations of the stakeholders and is especially vigilant in the current debate with regard to the responsibilities attributed to it by the media, politics, and society. A code of ethics, of course, is not better because it takes a stance on a particularly large number of issues. Rather, the key is to mention those topics that are really relevant to the company. In this context, there is no point in addressing a number of thematic areas: If even the most obvious aspects were all included in the code, it would quickly run into thousands of pages.

Morally defensible means that the positions of the company must be subjected to rigorous moral scrutiny. For a code to be responsible, it must be sufficiently clear in its wording and formulations. The stipulation of moral defensibility requires that the code's relevance be reassessed at regular intervals. More frequent modifications will be necessary to keep pace with social change especially when a code is very specific.

In recently updated ethics codes, for example, climate change, governance structures and transparency play a greater role.

A document that is comprehensive and morally defensible does not necessarily constitute a good code of ethics. Often, the ethics codes of other companies serve as a model, creating the risk that an already existing code will be imposed on one's own company without the necessary adjustments. The characteristic that a code is adapted to an organization is called authenticity. One way to check the authenticity of a code of ethics is to present several anonymized codes to a group and let them guess which code belongs to its own company: The result should clearly differ statistically from a random selection.

The fourth characteristic is the manageability of a code of ethics. It should be examined here what can be achieved in the medium term with good will and a collective effort. There will always be a gap between the requirements of the code of ethics and the actual procedures. If this is not the case, the code of ethics should probably be regarded as unambitious. If, however, the employees get the impression that the gap between the requirements and the behavior is so wide that a significant part of the code can probably never be achieved, the document can be quickly dismissed as being meaningless and purely cosmetic. A further check within the framework of manageability relates to the document's internal consistency. It should be regularly asked whether the code pursues conflicting objectives which, logically, preclude its feasibility. See practice box 6.5 for an example of a business code relating to standards of business conduct for employees.

Practice box 6.5 The McDonald's code of conduct

McDonald's is committed to conducting business ethically and in compliance with the letter and spirit of the law. This commitment is reflected in McDonald's Values. Inherent in each value is our commitment to be ethical, truthful and dependable and this is reflected through our *Standards of Business Conduct* which serves as a guide to making good decisions and conducting business ethically.

Each year McDonald's employees certify that they have read and will abide by our Standards of Business Conduct. Employees also complete regular training on the Standards, anti-bribery laws, and various other laws, regulations and company-specific policies. In addition, McDonald's and its employees in all countries must

Continued

Practice box 6.5 Continued

comply with the US Foreign Corrupt Practices Act (FCPA). To ensure compliance, McDonald's has adopted a Global Anti-Corruption Policy, which contains guidance for employees on all applicable anti-bribery laws, including the FCPA. In general, the FCPA prohibits improper payments to government officials for the purpose of obtaining or keeping business or improperly influencing government action. The anti-bribery prohibition applies to corrupt payments made directly or indirectly, through a third party. In addition to the FCPA, the Global Anti-Corruption Policy requires compliance with anti-bribery laws in other parts of the world, such as the UK Bribery Act, which have international jurisdiction and prohibit the giving of bribes to any government official as well as private entities and individuals. Employees in McDonald's international offices complete an annual certification of compliance with their local version of the Standards and complete annual anti-bribery training. McDonald's Global Compliance Office monitors and enforces the company's policies prohibiting money laundering, bribery and doing business with terrorist groups, as directed by the US Patriot Act, the FCPA and Executive Order 13224.

Source:
McDonald's Corporation (2019). Standards of Business Conduct for Employees. Last accessed July 28, 2020 at: https://corporate.mcdonalds.com/corpmcd/investors-relations/codes-of-conduct.html

6.1.3.1.2 "Whistleblowing" systems

Another important preventive measure is the establishment of a whistleblowing system. The establishment of such a system should allow employees and suppliers, in the event of suspicion, to report observed misconduct to a body outside the company hierarchy, i.e. to someone other than one's superior. The aim of these systems is to use the knowledge of employees and suppliers to identify and clarify compliance violations in the company at an early stage. The establishment of a whistleblowing system in a company is a sensitive issue. As it can quickly give the impression that a culture of denunciation is to be created, it can be a difficult balancing act. Indeed, in Germany in particular it is all too easy to draw parallels with the Block Leader of the Nazi era. Adequate communication is therefore paramount in this context.

Especially in large companies, when employees observe misconduct in their immediate work environment, they face a thorny set of circumstances. On the one hand, it is recognized that employees who have knowledge of compliance violations and yet cannot pass them on without risk carry a considerable psychological burden. This has a negative impact on employee morale, motivation, and loyalty (Tur, 2014). For example, the employee is not sure whether her report will be treated confidentially by her superior or whether the latter will not perceive her intervention as an unwelcome disturbance or even a "fouling of the corporate nest."

Tur (2014) summarizes six characteristics of effective whistleblowing systems. Anonymity includes the plausible assurance that the whistleblower will not be personally disadvantaged. Confidentiality can be ensured either by an authorized body or by technical means. Accessibility in terms of time and place ensures that the existing whistleblowing opportunities are optimally used. Psychological studies show that whistleblowers often observe a compliance violation over several years but are then only prepared to report it within a small window of time. Open communication enables the whistleblower to give feedback that the information she has provided has actually been used to correct a compliance violation. Even when internal investigations reach their limits, it may be important to again rely on the whistleblower's insider knowledge.

Language coverage is also of great importance in internationally active companies. It must be ensured that the system can be used in all relevant languages. In particular, whistleblowers must be able to communicate the information in their native language, i.e. without any language barriers. A narrowing of the issues to be recorded ensures that only infractions and violations of standards can be reported and not, for example, the workplace behavior of individual colleagues. The restriction is company- and country-specific. Finally, the documentation, archiving, and presentation of the results of dealing with a whistleblowing case have become increasingly important in order to reduce liability.

6.1.3.1.3 Compliance training and consultations

For the code of ethics to be applied correctly, its content must be regularly communicated to employees in compliance training. It should be noted that training of legal awareness and judgement places high demands on the conceptual design and implementation of the compliance training. The related sensitization process can hardly be achieved through a speaker's moralizing monologues. Besides the necessary imparting of factual knowledge, the moral competency development of employees must also play a key role. Compliance can only be taught and learned if an open and dialogue-oriented communication culture on compliance topics is embodied in the company. The methodically appropriate communication of contents and competencies must also be ensured within the framework of a comprehensive curriculum (Kleinfeld and Müller-Störr, 2014).

A further challenge is to ensure a uniform approach to employees despite the increasing decentralization of organizational units and the heterogeneity of target groups and communication channels. Viebranz et al. (2014) recommend using the full range of compliance training, such as e-learning modules on specific questions or the use of case simulations for risk-free learning through virtual experiences. Furthermore, management workshops for executives and apps that provide ad hoc support for sales staff can be used, for instance, with regard to legal questions and the appropriateness of gifts.

In addition to training, compliance consulting must be offered to the respective business units. Since this often involves integrating difficult legal issues into the business process, it is especially valuable for a company to have its own legal expertise. In this context, effective knowledge management is also critical. It can ensure that frequently recurring questions, which differ only slightly, are answered quickly and above all consistently (Moosmayer, 2015).

6.1.3.1.4 Due diligence of business partners

The careful selection of business partners also falls into the context of taking preventive measures. If compliance systems are to hinder violations of rules within the company, this means that transactions involving third parties need to be subject to similar requirements (Muth, 2014). In the course of related due diligence, potential partners are examined with regard to relevant compliance risks. The aim is to prevent legal risks arising from violations by third parties that can be attributed to the company. In particular, potential business partners from countries with an increased risk of corruption (according to the Corruption Perception Index) should be subject to special scrutiny. Other factors in the course of due diligence that require special attention include the express desire of the business partner to be remunerated based on success instead of receiving a fixed compensation, the fact that the business partner has ties to the public sector, as well as the business partner's insistence on unusual payment terms.

Before the actual due diligence is carried out, in a risk analysis phase a pre-selection should be made of the third parties to be examined and a risk-adjusted set of indicators should be developed (Muth, 2014). Often the ongoing development of compliance systems means that a large amount of information is already available "in-house" that can be used to evaluate business partners. Furthermore, a number of information service providers offer software applications that make it possible to check entire master data records against their database entries for sanction, search, or embargo listings. On the basis of the overall advanced findings, the business partner can then also be scrutinized directly, for example in the context of interviews, self-disclosure, or the exercise of agreed upon rights to audit operational processes (Muth, 2014). However, the regulatory requirements for the due diligence of business partners are also offset by the principle of reasonableness. Ultimately, this tension can only be resolved through a risk analysis. The concern here should be less with the logic of following regulations than the company's real interest in finding out something about the business partner before it is too late (Muth, 2014).

6.1.3.1.5 Effectiveness monitoring of implemented measures

In addition to the measures already mentioned, another form of prevention of compliance violations consists of monitoring the effectiveness of the introduced compliance measures. This monitoring can be carried out internally by the respective business units, by the compliance organization, or by the auditors. Some companies also rely on external experts to monitor their compliance measures. The "Grundsätze ordnungsmäßiger Prüfung von Compliance-Management-Systemen" published by the Institut der Wirtschaftsprüfer in Deutschland e. V. (IDW) provides an auditing standard. It sets out in detail the requirements for a compliance management system and presents the principles according to which auditors carry out voluntary audits of compliance management systems.

Figure 6.3 summarizes the basic elements of such an audit according to IDW. They interact with each other and are integrated into the business processes (Institut der Wirtschaftsprüfer in Deutschland e. V., 2010).

The compliance culture provides the foundation for the effectiveness of the compliance management system. The "tone from the top" determines how employees generally perceive their compliance with the rules. Within the framework of the compliance goals, the company's legal representatives define the compliance goals that are to be achieved with the compliance management system on the basis of the company goals and by analyzing the rules. These then form a basis for assessing the compliance risks.

The compliance organization regulates the distribution of tasks as well as the process and organizational structure in the compliance management system as part of corporate organization. The compliance risks establish which dangers can arise from rule violations. All risks identified are examined with regard to the likelihood of occurrence and the amount of damage. The compliance program introduces principles and measures based on the compliance risks, which are aimed at minimizing the risks. It also includes measures that are to be taken in the event of compliance violations.

This debate was further fueled by the introduction of the General Data Protection Regulation (GDPR) in the European Union in 2018. The GDPR can be considered as the strongest set of data protection rules worldwide. On

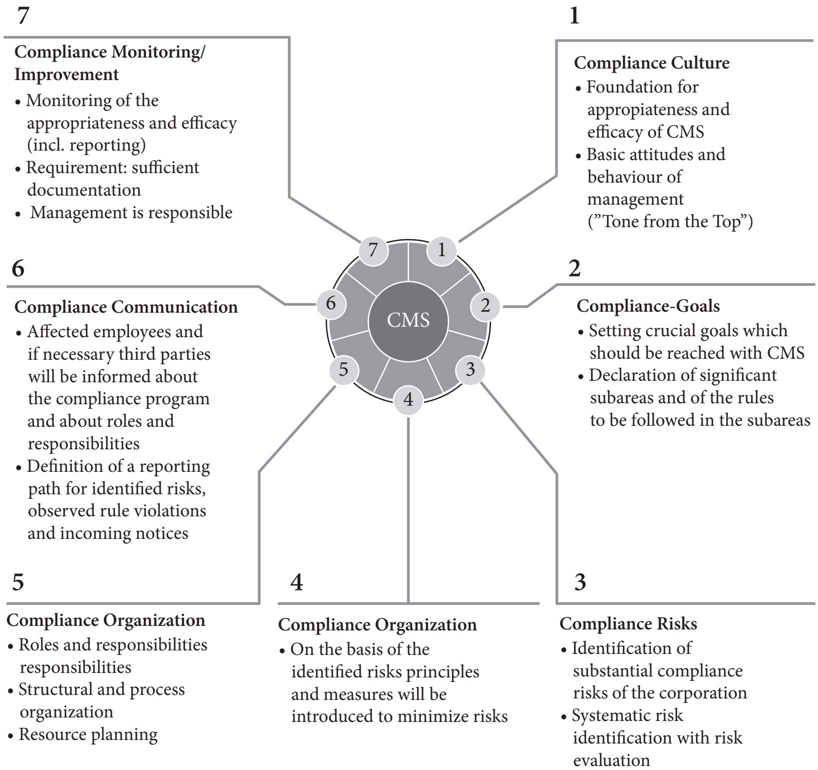


Figure 6.3 Basic elements of a compliance management system according to IDW PS 980
Source: Institut der Wirtschaftsprüfer in Deutschland e. V. (2010).

the one hand it aims to assure people the right to access and manage their personal information that was collected by companies or any other institution. On the other hand, it puts boundaries to what companies are allowed to do with the data, and how personal information must be stored securely. At the core of the GDPR there are seven principles that can be found in Article 5: lawfulness, fairness and transparency; purpose limitation; data minimization; accuracy; storage limitation; integrity and confidentiality; and accountability (PrivazyPlan, 2020).

Compliance communication describes the need to inform all concerned employees and, if necessary, third parties about the defined roles and responsibilities so that the tasks in the compliance management system can be adequately understood and properly completed. It also specifies how compliance risks and any rule violations are reported to the responsible bodies. The area of compliance monitoring and improvement includes reviewing the adequacy and effectiveness of the compliance management system. A prerequisite of the system is sufficient documentation. If deficiencies are identified in the course of monitoring, they are reported to the responsible department. The company's legal representatives then ensure that the weak points are remedied, and the compliance management system adjusted.

6.1.3.2 Detection of and response to misconduct

If the compliance organization receives indications of misconduct, these indications should be investigated. If the company management violates its appropriate supervisory function, it can be prosecuted in the event of proven misconduct. Internal investigations are an important means of identifying, putting an end to, and punishing compliance violations. In the course of such investigations in particular, it often becomes apparent where preventive compliance measures have failed and to what extent there is a need for making adjustments. However, it should be noted that internal investigations give rise to challenging legal problems, for the corresponding powers within the framework of the investigation process are severely limited. At this point, it might make sense to hand over a corresponding investigation to an investigating authority from the outset. Nonetheless, it should be noted that, especially for larger companies, whistleblowing systems can lead to numerous indications of potential misconduct, whereby only a few prove to be actual compliance violations after a detailed investigation. The recommended procedure in the course of an internal examination is illustrated in Figure 6.4.

Since the involvement of employees in internal investigations plays a decisive role, it may be worth considering granting amnesty to the interviewees in exchange for their cooperation (Moosmayer, 2015). However, the latter cannot refer to their exemption from investigations by the authorities. Of course, the company here has no co-determination rights. Rather, it is a question of exemption from civil liability, as well as from repercussions under employment law. Especially in the case of agreements relevant to antitrust law, often there is no written evidence and the statements from employees are decisive. Of course, it must be ensured that an amnesty is only granted in justified individual cases, otherwise this regulation could be systematically exploited by the concerned employees.

A company must take appropriate action in response to a misconduct uncovered in the course of an internal investigation. Otherwise, employees will quickly perceive the compliance regulations as mere lip service. Compliance with the regulations can hardly be expected if word spreads that there are no real consequences for misconduct. The first response to misconduct is to impose sanctions under labor law. Depending on the severity of the infringement and the applicable legal situation, these may be admonitions, warnings, the exclusion of bonus payments or other optional salary

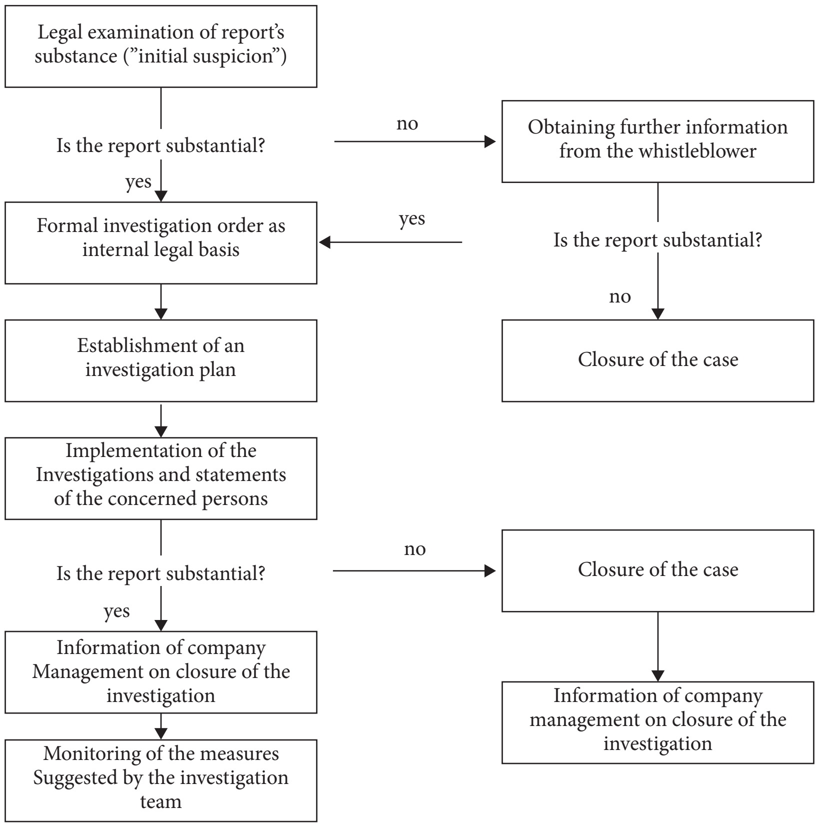


Figure 6.4 The structure of the internal investigation process
Source: authors' depiction, based on Moosmayer (2015, pp. 88–89).

components, transfers and termination without notice or ordinary termination. If the employee remains in the company after the disciplinary measures, additional compliance training is required to prevent future misconduct.

6.1.4 The compliance organization

A company must take appropriate action in response to a misconduct uncovered in the course of an internal investigation. In order for compliance to best perform its basic functions of preventing, detecting, and responding to misconduct in the company, it needs to be adequately integrated into the organization. Moosmayer (2015) distinguishes between two basic models: the autonomous organization and the matrix organization.

In the autonomous model (see Figure 6.5), compliance performs each of the above basic functions. All units responsible for compliance report to the

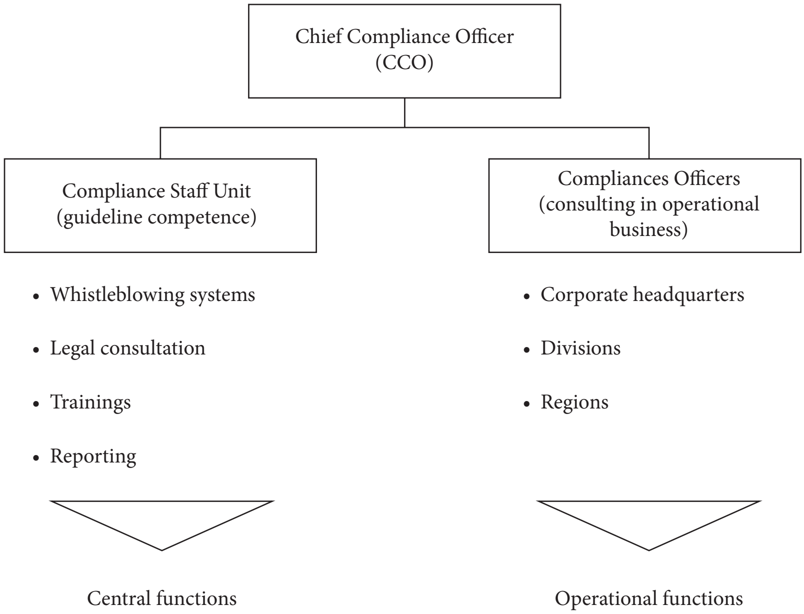


Figure 6.5 Autonomous organization of compliance
Source: authors' depiction, based on Moosmayer (2015, p. 32).

Figure 6.6 Matrix organization of compliance
Source: authors' depiction, based on Moosmayer (2015, p. 33).

Chief Compliance Office (CCO), which consequently has technical access to the entire compliance process within the company. Within a matrix organization (see Figure 6.6), the actual compliance department is limited primarily to the function of prevention. Detection of and reaction to misconduct, on the other hand, is only coordinated in a functional manner. Ultimately, it is carried out by other departments in the company such as the audit department or the human resources department. Such a matrix organization usually has a compliance committee, consisting of the CCO and the heads of department involved in the process. The matrix organization ties up fewer resources than the autonomous organization, but requires increased coordination efforts (Moosmayer, 2015). As a result, large companies unsurprisingly tend to opt for an autonomous compliance organization, while medium-sized companies are more likely to opt for a matrix organization.

Regardless of whether a company decides on the autonomous organization or the matrix organization for the structural underpinning of the compliance department, it is crucial that compliance has the option with company management to immediately escalate their investigation. The compliance organization must provide management with a conclusive picture of the company's risk situation and provide information on the development of the three basic functions. This requires that all necessary data have been collected from the operational units of the company and processed into an overall picture (Moosmayer, 2015).

Most companies (82 percent) assess company-wide compliance risks, two-thirds do so at least annually. A total of two-thirds of all German companies have internal anti-bribery/anti-corruption guidelines. In total, 76 percent of all companies have one (or more) official compliance officer; at least half of all companies now have an independent CCO (59 percent) or CCO in executive committees (50 percent). However, compliance is only of the highest priority for 54 percent of the CEOs of German companies. Compliance measures, therefore, are not firmly anchored in many companies.

At many companies, compliance is not a permanent item on the agenda at board meetings (44 percent), employees are not aware of whistleblowing hotlines (79 percent), or CCOs do not report directly to the CEO (62 percent) (Ernst & Young, 2017; Hogan Lovells, 2019). The compliance organization reports to the board of management at least quarterly in almost two-thirds of the companies. However, only 31 percent do so to the supervisory board. Nineteen percent of companies do not report at all to their supervisory board (Deloitte, 2019). More than half of all CCOs surveyed believe that many employees are unaware of the company's internal compliance guidelines.

Even large companies still often have small compliance teams and budgets. A little more than 80 percent of companies with less than 1,000 employees and roughly 60 percent of companies with 1,000–9,999 employees have only up to three full-time compliance positions. In contrast, 84 percent of companies with more than 100,000 employees have at least four full-time positions in this area and 40 percent of companies of this size have even more than 30 full-time positions. Not even one-third of all companies have an annual compliance budget of more than 500,000 dollars. While the compliance budget of a little more than a third of companies with more than 10,000 employees exceeds 5 million euros, 75 percent of small companies (less than 1,000 employees) have an annual compliance budget of less than 250,000 euro (Deloitte, 2019).

The key areas for which compliance departments are generally responsible include compliance training, the development of codes of conduct, and the handling of complaints and whistleblowing. The stated core tasks have remained constant, suggesting that there is consensus on the central tasks of the CCO. Only 23 percent of all German companies (globally: 31 percent) rated their own ethical standards as "very high" in 2017 and only 22 percent (globally: 34 percent) said that internal ethical standards have improved over the past two years. For a majority of CCOs (61 percent), compliance today represents a greater challenge than ever before, which is also reflected in generally growing budgets. The compliance budgets of the companies surveyed have tended to go up: In 2019, only 9 percent expected decreasing budgets in future, 62 percent expected no change, 30 percent expected an increase.

6.1.5 The limits of compliance

As explained at the beginning of this chapter, compliance can be understood as compliance with existing rules. Existing rules are not limited to legal requirements, but also include the clearly defined rules that a group has imposed on itself, as, for example, within the framework of an ethics code.

Compliance with legal and self-imposed rules alone does not protect a company from boycotts and image loss. This is true even if it operates exclusively in the business-to-business sector and therefore does not have to fear any end-consumer boycotts. The offshore activities of the non-domestic IHC Caland (today: SBM Offshore) in the Burmese Sea can serve as an example of how compliance with legal regulations does not protect against reputational damage (see practice box 6.6: IHC Caland in Burma).

Practice box 6.6 IHC Caland in Burma

The Company:

The Dutch company IHC Caland is a globally active stock corporation, today listed on Euronext Amsterdam under the name SBM Offshore. Until 2004 IHC Caland was grouped into two divisions: offshore gas and oil industry and shipbuilding. After selling its shipbuilding division, SBM Offshore is now a supplier and producer of products for the offshore industry.

Foreign investment in Burma:

In 1997, President Clinton issued a ban on new investments in Burma. The organizations BurmaNet and Free Burma Coalition (FBC) were established in 1994 and 1995 to raise awareness among the American public as to the increasingly deteriorating human rights situation in Burma. Large corporations such as Heineken, Interbrew, Philips Electronics, Hewlett-Packard (1996), PepsiCo (1997), and Ericsson (1998) withdrew from Burma. In the USA and also in the Netherlands there were consumer protests and boycotts threatened against companies operating in Burma.

IHC Caland's investment in Burma:

In 1998, IHC Caland signed a 15-year contract (until 2015) with the Burmese government for an offshore project off the Burmese coast worth several hundred million euros. The partner oil company was Premier Petroleum Myanmar Ltd, a British–Burmese joint venture, partially owned by British Premier Oil. The contract included the production, leasing, and maintenance of a Floating Production Storage and Offloading Unit (FSO). British Premier Oil itself had taken over the gas field from the US oil company Texaco, which had left Burma, probably due to the US investment ban.

Protests against the investment:

IHC Caland's involvement led to protests worldwide: The company was accused of indirectly supporting the oppression of the Burmese population with the investment, as the Burmese military government used the foreign currency to consolidate its power. During its reign, Burma suffered numerous human rights violations such as deportation, forced resettlement, imprisonment, and the torture of opposition members. The protest groups approached the IHC Caland workforce through the unions and acquired a stake in the company to attend the general meetings. In August 1998, a protest action was held at the gates of IHC Caland headquarters in Schiedam: The demonstrators laid three bloody "victims" of the Burmese regime before the gates. The action caused an uproar in the media. In addition, the protest groups appealed to Dutch companies and municipalities to not award contracts to IHC Caland as long as the company was active in Burma. In March 2002, representatives of the protest group Friends of the Earth Netherlands brought 6,000 liters of mud to the IHC Caland headquarters to draw attention to their "dirty dealings." Furthermore, the protest groups publicly exposed the financial networks around IHC Caland to show which investors were indirectly involved in the business in Burma. They also pointed out the Burmese government's involvement in the opium trade. According to the protest group, the money acquired by means of drug trafficking was being laundered through foreign investment.

IHC Caland's position:

IHC Caland took the view that their business was legitimate as long as there was no embargo on the part of the Netherlands or the EU. It argued the duty of a company was merely to act within the legal framework. In addition, IHC Caland's leadership argued that gas production through FSO was far from the Burmese coast and that intense competition in the industry was crucial to the investment. It was therefore in keeping with their obligation to the shareholders. A breach of contract would also entail costs and damage the company's reputation. There were attempts to impose an embargo on Burma in both the Netherlands and the EU, but the bans failed. IHC Caland explicitly pointed out that moral issues did not play a role in the company's exclusively business-to-business relationships. Nevertheless, the pressure intensified on IHC Caland: The company at first had difficulties financing the investments, as Dutch banks refused to fund them because of the considerable political risk. In addition, the banks indicated that their relations with the USA could deteriorate significantly following the US investment ban against Burma.

Code of conduct and further investments:

In 1999, IHC Caland announced its intention to establish a code of conduct after it was proposed by two shareholders (ABN-AMRO and ABP Pension Fund). Nevertheless, IHC Caland maintained its practice of concluding lucrative contracts in countries where there was no official embargo (1999). At the end of 1999, it came to light that IHC Caland had signed another small contract with Burma for a dredger. After renewed criticism, the leadership pointed to a lack of international guidelines, and the fact that a dredger cannot violate human rights. In 2000, ABN-AMRO and ABP sold their shares in IHC Caland. In the meantime, the company published its first code of conduct. Other companies left Burma under the pressure of Burma Centrum Nederland (BCN) and the trade organization FNV Burma.

Continued

Practice box 6.6 Continued

A compromise:

For the first time, IHC Caland announced that the company did not want to sign any new contracts with Burma. This met with criticism just the same, as the current contract was set to expire on schedule by 2015. Shortly afterwards, management announced that the new policy had cost the company a new order for three new oil production vessels worth 6 million euros. Ultimately, the order went to China. Finally, IHC Caland's partner British Premier Oil left Burma and sold its stake in the gas field to the Malaysian oil company Petronas. BCN and Friends of the Earth Netherlands now called on the five banks financing the project in Burma to pull out. Although the banks agreed, this did not exert any pressure on IHC Caland to follow suit. IHC Caland pledged to follow the OECD guidelines on voluntary rules for the conduct of international companies in 2000. These guidelines contain recommendations for dealing with employment relations, customer protection, human rights, and environmental protection. On the other hand, these directives do not prohibit business transactions with "rogue states." In 2003, representatives of IHC Caland met with the Burmese ambassador in London to express their concerns about the human rights situation in Burma (especially forced labor). They asked the ambassador to take up this issue with the government. The company also asked its partner, Malaysian Petronas, in Burma to follow OECD guidelines. IHC Caland and the trade organizations FNV and CNV reached a compromise whereby FNV and CNV would check within a year's time whether the company was implementing the OECD guidelines in Burma.

Outlook:

Peace activist Aung San Suu Kyi continued to advocate for an economic, tourism, and aid embargo while the military regime was in power. The US administration under President Bush imposed tougher sanctions on Burma in 2003, banning imports from the country, freezing Burmese government capital in the US, and banning government officials from entering the USA. The law must be annually ratified.

Source:
de Bakker, Frank and den Hond, Frank (2011). Case Description: A Disputed Contract—IHC Caland in Burma. In: W. Dubbink, L. van Liederkerke, and H. van Luijk (Eds.), *European Business Ethics Cases in Context*. Wiesbaden: Springer.

To avoid such risks, a company must therefore take stock of itself in the course of a continuous learning process. It must ask whether the existing rules are still up to the task or whether new rules are in fact required, for instance to account for recent developments. Effective risk management therefore requires a company to anticipate societal developments in the area of social responsibility and, if necessary, to impose rules on itself even before they are legally codified. While compliance rules can be regarded as exogenous, the domain of corporate social responsibility (Section 6.3) raises the question as to which rules a company should submit itself. In contrast to compliance, rules must therefore be regarded as endogenous within the context of corporate social responsibility.

6.2 Different perspectives on corporate responsibility

6.2.1 Corporate ethics as profit maximization

The starting point of many discussions on the subject of corporate ethics is the problematic view that the actual, even exclusive, responsibility of a company lies in meeting the long-term interests of its shareholders. This ethical approach to profit maximization draws on the theoretical concept of the company as an institution with long-term interests. Probably the best-known representative of this position is Milton Friedman (1912–2006), the Nobel Prize winner in economics (1976). His article "The Social Responsibility of Business Is to Increase Its Profits" (Friedman, 1970), published in the *New York Times* in 1970, became a central touchstone in the ethical discussion on corporate responsibility for all other approaches. According to Friedman, the only responsibility a business leader has is: "To use its [the company's] resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud" (Friedman, 1970).

In order to correctly classify this theory of profit maximization, it is necessary to consider two fundamental points first:

The corporate ethical approach of profit maximization can only be understood in the context of the neoclassical paradigm. As long as ownership rights are clearly defined and the free exchange of property can take place via efficient markets, there should be an optimization of the results (Coase, 1960). The incentives for companies are plain from the explicit property rights: Every company tries to generate the most efficient result possible from the limited resources it has. A company that manufactures and sells products thus promotes the prosperity of a society. A company acts responsibly when it makes maximum profit from the limited resources at its disposal. The neoclassical paradigm assumes that individuals basically act according to their own interests in their actions and decisions. Friedman makes clear that the interests of individuals can be very dissimilar and must be seen in their interaction with the interests of others, so that there is a mutual advantage.

The second important point relates to the systematic perspective of this approach. The focus is on justifying a property-based free-market economy and the associated promotion of welfare. Such a market economy is an expression of a free society in which individuals can make important decisions in two respects: First, they have fundamental economic freedoms that enable them to act as consumers and producers in the marketplace without having to be heteronomously driven to an excessive extent by state bodies. Secondly, as citizens of the state, they have a political say (such as the right to vote and stand for election) to influence political decision-making. Above all, the possibility of exerting political influence allows individuals to protect their freedoms in the economic sphere from encroachments by the state.

According to Friedman's approach to business ethics, the false—because excessive—demands on entrepreneurs to fulfill certain social, ecological, and other objectives that are not in line with profit maximization are a threat to the liberal economic system. They supposedly result in a loss of prosperity or even a decline in the free economic order.

Against this backdrop, it is clear why many economists have gravitated to this approach. After all, the question of whether a company has any responsibility outside the dimension of profit maximization does not even arise. Irresponsible behavior is only at issue to the extent that the aim of maximizing profits involves actions that violate the law, i.e. are illegal or violate fundamental ethical norms of a society. The fact that Friedman emphasizes this point is often ignored or marginalized, especially by his critics. In his work *Capitalism and Freedom* (Friedman, 1971), he clearly states that a company should maximize profits as long as it acts within society's regulatory framework. Friedman even goes one step further, demanding that every individual in a society work together to create a regulatory framework in which the often-quoted Smith's invisible hand (Chapter 1) benefits everyone. What matters is that the self-interested actor increases the prosperity of all without ever having had this in mind, let alone having actually intended it. The core task of the state is to establish and maintain this regulatory framework. The greatest possible leeway must be given to the market and the associated free development of the acting individuals. By the same token, this means that the power of the state must be curtailed, especially in its ability to intervene in market processes. Friedman does not assume that markets function perfectly once they are unregulated and grow. This criticism of his approach is unfounded, for it is precisely to keep the markets functioning properly that certain "rules of the game" must be created exogenously, above all through state regulation. On the other hand, any additional government intervention at the level of market participants' actions would be counterproductive.

Starting from this premise of a free market economy of free individuals, Friedman further argues that companies are organizations that emerge from the free association of individuals and their property. Friedman believes that this fact gives rise to the right to determine the objectives and tasks of these associations. A company is ultimately "an instrument of the stockholders who own it." The right to property thus entails here the possibility to determine which targets should be set for the company and who is to be responsible for implementing them. The latter is central, for owners usually hire managers to handle their day-to-day business for them. Friedman claims that an entity such as a company cannot be responsible for any particular action at all and that the category of accountability only applies to persons. According to Friedman, then, the term "corporate responsibility" is a semantic error—only individuals in the sense of natural persons possessing decision-making authority can be held liable for their actions.

This leads to another important point that Friedman underscores: the suitability and ability of managers to achieve social goals. The assumption that companies should do more than just maximize their profits is often fueled by the perception of companies as resource-rich and well-organized actors with the "power" to bring about fundamental improvements of a social nature. However, if one assumes that companies or their executives have a responsibility that goes beyond maximizing profits, the question arises as to how they can specifically recognize this responsibility. How and under what circumstances can an individual know whether a certain use of resources serves the "social interest" if the responsible manager cannot know what the "social interest" is?

The relationship between owner and manager is that of a principal and his or her agent.[1] In the final analysis, the agent is primarily bound to his or her principal. The goal of profit maximization has the advantage that the principal can generally assess the degree of its fulfillment—in other words the quality of the work of the agent—since the figures are easily accessible. In addition, managers have usually been trained to act in way that is consistent with the principal's expectations. This stands in contrast to achieving any kind of "social" goals that are neither in the principal's immediate interest nor within the manager's competency. Compliance with the legal framework and fundamental moral standards already account for the potential responsibility of managers towards other stakeholder groups (such as suppliers, customers, and employees). The manager's fiduciary duty is to use the funds entrusted by the owners to achieve their objectives. No further obligation exists. If the manager is expected to maximize more than just the profit and this requirement is supposed to be more than mere rhetoric, then it means the manager has to act in a way that serves the interests of the owners and thus the company has been entrusted to manage.

The emphasis on the social responsibility of companies, which, much to Milton Friedman's displeasure, is also propagated by managers, seems to imply on a semantic level that the quest for profit is problematic and wrong in itself and that a sense of social responsibility is needed to serve as a corrective for the otherwise morally questionable quest for profit ("it helps to strengthen the already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces" (Friedman, 1970)). If it then becomes apparent over time that managers are not able to fulfill the hopes placed in them, the path is wide open to the "iron fist" (Friedman, 1970) of government bureaucracy.

The accompanying state coercion endangers all the prerequisites that are constitutive of a free social order: private property, competition, and individual discretion over the use of lawfully acquired property.

Friedman's position is correct in many respects and his criticism of the concept of social responsibility seems valid. This is where the question arises as to why business ethics is still necessary. The answer is that while Friedman's criticism spoke to the era of 1970, it is less apt in the twenty-first century. In some points, it remains highly germane, in other respects it is insufficient or one-sided. Friedman distinguishes between the right form of social responsibility, namely that of maximizing profits under the appropriate conditions, and the wrong form. The latter encourages managers to misuse company resources, which leads to the risk of diminishing the perceived legitimacy of the market economy and thus the fundamental order of freedom. Yet, a distinction must also be made on a deeper level: the type of profit maximization. A "right" form of profit maximization, which adheres to the rules and brings prosperity to society and businesses through its institutional integration, contrasts with a "misguided" form which makes profit maximization possible at the expense of third parties (Suchanek, 2004).

This distinction, which Friedman does not address, is the starting point of business ethics research. Resolving these cases only in favor of direct profit maximization could have just as serious ramifications as the assumption Friedman criticizes, namely, that social responsibility is preferable to profit maximization. These cases are characterized by the fact that managers can find themselves in situations where they are able to achieve an increase in profits by taking an action that—in actual fact or at least in the minds of most people—comes at the expense of third parties. Examples of such situations are easy to find: Whenever Friedman's "rules of the game" provide a certain latitude, they can be irresponsibly exploited. Thus, a company could outsource production to a country where child labor is not a punishable offense or where corruption is routine in the contracting of products. Latitude for increasing profits at the expense of third parties can also occur even in Western societies, which have a functioning set of laws and institutions. For instance, a company with considerable market clout and liquidity can deliberately delay the payment of invoices to suppliers, putting the latter in a situation that threatens their existence. Such behavior carries as much risk of undermining the market economy as a focus on social justice, criticized by Friedman. If companies continually decide to increase profits at the expense of legitimate third-party interests, they run the risk of losing their "license to operate," which is critical to their success and the acceptance of the market economy in general.

While Friedman sets limits to profit maximization in the form of laws and fundamental moral norms, they do not adequately solve these problems. Taking recourse, however, to the position that these examples do not violate laws, but fundamental moral norms only defines the problem out of existence. Likewise, advocates of the concept of social responsibility could argue that the "correct" perception of social responsibility always entails the interest of the company without endangering the fundamental order of freedom. It is therefore essential in business ethics to discuss the problem of the "incorrect" way of maximizing profits and to illustrate the opportunities and risks to a company. The opportunity for a company to maximize profits depends to a large extent on the institutional framework, which itself is to a certain extent determined by how companies put their profit objectives into practice. If the majority of the population finds that an undesirable form of profit maximization predominates at the expense of third parties, companies may find themselves disadvantaged due to institutional changes, such as in the law.

The matter of how to implement a company's profit maximization strategy is therefore critical. The question that arises is this: How does Friedmann's approach deal with strategies for maximizing profits, which are wrong and undesirable in the eyes of society? Suchanek (2004, p. 115) offers a good example in possible "hit-and-run strategies." Such a strategy enables a company to generate short-term profits with products and services that are of inferior quality and not sustainable. Soon the companies pursuing this strategy will leave the market, however, and thus do not have to make any investments in a lasting reputation.

Friedman has not overlooked these short-term forms of profit making, but he implicitly plays down their importance by pointing to market forces: To begin with, in his view such behavior would be sorted out by the market and would therefore not be incentivized. Any undesirable behavior, after all, would be punished by the company's shareholder groups. What is more, customers, investors, and suppliers could end their cooperation with the company.

Secondly, in cases where market forces could not produce the desired result through the right incentives, the state regulatory framework—Friedman's so-called "rules of the game"—would still apply. He recognizes this primarily in obligation, especially when it comes to so-called external effects (or externalities) or what Friedman calls "neighborhood effects." By adapting the regulatory framework and thereby preventing harmful behavior, bad forms of profit maximization could therefore be successfully sanctioned and prevented. Thus, the state should ultimately "resolve all those conflicts of profit and morality…that are not resolved by the market itself" (Suchanek, 2004, p. 116).

If one looks at Friedman's argumentation in the light of his scholarly oeuvre, one notices an inherent problem: In order for the state to ensure that undesirable forms of profit maximization are excluded by a particular regulatory framework, it must have both regulatory capacity and the power to implement these regulations. Throughout his life, Friedman argued, if not for an abolition, then at least for a strong restriction on state activities, especially state interference in the free forces of the market. For Friedman, the individual's economic freedom was the basis for a free society. In his assessment of the state's ability to act sensibly, he even claimed that if the state were to take care of the Sahara, it would manage in a short time to have no more sand. So how can putting constraints on the state due to the threat to individual freedoms and general regulatory incompetence be reconciled with the demand for a good regulatory framework that remedies all problems?

For Friedman's approach this leads to the one of two problems: Either the state should be accorded more power and influence, at least with regard to the regulatory framework and its design, or the reference to the state regulatory framework is insufficient to prevent all undesirable forms of profit maximization, which is specifically relevant to the question of business ethics. Friedman spoke of two restrictions within which companies should maximize their profits: the rules of the game, i.e. the institutional framework (the totality of regulations and rules), and basic moral principles. So long as neither has been violated, profit maximization remains the sole imperative of an enterprise. However, if the regulatory framework is incomplete in some respects and thus permits socially undesirable forms of the profit maximization, this task can hardly be passed on to state actors alone in a liberal society. Rather, it seems that in addition to the two above-mentioned restrictions on companies, there is also a responsibility: They are responsible for maintaining their future autonomy of decision-making and if possible for improving their respective conditions by resolving profit-morality conflicts (Suchanek, 2004).

In some respects, companies share responsibility for whether or not a framework is viable. Since it is in the companies' own interest to minimize state regulations as much as possible, it also seems sensible from their—long-term—perspective to follow the rules of the regulatory framework. This is true even if is disadvantageous in individual cases—if, for instance, short-term success can be achieved with a low probability of detection. Ultimately a society will only give companies greater room to maneuver over the long term if it is convinced that they are not being exploited and that a more constrictive straitjacket and expensive monitoring would turn out to be superfluous. If the social consensus is constructed in such a way that society basically trusts companies to not abuse their freedoms by acting against the legitimate interests of third parties, it waives having a detailed and comprehensive regulation. The resulting latitude can often be cheaper for companies and preserve the flexibility they urgently need in competition.

6.2.2 Corporate ethics based on the honorable businessman

6.2.2.1 The revival of the honorable businessman

Since the end of the 2000s, efforts have been made to revive a venerable concept of corporate management: the honorable businessman. Then Federal President Horst Köhler (2004–2010), for example, spoke out in several speeches in favor of a return to this concept, as did the President of the Association of German Chambers of Industry and Commerce. Institutions like the Protestant Church drew attention to the principles of the honorable businessman and demanded that company leaders adhere to them. The financial crisis and the failure of the financial elites were seized upon as an opportunity to revitalize this approach.

For starters, the concept of the honorable businessman can be described as a collection of correct or desired behaviors. These basic ethical rules—often in the form of codes of conduct—contain above all appeals to the business elites to embody certain virtues in their actions. A prominent example of this is the manifesto "A Model of Responsible Business Conduct" ("Leitbild für verantwortliches Handeln in der Wirtschaft) published in 2010, which was signed by many top German business executives, including Josef Ackermann, then CEO of Deutsche Bank AG, former Siemens CEO Peter Löscher, and many other DAX board members and leading employees of influential German companies. In the political arena, the CDU Economic Council, among others, has made a name for itself with the publication of the "Ten Manager Commandments."

In the face of public demand for returning to the principles of the honorable businessman, it soon becomes apparent that the concept is not based on a general principle or even a uniform ethical theory. Still, its proponents view it as a normative model, whose roots can be traced back to the merchant culture of the northern Italian cities and northern German merchant strongholds (above all the Hanseatic League) of the late Middle Ages. There is no clear definition of the term. However, some terms are repeatedly mentioned as buzzwords in connection with the notion of the honorable businessman: honesty, moderation, accountability, decency, meticulousness, reliability (in the sense of keeping one's word), sustainability, integrity, and role-model function.

A glance at this list shows that the concept of the honorable businessman is very similar to the concept of corporate social responsibility. But, there is a significant difference between the two conceptions: While corporate social responsibility operates on the level of the business, the concept of the "honorable businessman" specifically deals with acting persons—the merchant, the manager, the banker, or the CEO. It is therefore not primarily concerned—at least not directly—with promoting the ethical behavior of a legal person in the form of an enterprise. The approach of the honorable businessman is aimed at personal qualities, that is the character of the entrepreneur. The concept of the honorable businessman is thus an individual ethical concept, which places moral demands on the individual that apply independently of external factors. Due to the strong connection to individual character traits and virtues, the honorable businessman can be classified as a virtue-ethical approach. By focusing on the individual, his or her values and abilities as well as virtue and strength of character, the model of the honorable businessman fits best into the realm of small and medium-sized businesses. The relationship to other concepts of responsibility such as corporate social responsibility remains unclear, albeit there are undeniable similarities between the honorable businessman and some approaches to CSR. CSR, however, is aimed more at larger companies, since value-based individual ethics increasingly reaches its limits with the greater size and complexity of the chain of responsibility.

The concept of the honorable businessman is to be understood as a point of orientation for certain branches of industry. There is nothing unusual about this. In fact, many professional groups have guiding principles, which may not always be practiced, but nevertheless have a binding character. Guiding principles can be found among others among doctors, lawyers, or craftsmen. For example, the first paragraph of the “Gesetz zur vorläufigen Regelung des Rechts der Industrie- und Handelskammern” (“Statute on the Provisional Regulation of the Law of Chambers of Commerce and Industry”) originally promulgated in 1956 refers to the model of the honorable businessman:

> ...it is incumbent on them in particular to support and advise the authorities through proposals, expert opinions, and reports and to work for the preservation of the decency and customs of the honorable businessman.
>
> (IHK-Gesetz, 2017, §1, para. 1)

The duties of the honorable businessman are summarized as follows: “The honorable businessman should, firstly, commit himself as a person to the preservation of values, secondly, create conditions for honorable action in his company and, thirdly, help shape the framework for honorable action in business and society (IHK Nürnberg, 2012).

The Hamburg-based association “Versammlung eines ehrbaren Kaufmanns zu Hamburg e. V.,” which is committed to the model of the honorable businessman in the Hanseatic tradition, describes the model of the honorable businessman in this way:

> The honorable businessman is cosmopolitan and liberal-minded. The honorable businessman’s word is his bond; his handshake counts. He extends and demands trust in commercial relations. The following applies to him: fair negotiating, punctual performance, correct invoicing. The honorable businessman develops his business acumen. He has sound economic knowledge that enables him to run his business successfully. The honorable businessman is a role model in his behavior. He is guided by his values, even when he finds himself in difficult situations. The honorable businessman creates conditions within his company for acting honorably. He influences the organization and appears to embody his maxims. He passes on the values of the honorable businessman to future generations. The honorable businessman has a long-term and sustainable approach to his entrepreneurial activity. He reflects on the consequences of his actions for his company and his environment.

Despite the similarity of the demands put on the model, the principles derived from it are nonetheless indeterminate and abstract. Since the concept of the honorable businessman obviously lacks a uniform basis, we would do well to understand its conceptual significance as well as its historical development and transformation over time. Unquestionably, the former is strongly to the latter, since both the concept of the businessman and—and above all—the understanding of “honor” was and still is shaped by historical developments.

6.2.2.2 The concept of the honorable businessman

The term “businessman” basically refers to economic subjects who conduct any kind of commerce. This includes classic retail tasks in the form of purchasing and resale as well as manufacturing, in which products are produced and then sold. The title of “businessman” implicitly entails a certain degree of autonomy. The concept is thus primarily aimed at decision-makers, rather than specialized employees involved in processing.

The concept of honor, on the other hand, is far more complicated, for its implications have fluctuated considerably over time. Notions of “honorable” or “dishonorable” acts can only ever be interpreted in a social context. The Old High German root (êre), supplemented by the Greek *τιμήεὐδοκία* (good reputation), emphasizes the term’s social character. An action is honorable if it is assessed positively by society, i.e. if it meets the accepted norms or even exceeds them (so-called supererogatory actions). This is affirmed by the Latin term honor, which can be translated as “recognition.” In the history of ideas, honor is often regarded as a dual concept. There is internal and external honor: The latter pertains to the evaluations of the social group, namely, outsiders; the former concerns the feelings of the individual about his or her actions or conscience. This dichotomy is not clear-cut, for internal honor is the necessary condition for other people being able to witness an act’s honorable character (Schwalbach and Klink, 2012). Not every action that is regarded as honorable in society, however, is also necessarily conceived by the acting individual as honorable. It is not difficult to imagine an individual, who, against his own better judgment, disguises what he considers to be a dishonorable act so that it appears honorable to the outside world. On the other hand, it is likely that the individual’s social milieu would not describe the action as honorable if it knew there was some kind of deception.

This dichotomy is part of the inherent makeup of the concept of honor (Burkhart, 2006). It is important with regard to the businessman inasmuch as his work makes him dependent on the community. Economic activity always take place in a social context. Even in today’s far-flung globalized world, a company’s reputation is critical. The above-mentioned “Model of Responsible Business Conduct” accordingly states: “Our aim with the model is to establish visible and verifiable standards of responsible corporate action that are suited to everyday use. This should be in alignment with society’s expectations and values. To this end, the model also draws on the existing principles and initiatives of companies” (employers.de, mission statement).

In the scientific literature, the concept of the honorable businessman has so far primarily been examined conceptually (Schwalbach and Klink, 2012; Lütge and Strosetzki, 2017). Special attention has been paid to its distinction from corporate social responsibility approaches. The ethical content of the concept is also discussed as well as its applicability to the conditions of the modern business world. In some ways, they differ fundamentally from the historical context that gave rise to the concept of the honorable businessman. In business ethics matters, the key aspect in the concept of the honorable businessman of trust certainly touches on a central point. It is by no means a selling point that is unique to this approach, however.

Finally, the term is partly used to refer to the conduct of family entrepreneurs who have made certain personal values the basis of their business.

Today, virtue-ethical approaches such as that of the honorable businessman are also increasingly popular. Similar concepts of a character-based moral code are once again being discussed in the United States and elsewhere. Harvard Business School issued a code for all its future graduates in order to ensure "ethical conduct" in business-related decisions. The so-called "MBA Oath" focuses on the personal characteristics of future entrepreneurs. Similar to the concept of the honorable businessman, individual entrepreneurs are entrusted with upholding an ethical market economy. Among other things, the graduates who sign the "MBA Oath" (Harvard University, 2008) commit themselves

- to not promoting their own interests at the expense of their company or society,
- to rejecting corruption and avoiding business practices that do harm to society,
- to supporting the larger management profession, to acting ethically and to creating sustainable and accessible prosperity, and
- to reinforcing integrity and confidence in oneself through one's own behavior—especially with respect to those one serves.

The "MBA Oath" concludes with a reference to one's own honor ("Upon my honor," Harvard University, 2008) and the voluntary nature with which the oath is signed. The oath is explicitly not meant to be legally binding, but rather regarded as the voluntary commitment of the signatory to implement the values and guidelines contained therein.

Harvard Business School is leading the way with this concept. As one of the world's top business management schools, it is providing a prominent stage for individualistic concepts and moral codes based on personal honor.

It should be noted that these approaches, especially that of the honorable businessman in Germany, are widespread and that many people share their basic demands. The individualistic approaches will be critically examined in the following.

6.2.2.3 Criticism of the concept of the honorable businessman

The concept of external honor has not only changed historically, but it has also been subject to intercultural fluctuations (Lütge and Strosetzki, 2017). The concept of the honorable businessman is accordingly difficult to grasp. Different cultures have different understandings of honor. It may be necessary, therefore, to behave differently in different markets to receive and retain the social recognition of the respective society. It may be concluded, then, that the concept of the honorable businessman cannot have immutable content but must be adapted to the expectations of society. While it is still conceivable that certain values are permanently shared within a certain cultural sphere, the characteristics and virtues that make the honorable businessman appear virtuous in the intercultural market are unclear and undefined.

What is more, the question arises as to how an ethical model such as the honorable businessman can be implemented in concrete terms in the context of value pluralism. Even if it were possible to agree on certain values—at least within a certain cultural sphere—there would be obvious disparities in the actual evaluation and respective weighting of particular actions. The concept of the honorable businessman therefore cannot serve as an unambiguous yardstick.

There is also the problem within the free market economy that the requirement for an honest businessman may be superfluous. Companies have an inherent interest in being perceived by other interaction partners as trustworthy and reliable, that is, "honorable." It is also doubtful whether motivation in the form of internal honor is verifiable or even relevant. A businessman who disregards virtue in his actions but does exactly what is expected of him in purely instrumental terms would not be an honorable businessman. This is true even if his behavior appears proper to the outside world and if his social environment ascribes to him many of the attributes listed above. The model's focus on the aspect of trust is also not unique. The importance of a trust-based relationship in the economic sphere is emphasized by most approaches of corporate ethics.

Another strong point of criticism is that the concept of the honorable businessman is no longer in keeping with the times. In hindsight, the concept appears to have been developed at a time when economic activity and the structure of society were much simpler. To be sure, a good reputation is still of central importance. However, "honorable" behavior was easier to control socially in the late Middle Ages. In particular, businesses could often be attributed to specific individuals and were not carried out in large organizations with complex chains of action and responsibility.

This latter criticism reflects the reality that individual ethics in the complex, modern world is highly contingent. The complexity of the modern business world requires the implementation of ethical values in the form of rules and institutions. By contrast, the emphasis on the personal traits and virtues of the classical merchant seems to be an artifact of the past. Individual appeals to business people to behave “morally” are not feasible as long as the competition does not uphold these “honorable” characteristics in its own conduct and can thus gain an advantage. Confidence-creating behavior is certainly essential for many companies, but above all because having an excellent reputation is an investment in the future. Upholding a “concept of honor” in the sense of exhibiting the strength of character which the concept demands seems unnecessary at best (assuming it pays to be honest) and an existential hazard at worst.

In conclusion, it can be argued that the concept entails an outdated normative ideal of the entrepreneur. The honorable businessman connotes rather a trustworthy and upright civil servant. Yet the dynamism of entrepreneurship cannot recede into the background—we need an ethics for a modern and vibrant commercial society (Lütge, 2019). Here it is difficult to reconcile the honorable businessman with Schumpeter’s notion of creative destruction.

6.2.3 Corporate ethics as management of moral risks

6.2.3.1 The Ford Pinto and the birth of corporate ethics

The Ford Pinto rolled off the production line in 1971. It was a low-priced mid-range car that competed with comparable models from Japanese and German manufacturers and cost no more than 2,000 dollars. Years later, the case of the Ford Pinto would go down in history as a corporate scandal which, from today’s perspective, represents a milestone. It contributed to nothing less than the awakening of a public corporate ethical conscience. So, what happened?

Due to a specific design flaw, the model occasionally went up in flames in the event of an accident. To date, there have been 27 deaths and 24 serious injuries in accidents. Other estimates, however, are significantly higher with 500 to 900 deaths caused by vehicle fires. According to Douglas Birsch and John Fielder, who comprehensively analyzed the case in their edited book *The Ford Pinto Case*, the actual number probably lies somewhere in the middle (Birsch and Fielder, 1994, pp. 9f.). The car was designed in such a way that the fuel tank was behind the rear axle. The tank was therefore susceptible to being damaged in rear collisions at comparatively low speeds. In an accident, leaking, highly flammable petrol could set fire to the vehicles in question, resulting in devastating consequences for otherwise minor accidents.

This problem, however, did not come as a surprise to Ford. Engineers had pointed out the danger already in the build phase. They suggested minimizing the risk of leaking petrol by using rubber covers that would be placed around the tank. But instead of equipping the model in this way, Ford's management took account of the costs: Retrofitting the vehicles with rubber covers would have cost 11 dollars per vehicle, which would have meant a total of 137.5 million dollars with 12.5 million planned cars. Ford, conversely, tried to estimate the costs of not retrofitting: They estimated that 2,100 vehicles would burn with an average fair value of 700 dollars. Furthermore, the management took 180 deaths and 180 serious injuries into account. As a "value indication" for a dead person, Ford used the official statement of the US government at the time, namely 200,000 dollars. For each seriously injured person, they reckoned with the 67,000 dollars estimated by insurance companies at the time. Consequently, the calculated damage resulted in a total of 49.5 million dollars, about a third of the amount Ford would have had to pay for retrofitting of the tanks. The company management therefore decided against doing this, and the Ford Pinto was still produced with unprotected tanks. Predictably, there were 60 fatal accidents in the years that followed, and 120 people were seriously injured. The Pinto was finally taken off the market in 1980, although this corresponds to an average product cycle.

An article by journalist Mark Dowie (1977) entitled "Pinto Madness" helped unleash a highly critical public response against Ford's actions. Be that as it may, how should this case be assessed from an ethical point of view? The following points could be seen to mitigate Ford's moral culpability: No statutory regulations were violated in the construction of the Pinto. According to regulations, a car's tank only had to remain intact in rear-end collisions at a speed of 20 miles per hour. The Pinto met this requirement. Moreover, according to Ford, the Pinto was statistically no less safe than other cars on the road. The deliberate decision against retrofitting the Pinto can also be justified by the fact that this would have constituted 0.5 percent of the vehicle's sales, a considerable amount that could have had an impact on the model's overall profitability. Finally, it should be noted—again in Ford's favor—that the value of a human life is constantly evaluated whether when assessing the economic implications of a road-safety measure or for insurance purposes.

Nevertheless, the Ford Pinto case developed into one of the most severe and notorious scandals in automotive history. How did this happen? Looking back, the scandal can mainly be traced to the revelation of Ford's cost–benefit calculation, which was met with a considerable public uproar. As the first US company to be charged with manslaughter, its reputation was severely damaged. Ultimately, however, it was not convicted of any crime. The Pinto case can be seen, alongside other scandals, as the beginning of corporate ethics. First, it marks the emergence of an increasingly critical public that began to demand responsible corporate behavior. This also meant, second, that companies now had to take their reputations into consideration. At the very least, the Ford Pinto case showed that reputational damage to a company can lead to devastating financial losses.

6.2.3.2 Cambridge Analytica and the timeliness of corporate ethics

While the Ford Pinto case is considered the birth of corporate ethics, there are of course numerous other cases involving well-known companies that illustrate the existential reputational threats of disregarding corporate responsibility. One of the most prominent recent ones was the scandal around the data-analytics company Cambridge Analytica that had a profound negative impact on the image of the social-media giant Facebook. In July 2019, the US Federal Trade Commission (FTC) announced the imposition of a $5 billion penalty on Facebook for the violation of their users' privacy. According to the FTC, this penalty was the world's largest fine ever imposed on a company for violating consumer privacy (FTC, 2019). FTC Chairman Joe Simons states the decision was made due to Facebook repeatedly undermining consumers' choices, which is why the FTC aimed "not only to punish future violations but, more importantly, to change Facebook's entire privacy culture to decrease the likelihood of continued violations" (FTC, 2019). How did the FTC come to this decision?

6.2.3.2.1 The roots of the scandal

In late 2015, *The Guardian* first reported that Ted Cruz's presidential campaign had worked with the nearly unknown data-analysis company Cambridge Analytica (Davies, 2015). This company, referring to itself as a "behavioral microtargeting company," had contracted an ostensibly academic venture, Global Science Research (GSR), under the lead of Cambridge University academic Aleksandr Kogan, to collect the data of a massive number of Facebook users (Davies, 2015; Cadwalladr and Graham-Harrison, 2018). For this purpose, GSR paid several hundred thousand Facebook users to complete an app-based personality test in June 2014 (Confessore and Hakim, 2017). In exchange for the results, the app "thisisyourdigitallife" requested permission to collect data from the respondents' Facebook profiles, e.g. demographic details and information about an individual's Facebook activity, like records of "likes" and "shares" (O'Neil, 2016). The study participants were assured that the data collected would remain anonymous and secure and would be used exclusively for academic purposes. Yet, the data was sold to Cambridge Analytica (Davies, 2015).

In 2013, researchers from the University of Cambridge's Psychometrics Centre had shown that a person's so-called "Big Five" personality profile (also called "OCEAN model" for the five distinguished personality traits openness, conscientiousness, extraversion, agreeableness, neuroticism) could be derived fairly accurately by looking at the individual's Facebook activities and other online indicators, without using a formal psychographic test (Kosinski et al., 2014). Knowing about this finding, Cambridge Analytica aimed to specify the parameters required to deduce an individual's personality profile from online data, with the intention to reveal "hidden voter trends and behavioral triggers" (Isaak and Hanna, 2018). For this purpose, the test takers' Facebook information was integrated with a range of data bought from other platforms (e.g. online purchases, bonus cards, club memberships, land registries, automotive data, electoral rolls) and then blended with their personality profiles (Confessore and Hakim, 2017; Grassegger and Krogerus, 2016). At the time of the data collection, the standard Facebook API allowed apps not only to gather information about app users, but to collect public data from all their friends' Facebook profiles (Isaak and Hanna, 2018). Thus, Cambridge Analytica could apply their psychographic analyses not only on the 270,000 survey respondents (Facebook, 2018a), but on tens of millions of other users. According to its own account, the company's psychographic profiles allowed them to "predict the personality and hidden political leanings of every American adult" (Confessore and Hakim, 2017).

Cambridge Analytica was first involved in Ted Cruz's presidential campaign for the 2016 elections and later in the Trump campaign. In both campaigns, the company's methods were intended to be used to "micro-target" potential voters, i.e. to show them political advertisements, customized to what would be most likely to influence their voting behavior (Brown, 2020; Davies, 2015; Isaak and Hanna, 2018; O'Neil, 2016). Especially in the Trump campaign, Cambridge Analytica's data allegedly largely determined the digital strategy and ultimately swung the election results, according to the company's former CEO Alexander Nix (Senate Committee on the Judiciary and Senate Committee on Commerce, Science, and Transportation, 2018; Risso, 2018). Cambridge Analytica is also said to have been involved in the Leave.EU campaign in the run-up to the 2016 referendum to increase British citizens' support for Brexit, though it remains unclear how deeply (MacAskill, 2018; Risso, 2018).

In contrast to company brochures and statements, the actual effectiveness of Cambridge Analytica's methods for targeting voters and their ability to skew elections has been questioned by political scientists and technology experts (Confessore and Hakim, 2017; Trump, 2018). These doubts are reinforced by former employees who state that the company has never demonstrated that it really can make accurate predictions on a large scale and had played a relatively modest role in the presidential campaigns, actually not even using any psychographics (Confessore and Hakim, 2017; Davies, 2015; Risso, 2018).

6.2.3.2.2 The emergence of the scandal

During a UK parliamentary inquiry on fake news in early 2018, both Facebook and Cambridge Analytica denied that the latter had acquired or worked with any Facebook data collected by GSR (Cadwalladr and Graham-Harrison, 2018). However, evidence indicates that Facebook had learned about the privacy breach already in 2015. After the first *Guardian* article had been published, Facebook stated it would "take swift action" against any company misusing users' data (Davies, 2015; Rosenberg et al., 2018). Yet, the social network did not alert potentially affected users and took only limited steps to secure their private information. In August 2016, more than half a year after they had learned of the incident, Facebook requested Cambridge Analytica to destroy all data they had received from GSR and demanded the data deletion to be confirmed in writing, but did not ask for any forensic evidence (Cadwalladr and Graham-Harrison, 2018; Rosenberg et al., 2018). As discovered in 2018, Cambridge Analytica still used the data two years later (Cadwalladr and Graham-Harrison, 2018; Rosenberg et al., 2018). Aleksandr Kogan and Cambridge Analytica were finally banned from the network only in March 2018 for violating platform policies (Facebook, 2018a).

Several articles had disclosed since late 2015 that Cambridge Analytica had amassed Facebook data (Davies, 2015) and how this data was used for political ends (Grassegger and Krogerus, 2016; Confessore and Hakim, 2017). Yet, the incident only hit the headlines in March 2018, when *The New York Times* and *The Guardian* simultaneously published their stories about the privacy breach based on insider information of a whistleblowing ex-Cambridge Analytica employee (Cadwalladr and Graham-Harrison, 2018; Rosenberg et al., 2018). Within a week, the collection of personally identifiable information of several millions of Facebook users initiated a scandal. Newspapers worldwide were writing about data misuse of Facebook and manipulative activities of Cambridge Analytica, US and UK politicians were asking questions of Facebook CEO Mark Zuckerberg. This eventually lead to Zuckerberg publishing an apology for Facebook not living up to its responsibility to protect its users' data resulting in this "major breach of trust" (Zuckerberg, 2018) and having to testify before US Congress in April 2018 (Senate Committee on the Judiciary and Senate Committee on Commerce, Science, and Transportation, 2018).

Facebook's market capitalization was reduced by roughly $134 billion within a few days after the scandal broke, yet the company recovered its losses within less than two months and posted a record revenue and profit by the end of 2018 (Mirhaydari, 2018; Facebook, 2019). For Cambridge Analytica, the incident had more far-reaching financial consequences: On May 1, 2018, 40 days after the scandal peaked, Cambridge Analytica announced it was ceasing all operations with immediate effect and had filed for bankruptcy as the "siege of media coverage [had] driven away virtually all of the Company's customers and suppliers" (Salinas, 2018). In March 2018, the FTC opened an investigation into whether Facebook had violated a 2011 settlement over user privacy protections which resulted in the aforementioned monetary penalty and the obligation for Facebook to submit to further restrictions to overhaul its privacy culture. The restrictions include explicit privacy requirements, such as the prohibition on using phone numbers obtained to activate certain security features for advertising purposes and the obligation to monitor third-party apps more closely regarding their compliance with the network's policies (FTC, 2019). Apart from this, the FTC directive includes specifications for a modified corporate structure that holds the company accountable for its decisions regarding users' privacy. Among other things, the order provides for the establishment of an independent data protection committee at board level and strengthens external oversight of Facebook (FTC, 2019).

6.2.3.2.3 Facebook's reputational damage

Although Facebook itself was not directly involved in the privacy breach, the network came under fire for the compromise of its users' data and not being proactive enough when learning about the privacy violations (Brown, 2020). As a consequence, users' trust in the company dropped by 66 percent within the first week after the scandal peaked, from 79 percent at the end of 2017 to merely 27 percent (Weisbaum, 2018). The protest campaigns "DeleteFacebook" and "Faceblock" were trending for several days following the disclosure of the privacy breach, calling for people to boycott Facebook's services and apps for at least a day or to completely delete their accounts (Slawson, 2018; Griffin, 2018). In 2019, the Axios Harris Poll 100, a yearly survey ranking the 100 most visible US companies according to their public reputation, revealed that Facebook's reputation was greatly damaged during the year of 2018. The company fell 43 spots to rank 94, which represents the highest decline in reputation of the companies evaluated in the survey (Axios Harris Poll, 2019). Regarding data privacy, only 15 percent of the respondents agreed to the statement that Facebook "securely protects its customers personal information and data" (Axios Harris Poll, 2019). Not surprisingly, for three of the features that make up the overall score, Facebook was rated particularly low: trust of users, ethics, and citizenship (Rosenberg, 2019).

Since 98 to 99 percent of Facebook's revenues are generated from advertising, the company's financial success substantially depends on a large number of marketers paying for ad products on Facebook services, affiliated third-party websites or apps and a high number of reachable potential customers, i.e. users of the social network (Facebook, 2020). After the privacy breach became public, it was therefore essential for Facebook to prevent both its users and customers from migrating away from the platform. This was attempted on the one hand by regaining users' trust through improved privacy policies and terms of service with regard to giving users better control about the collection, retention, and deletion of personal information and higher transparency about how data are used across the company's services. In May 2018, Facebook moreover announced the launch of the "Social Science One" initiative which provides aggregated and anonymous Facebook data for academic research projects (Facebook, 2018b).

In 2019, an estimated 2.95 billion people worldwide were using social media, a number that is expected to pass the 3 billion mark in 2020 (Statista, 2020a). The world's most popular social network, Facebook, was the first to surpass one billion registered users and has by far the most active monthly users, almost 2.5 billion as of April 2020 (Statista, 2020b). While there had been repeated discussions about Facebook's handling of its users' privacy since the early days of the network, many users found it particularly disturbing that social media was being used to try to influence public opinion in the run-up to the 2016 US elections (Brown, 2020). The disclosures of *The Guardian* and *The New York Times* made a broad public aware that data from social media could be used to influence or even manipulate people on a large scale, which sparked wider discussions over the societal impact of technology and ethical standards for people's privacy on the Internet (Isaak and Hanna, 2018; Weisbaum 2018).

By information security standards, Facebook was right that the incident was not a "data breach," as "people knowingly provided their information, no systems were infiltrated, and no passwords or sensitive pieces of information were stolen or hacked" (Facebook, 2018a). Nevertheless, the scandal that resulted from the incident and caused Cambridge Analytica to go out of business demonstrates the serious consequences that irresponsible use of data can have (Hirsch, 2019). It also made it clear that it may not be sufficient for the reputation of a company to do what the law requires in terms of data security and data protection, but rather to do what is considered "ethical" in a broader sense, such as implementing responsible data practices (Hirsch, 2019).

6.2.3.3 Why do companies practice business ethics?

The classic Ford Pinto case and the recent Cambridge Analytica case demonstrate that immoral behavior can become a business risk for companies. In general, it can be said that in many countries today there are hardly any large companies that completely dispense with business ethics activities (understood in the broadest sense). This chapter will discuss in detail just what these activities can entail. But one question that immediately presents itself from an economic point of view is this: Why do companies practice business ethics at all? Milton Friedman, one of the most prominent critics, powerfully denied the legitimacy of business ethics activities in his article from 1970 that is still widely quoted to this day. He coined the phrase which, ever since, has figured prominently in almost every treatise dealing with the justification of corporate ethics: "The social responsibility of business is to increase its profits." Friedman's statement is informed by a deep skepticism towards all activities of companies that go beyond their original core task, namely profit maximization within the constraints of the law. In his view, social responsibility—for example, the creation of a social safety net through redistribution—lies solely with the state. Friedman considers the arbitrary redistribution of corporate profits to local target groups through a company's management to be a misappropriation of the owners' capital and an undemocratic distribution of funds (Friedman, 1970).

This view can be criticized, however. On the one hand, one can argue that the state for various reasons is not in a position to take on tasks such as the correction of externalities or the institution of redistribution mechanisms. Such a situation may arise, for example, if the state is dominated by interest groups, if social problems are outside its legislative purview, or if, due to high transaction costs and insufficient information, it is unable to carry out the corresponding tasks or can do so only very inefficiently (Bénabou and Tirole, 2010). This view implies, however, that Friedman's position would still hold if the state could act to the full extent of its powers.

Furthermore, there is the fundamental and normative objection to Friedman's view that every company has an inherent duty to be socially responsible. In this context, one may call on ethical stakeholder theories.

They posit the presence of corporate responsibility—even when it is against the economic interests of a company. This expectation is often justified by the financial power and influence of large corporations. And yet it is also necessary to address the question here of how such a demand can be permanently realized under competitive conditions.

In the following, we explain to what extent corporate ethics can be reconstructed as a legitimate, even necessary, corporate strategy that combines the seemingly contradictory demands of profit maximization and adhering to a moral imperative. To begin with, we look at the notions of reputation, trust, and social capital.

6.2.3.3.1 Reputation

The book's first chapter roughly outlines how business and corporate ethics are interwoven. Its theoretical touchstone is monism: Problems characterized by interest conflicts are not considered in a trade-off scheme, in which either one side or the other is favored. Rather solutions are sought in which both parties benefit (at least in the long term). The ultimate goal is to achieve win-win situations. Business ethics is particularly needed when unpredictable interaction uncertainties arise where neither contracts nor laws fully regulate the rights and obligations of the contracting parties or interest groups. Incomplete contracts offer great advantages because they can be flexibly adapted to new circumstances, resulting in lower costs for the contracting parties. The downside, however, is that the partners cannot be sure that their counterpart is not using the existing loopholes for their own benefit. The actors can counteract this mistrust, which can lead to a preventive counter-defection, by investing in confidence-building measures, i.e. by building up their reputations.

An actor's reputation represents a kind of capital for establishing business relationships and thus for saving transaction costs. The latter can arise, for example, from expensive legal proceedings or from revenue losses due to consumer boycotts. An individual actor or even a company can build up their reputation by adhering to moral principles such as integrity and fairness, and even by choosing to not erode this capital when there is an opportunity to engage in opportunistic conduct. In this way, the company becomes a reliable and attractive interaction partner.

Reputation capital, which emits a signal to potential business partners, is an important prerequisite for successful entrepreneurship, especially under the conditions of globalization. In the small-group societies of the premodern era, where trade was usually limited to a few actors, an effective face-to-face control was for the most part possible. Immoral behavior could thus be punished directly by the community (for example by ostracism). Due to a lack of mobility, new trading partners were not endlessly available. In the globalized world, on the other hand, high mobility and the new communication media allow interactions with trading partners all over the world. Such control is therefore systematically eliminated, which, in turn, increases the tendency to mistrust and the risk of preventive counter-defections between the actors. Reputation capital plays an important role here, for it establishes trust and reliability.

6.2.3.3.2 Trust

From an economic standpoint, trust results in lower transaction costs. The economic view of the ethical concept of trust yields insights into how trust can be built up and maintained under the conditions of modern society and what risks this entails. Trust can be defined as follows:

> The definition of trust proposed in this research is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party. (Mayer et al., 1995, p. 712)

In the economic reconstruction, the essence of trust is a "reciprocal altruism." The term altruism does not mean that there is no quid pro quo; it merely means that the performance and counter-performance are temporally and factually decoupled and not explicitly secured by a contract (Ripperger, 1998).

Trust capital extends beyond having a positive effect on individual players, for the economy as a whole may also benefit from it. Thus, the trust of citizens in a country correlates (surveyed on the basis of a positive response to the following assertion: "I can trust most people") with a country's prosperity indicator. This can be interpreted to mean that higher trust in an economic area also leads to greater prosperity (World Values Survey, 2015).

6.2.3.3.3 Social capital

One speaks of social capital if a trusting relationship between two actors—for example between principal and agent or employer and employee—is extended to include multilateral relationships. Thus, a trustee whose behavior is consistent with the expectations of the trustor is also entitled to the trust of third parties from within the same trust community. Performance and counter-performance are not only decoupled temporally and factually, but also personally. The trust community here has social capital at its disposal. An example of this are alumni associations, in which the graduates of a university can expect support from each other, even if the individual members are otherwise strangers. Social capital thus facilitates interactions to a considerable degree and conserves resources by making costly and time-consuming controls unnecessary.

However, social capital must also be protected against an abuse of trust by means of sanctions. These sanctions may be imposed by the trustor but also by third parties. Due to the implicit nature of the contracts between the parties to the trust community, sanctions are usually of an informal nature: For an abuse of trust, an actor can be punished with reputational damage, public disdain, or social exclusion.

This shows that even in a globalized world moral misconduct can become a risk factor for companies. For example, moral missteps such as bribery or fraud can have legal consequences for a company that endangers business. A prominent example is the case of the US energy trading company Enron, which had to file for insolvency after its sophisticated system of fraud was exposed (Haley and Palepu, 2003). Even in those cases where companies conduct business in areas that are to some extent a legal vacuum—for example when transactions are carried out between companies under different legal regimes—there remains a risk of reputational damage for moral misconduct.

It is therefore in the economic interest of companies not only to comply with laws, but also to include moral considerations in their risk management. Consequently, we want to understand corporate ethics here as the management of moral risks.

6.3 Corporate social responsibility: approaches and criticism

6.3.1 What is CSR?

Corporate social responsibility deals with the social commitment of companies. Besides the economy, this commitment, or the responsibility that a company assumes can extend in particular to the areas of the environment, social affairs, and governance.

6.3.1.1 CSR definitions

The most common definition of CSR in Europe comes from the European Commission's 2001 Green Paper. CSR is the "concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis." In a follow-up paper, the European Commission defined CSR even more succinctly as "the responsibility of enterprises for their impacts on society" (European Commission, 2011). To encourage companies to take on this responsibility, the definition is followed by an appeal for them to integrate social, environmental, ethical, human rights, and consumer concerns into their core strategies in cooperation with stakeholders. The aim is to maximize the shared value of both the shareholders and the stakeholders. The Commission paper recommends long-term strategies for implementing CSR.

6.3.1.2 Conceptual pluralism

The European Commission's definition already includes several aspects of CSR, which are discussed in more detail below. It must be said that the term CSR is used in a variety of different ways. Different terms emphasize different aspects, and numerous overlapping definitions make it difficult to distinguish between them. In his journal article "How Corporate Social Responsibility Is Defined," for example, Alexander Dahlsrud analyzed 37 CSR definitions with regard to their substantive dimensions and the number of hits on Google (Dahlsrud, 2008). He distinguishes between an environmental dimension, a social dimension, an economic dimension, a stakeholder dimension, and, finally, a dimension of voluntariness. For example, in eight of the 37 CSR definitions he finds all five dimensions mentioned, while 20 definitions contain at least four of the aspects.

It may be assumed that this conceptual analysis is also only provisional, as new definitions of CSR with additional substantive aspects and new terms referring to old definitions are constantly emerging. Nonetheless, this does not change the fact that the term CSR has established itself globally as a generic term for business ethics theories and issues (Scherer and Patzer, 2011).

6.3.1.3 Carroll's CSR pyramid

Archie B. Carroll has strongly influenced the definition of CSR through his CSR pyramid (Carroll, 1991; see Figure 6.7). Here, he describes the different levels of corporate responsibility. Economic responsibility is fundamental and therefore forms the basis of the pyramid. Without being able to profitably produce goods and services that meet customer requirements, a company can neither survive over the long term, nor can it meet any additional obligations. Carroll designates the next level legal responsibility. A company has a duty to comply with laws and regulations issued by the national or regional legislature and to pursue its business objectives only within this

Figure 6.7 The CSR pyramid
Source: Carroll (1991).

framework. Traditionally, compliance departments in companies are tasked with checking to what extent individual transactions are within the legal framework. Increasingly, however, compliance employees are also being entrusted with issues that go beyond mere legal compliance.

Above the levels of profitability and compliance lies the level of ethical responsibility. Some ethical standards have already been incorporated into the economic and legal framework. Ethical responsibility extends beyond this, however. At issue here are also practices which are desired or even rejected by society and are not codified in laws. According to Carroll, a company that fulfills its ethical responsibility is concerned with standards, norms, and expectations that reflect the moral expectations of consumers, employees, shareholders, and society. These social demands, which are initially met voluntarily, can also be incorporated into binding laws at a later date. Thus, the legal and ethical responsibilities of the pyramid are in constant interaction with each other.

At the top of the pyramid, Carroll places philanthropic responsibility. Geared toward the civic commitment of entrepreneurs, it corresponds to the notion that companies are corporate citizens. It involves an active commitment to promoting the common good, for example by supporting the arts, education, or other social initiatives. How is the philanthropic level distinguished from the ethical level? Philanthropic responsibility arises from companies' aspiration to be good citizens in their communities. As Carroll sees it, it is the veritable icing on the cake and less important than the layers underneath.

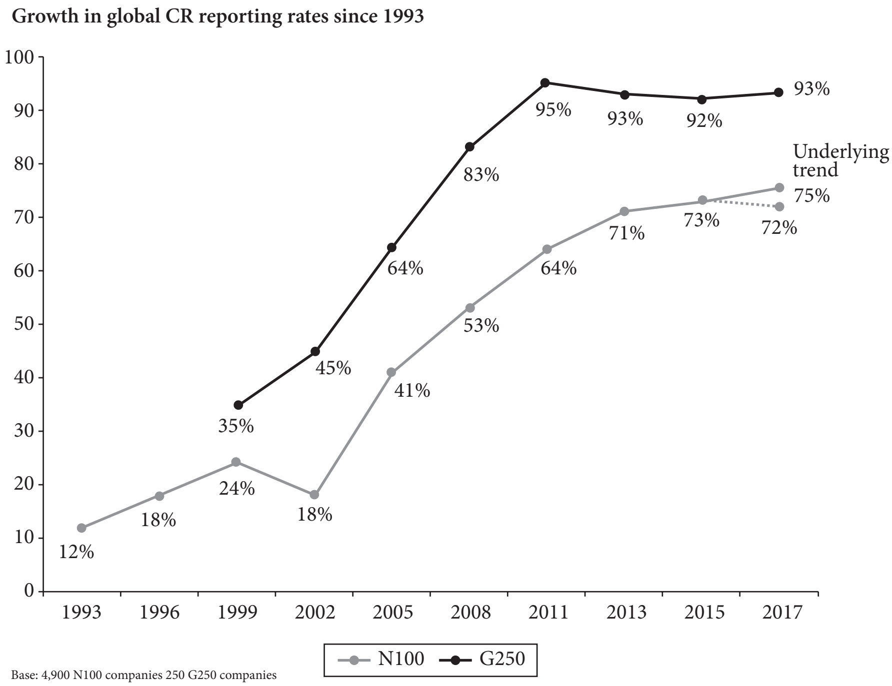


Figure 6.8 Growth in global CSR reporting rates since 1993
Source: KPMG (2017, p. 9).

6.3.1.4 CSR development: some figures

No doubt, the awareness of the need for corporate responsibility has slowly grown since the Ford Pinto scandal. Since the end of the 1990s, the movement has gained more and more momentum. As Figure 6.8 shows, the rate of CSR reporting for the 250 largest companies worldwide on their CSR activities has increased from 35 percent in 1999 to 95 percent in 2011 and has stabilized at a high level.

CSR became increasingly important especially in the first decade of the twenty-first century. In the EU, for example, the number of companies that signed the Ten Principles of the UN Global Compact grew from 600 in 2006 to 1,900 in 2011 (UN Global Compact, 2015). There has also been a significant increase in the number of initiatives supported by industry, such as the "Business Social Compliance Initiative," which aims to improve working conditions in the supply chain: While 69 companies were members of the initiative in 2007, the number had already exceeded 2,400 by June 2020 (amfori, 2020). In the same period, the number of European companies whose sustainability reports comply with the guidelines of the Global Reporting Initiative tripled (European Commission, 2011, pp. 4–5).

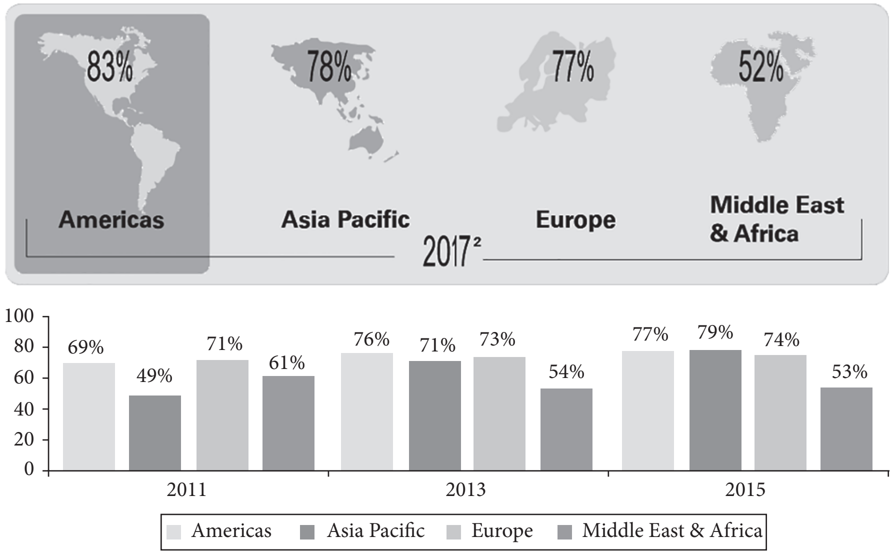


Figure 6.9 CSR reporting rates by region
Source: KPMG (2017, p. 11).

Figure 6.9 shows that there has been an increase of CSR reporting rates in most regions of the word. The development figures of the CSR reports initially provide a quantitative snapshot of how many companies are at least committed to assuming social responsibility. The extent of this commitment and exactly what these activities involve is another matter and a subject of current CSR research.

6.3.2 Different theoretical concepts of CSR

The definitions of CSR are informed by different theoretical concepts. The following points provide an overview.

6.3.2.1 Implicit and explicit CSR

The various CSR concepts are often classified as implicit and explicit CSR. These two different trains of thought can be attributed to the cultural differences in the traditional institutional frameworks of different nations (Matten and Moon, 2008). In general, explicit CSR is more strongly represented in the United States, while companies in Europe tend to practice implicit CSR.

In the United States, for example, companies have a long history of playing a major role in taking on social responsibilities. Moreover, the stock market is the most important source of capital for US companies, which means that transparency and accountability are widely implemented. In Europe, on the other hand, responsibility for social welfare has traditionally fallen to the state. Table 6.3 gives an overview of the most important cultural differences that require either a more implicit or explicit concept of CSR.

"Explicit CSR" refers to activities in which a company assumes direct responsibility for society. In the case of "implicit CSR," this tends to happen within formal and informal institutions. The difference in the degree of institutionalization is also evident in the specific CSR measures themselves. In explicit CSR, they are always part of voluntary corporate policy and are implemented through programs and strategies. In the case of implicit CSR, however, CSR activities are often regulated by codified corporate obligations.

Likewise, the motivation to take responsibility differs in both approaches: While explicit CSR is often motivated by the (perceived) expectations of different stakeholders, implicit CSR is prompted by social consensus on the legitimate expectations of the roles and contributions of all social actors (see practice box 6.7 for an example of explicit versus implicit CSR in the case of genetically modified organisms).

Practice box 6.7 The US and EU position on genetically modified organisms (GMOs)—explicit versus implicit CSR

Genetically modified organisms—for human consumption or as animal feed—are a relatively new technology in plant breeding. The risks for humans, animals, and ecosystems, therefore, have not yet been fully determined.

There are different attitudes in the USA and the EU.

GMOs in the USA

The Food and Drug Administration (FDA) of the United States Department of Agriculture (USDA) has adopted a stance towards GMOs that could be considered "laissez-faire": By 2011, 111 GMOs had been approved for cultivation. Paramount in the approval process is the "nature" of the product, less the manufacturing process. There is no separate law for regulation: Most GMO plants require approval from the Animal and Plant Health Inspection Service (APHIS) of the USDA. This authority regulates cultivation, import, and transport. GMO-producing companies must provide the department with information on the composition, application, etc. of their products. The FDA bans harmful and mislabeled foods and regulates food additives. The procedures for genetically modified animals are much stricter and must always be approved by the FDA. By 2012, 40 percent of the world's arable land used to cultivate GMOs was in the USA (69.5 million hectares). The US public is much less aware of the risks of GMOs than the population in the EU; 93 percent of Americans are in favor of voluntary labeling. In July 2016, US Congress passed the National Bioengineered Food Disclosure Law, directing the USDA to implement a national mandatory standard for disclosing information about certain types of GMOs. As of January 2022, this standard will require all food producers, importers, and retailers to label bioengineered food or food that contains bioengineered ingredients. Nevertheless, some US companies expressly waive the use of GMOs (McDonald's, Gerber, McCain). By responding to pressure from stakeholders (activists against GMOs), these companies assume explicit CSR responsibility.

GMOs in the EU

The EU is much more restrictive when it comes to GMOs than the USA: As of 2015, only 70 organisms had been approved for animal feed and as foodstuffs; only one organism, the corn variety MON 810, had been approved for cultivation. (A list of all authorized GMOs can be found at: https://webgate.ec.europa.eu/dyna/gm_register/index_en.cfm.) In the EU, 36 million tons of soya bean equivalents are needed annually for feed, of which only 1.4 million tons are produced by the EU itself. The rest must therefore be imported from countries where GMO cultivation predominates. There exists a strict separation of risk assessment and risk management: The European Food Safety Authority (EFSA) is responsible for evaluation and monitoring, the EU Commission decides on approval. Member states can prevent the cultivation of GMOs on their territory despite EU approval. All feed and food containing GMOs must be labeled, unless the amount is below 0.9% The skepticism of the European public regarding GMOs seems to have been reduced somewhat in recent years: While 66 percent were worried about GMOs in 2010, only 27 percent said they were most concerned about GMOs in food or drinks in 2019 (European Food Safety Authority, 2019). Through its restrictive stance, the EU government takes responsibility for the risk assessment of GMOs. Companies are not given a lot of latitude when it comes to assuming social responsibility with regard to GMOs. Explicit CSR is therefore not possible, but responsibility is implicitly assumed by the public authorities.

Sources:

European Commission (2015). *Factsheet: Fragen und Antworten zur GVO-Politik der EU*, April 22. Last accessed June 2, 2017 at: http://europa.eu/rapid/press-release_MEMO-15-4778_de.htm

European Food Safety Authority (2019). Food Safety in the EU: Special Eurobarometer Wave EB91.3, Last accessed January 17, 2021 at: https://www.efsa.europa.eu/sites/default/files/corporate_publications/files/Eurobarometer2019_Food-safety-in-the-EU_Full-report.pdf

Continued

Practice box 6.7 Continued

Johnson, David and O'Conner, Siobhan (2015). These Charts Show Every Genetically Modified Food People Already Eat in the U.S. *Time*, April 30. Last accessed June 2, 2017 at: http://time.com/3840073/gmo-food-charts/

Law Library of Congress (2015). *Restrictions on Genetically Modified Organisms: United States*. Last accessed June 2, 2017 at: https://www.loc.gov/law/help/restrictions-on-gmos/usa.php

Löfstedt, Ragnar E. and Vogel, David (2001). The Changing Character of Regulation: A Comparison of Europe and the United States. *Risk Analysis*, 21(3), 399–416.

Matten, Dirk and Moon, Jeremy (2008). "Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility. *Academy of Management Review*, 33(2), 404–24.

The National Law Review (2016). President Signs Bill to Pre-empt Vermont's GMO Labelling Law, August 2. Last accessed June 2, 2017 at: http://www.natlawreview.com/article/president-signs-bill-to-pre-empt-vermont-s-gmo-labeling-law

Vogel, David (2003). The Politics of Risk Regulation in Europe and the United States. *Yearbook of European Environmental Law*, 3, 1–43.

6.3.2.2 Different research approaches to CSR following Garriga and Melé

There are different criteria according to which one can arrange the theoretical approaches to CSR. They give rise to umbrella terms that make it easier to classify different theories. Of course, these categories are neither exhaustive nor distinct. Nevertheless, they can provide useful orientation. A widespread classification of CSR approaches follows the research of Garriga and Melé (2004). They distinguish between ethical, instrumental, political, and integrative CSR theories. They are presented below.

6.3.2.2.1 Ethical theories

Ethical CSR theories focus on the ethical prerequisites which they see as the basis of the relationship between companies and society. Such approaches are represented by those moral philosophers who extend classical ethical theories to the behavior of companies. Thus, moral philosophical theories such as Kantian/deontological ethics, utilitarianism, and contract theories have had a decisive impact on the debate about a normative justification of CSR. Table 6.4 provides an overview of the various ethical theories that underlie CSR theories.

The idea of universally valid human rights is also used as a basis for ethical CSR (Garriga and Melé, 2004). The most prominent example of this is the UN Global Compact, which contains nine principles that set out guidelines for the areas of human rights, labor, and the environment. In what follows,

Table 6.3 Different conditions for explicit and implicit CSR

	CSR as explicit instrument of corporate policy	CSR as implicit element of institutional framework
Market system	Oriented towards a liberal market economy	Oriented towards a social market economy
Political system	• Greater entrepreneurial freedom • State intervention less frequent and more via incentives (negative taxes for companies)	• Greater state involvement in economic and social issues • National insurance schemes or obligations of corporations
Financial system	• Stock market as central source of capital • This results in a greater need for transparency and accountability	• Main financial source is a smaller number of investors, for example banks, which play a significant role • Closely meshed network of company owners • Stakeholders play an important role alongside shareholders
Education system and job market	• Design by the companies themselves • Labor market issues traditionally dealt with at company level	• Focus on government education • Active labor market policy • Labor market issues are traditionally dealt with at sectoral or national level
Cultural system	Greater participation, more philanthropy, also by companies • Greater skepticism towards "big government" • Greater trust in the moral quality of the market economy • "The duty of man of Wealth [is] to consider all surplus revenues which come to him simply as trust funds, which he is called upon to administer . . . in a manner . . . best calculated to produce the most beneficial results for the community" (Carnegie, 1889)	• Greater trust in representative organizations, like parties, unions, associations or the state
Type of companies	• Market- and contract-based ownerships	• Direct ownership and common ownership (by networks, banks, insurers, state ownerships)
Organization of market processes	• Strong emphasis on self-organization of the market • Strong antitrust laws	• Organization of the market by producer group alliances

Source: Matten and Moon (2008).

Table 6.4 Overview of normative approaches in the CSR discussion

Foundations	Justification patterns	Literature
Kantian/ Deontological Ethics	• Man always as an end in himself and never merely as a means • "Humanity" (as an end in itself) in various stakeholder groups must be respected • Terminology: Duties and rights	Bowie (1998) Beauchamp and Bowie (1979) Lea (2004) Atterton (2007) Gibson (2000) Rawls (1979)
Virtue Ethics	• Training of character traits to achieve a successful life (*Eudaimonia*) • Manager responsible for moral conduct through character traits	Solomon (2003)
Utilitarianism	• Maximizing the greatest "happiness" for the greatest number • Companies have a duty to achieve the best possible result (in terms of maximizing happiness) • Impartiality with regard to the question of who benefits from the actions is assumed • Based on: Mill (1863)	Singer (1972) Kagan (1989)
Liberalism (Theories that postulate a minimal state)	• Unconditional enforcement of negative freedom (absence of coercion) • No positive duties to beneficence (but—if voluntarily—appreciated) • Companies only have to comply with laws and, at best, general social rules in order not to violate negative rights • Protection of natural human rights (freedom, property) • Based on: Nozick (1974/2006); Locke (1764); Smith (1776/1990)	Frederiksen (2010) Parkan (2008)

another ethical CSR theory will be presented, namely the theory of sustainable economic activity or what is commonly known as sustainable development. In recent decades, a sustainable-development concept of CSR has emerged, which can also largely be classified as an ethical theory.

Sustainable development is the kind of development that meets the needs of the present without compromising the ability of future generations to meet their own needs (Thomsen, 2013). This definition was elaborated by the Brundtland Commission, which met under the mandate of the UN in 1983. The 1987 report, *Our Common Future*, goes on to say: "In essence, sustainable development is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations" (United Nations, 1987, p. 57, paragraph 15). The Commission has elaborated two cornerstones of sustainable development: The first is to prioritize the needs

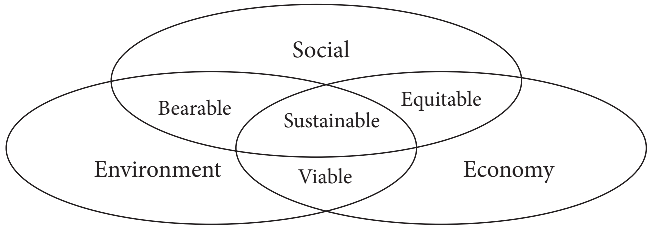


Figure 6.10 Definition of sustainability
Source: authors' depiction, based on Thomsen (2013).

of workers, the second to limit the technological and social pressure exerted on the environment of present and future generations.

These clarifications show that the term sustainability is not—contrary to colloquial usage—limited to the environment. Rather, as illustrated in Figure 6.10, sustainability consists of an agreement on environmental, social, and economic aspects. At the 2005 World Summit, the UN member states agreed on this three-pillar model of sustainability. Here, social and ecological aspects are also accounted for. The integration of the three dimensions into the balance sheet of companies—i.e. the inclusion of social and ecological aspects in the accounting—is referred to as a "triple bottom line."

Ecological sustainability is a company's goal when it takes initiatives aimed at the problem of the exploitation of non-renewable resources or climate change. Such initiatives may involve saving packaging material, reducing energy consumption, or increasing the recyclability of the company's products.

The Environmental Performance Index (http://epi.yale.edu/) seeks to quantify companies' ecological performance at a national level. The index was created to support the implementation of the UN Millennium Development Goals (since 2015 the UN Sustainable Development Goals) (Thomsen, 2013).

The Brundtland Commission defined social sustainability as the contribution of companies to the well-being and quality of life of individuals and society as a whole. It is important here that not only present but also future generations are included in the considerations. For companies, this means minimizing as much as possible the possible risks posed by a product during the entire production cycle and includes product and usage safety and disposal. Dealing with employees also plays an important role—from working conditions to equal treatment and further training. The tasks of social sustainability overlap with ethical supply chain management, in which not only the treatment of employees, but also the working and production conditions of suppliers are subject to moral considerations. Stakeholders' needs can also be included in the concept of social sustainability.

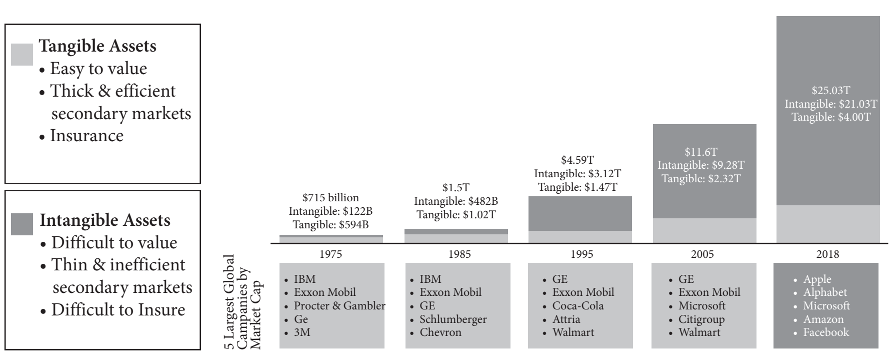
Economic sustainability is based on the long-term achievement of *economic* growth in conjunction with ecological and social sustainability. It aims to realize all aspects of sustainability at the same time.

6.3.2.2.2 Instrumental theories

If, from the point of view of ethical theories, the stakeholders are regarded as groups that have a legitimate, ethically justified claim on companies, they are judged from an instrumental CSR perspective on their power to influence an enterprise, i.e. on their potential for threat or benefit. The consideration of the interests of the stakeholders is therefore strictly assessed according to the benefit they have for a company. Instrumental CSR is essentially empirical and oriented towards hypothetical imperatives such as: "What do I need to do to achieve corporate goal X?" On the one hand, it uses data from social science studies and, on the other, it attempts to implement these findings in company practice. These particular steps, which usually aim at "establishing a positive correlation between the consideration of stakeholders and the success of a company" (Lin-Hi, 2009, p. 17), are referred to as a business case. CSR is to be seen here as a means of achieving economic goals and thus as a profitable investment. CSR is never an end in itself, nor is it directed against economic interests. For example, by entering the fair-trade market, a company can strengthen its own market position and also control the profits of a niche market.

Five points can be identified that show how CSR can lead to a business case (Das Gupta, 2013).

Reputation management plays a major role. Companies not only trade their production and services, but also their reputation, brand value, and



**Five Largest Global Companies by Market Cap as of December 31, 2018*

Figure 6.11 Tangible vs. intangible assets for S&P 500 companies, 1975–2018
Source: Ponemon Institute LLC (2019).

intellectual capital. These intangible assets now account for an estimated 84 percent of the total value of the Fortune 500 companies (see Figure 6.11).

This shows that reputation has become a necessary part of successful corporate management. Closely linked to a company's reputation is its *risk management*. CSR helps companies identify the risks that can have an adverse impact on their public image. By taking precautions, the company shows investors that it is reliable partner.

Understood as a business case, CSR can also improve a company's personnel situation. In a recent survey, 25 percent of employees said that their ideal employer is a company whose values match their own (PwC, 2018). Consequently, it is in the interest of a company to present itself as an employer with attractive values and thereby to recruit or retain highly qualified personnel.

In addition, CSR can have a positive effect on a company's relationship with its investors and thus secure access to capital. According to one study (Taylor Nelson, 2001), 86 percent of all institutional investors believe that CSR has a positive effect on business. In addition, more and more investment portfolios are being created that favor companies that are characterized by CSR activities.

Furthermore, CSR can be helpful for a company in maintaining its market share and opening up new markets. The majority of the world's population comes from the lower class or the lower middle class. It is estimated that 4 billion people belong to these social strata. Business initiatives that benefit the poor by offering them suitable and inexpensive products while at the same time allowing the company to make a profit exemplify instrumental CSR or CSR as a business case (Garriga and Melé, 2004).

Finally, CSR can help a company increase operational efficiency. For example, costs can be reduced by minimizing waste or reducing energy consumption. These measures can also help a company to maintain its legitimacy or license to operate. Especially at a time when corporate scandals are giving rise to bad press and the public is often critical of large companies, positive CSR activities can go some way to convincing customers and investors that the company has a positive impact on society. This, too, is another reason why a company should be socially committed from the point of view of instrumental CSR.

A CSR practice that can also be classified as instrumental is cause-related marketing (CRM). This involves a mutually beneficial cooperation between a commercial and a non-profit organization. Varadarajan and Menon (1988, p. 60) defined CRM as follows:

> The process of formulating and implementing marketing activities that are characterized by an offer from the firm to contribute a specified amount to a

designated cause when customers engage in revenue-producing exchanges that satisfy organizational and individual objectives.

In this context, CRM is a means of CSR communication, in which the public is shown how a company's social responsibility is reflected in actual benefits for society (Beise-Zee, 2013). The term was coined by the marketing department of American Express in connection with a campaign in 1983. American Express promised customers that they would donate a certain amount to various non-profit organizations each time they used their credit card. Among other things, the donated money supported the renovation of the Statue of Liberty. Another example of cause-related marketing is a campaign by Germany's Krombacher brewery in cooperation with the WWF to protect the rainforest. Krombacher told customers that for every case of beer purchased a donation would be made to WWF to save one square meter of rainforest (see practice box 6.8: Krombacher's rainforest campaign).

Practice box 6.8 Krombacher's rainforest campaign

The German brewery Krombacher ran a total of five promotional campaigns between 2002 and 2008. These were based on a cooperation with WWF (World Wide Fund for Nature) to protect the Dzanga Sangha rainforest in Central Africa for a period of 100 years. The key idea was to link beer sales to donations (one square meter of forest per crate, one cent donation per bottle sold). Overall, an area of 9,700 hectares of rainforest were protected. Four million euros were donated to the rainforest project. In terms of corporate success, Krombacher increased its sales from 2001 (425.6 million) to 2008 (556 million) by approximately 30 percent. The company thus defied the general beer market trend in Germany, which was down 12 percent in the same period. The promotion campaigns led to legal consequences: A German district court decided Krombacher was guilty of "misleading consumers" with its slogan "1 case of beer = 1 square meter of rainforest." However, after a successful overhaul of the campaign, it resumed using the slogan.

Sources:

Bundesgerichtshof (2006). Mitteilung der Pressestelle Nr. 147/2006. Last accessed August 19, 2007 at: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py? Gericht=bgh&Art=pm&pm_nummer=0147/06

Krombacher Brauerei, press releases from April 23, 2003, August 13, 2003, May 3, 2004, October 23, 2006, April 4, 2008, July 22, 2008, May 30, 2011, May 24, 2012. Last accessed October 19, 2017 at: https://www.krombacher.de/DieBrauerei/Presseservice/Pressearchiv

The main point of CRM, therefore, is that a company's contribution to a non-profit organization is linked to the turnover of its products or services (Meffert and Holzberg, 2009). The company benefits not only through increased sales, but also from the fact that its products and/or brand name are visibly linked to the socially desirable purpose that a non-profit organization credibly represents. As a result of the direct involvement of the customer in the company's donation activities, the customer is emotionally involved and thus also invested in the brand over the long term. CRM is often carried out in the form of a highly collaborative campaign with intensive advertising on all the relevant marketing channels. The aim is to merge social and commercial interests.

By tailoring CRM to a specific charitable purpose, a company's social responsibility is simplified and made more tangible. This contrasts with CSR activities, which often remain abstract for the customer. According to Meffert and Holzberg (2009), effective CRM requires that various customized alignments or "fits" be satisfied. On the one hand, the social concern must fit the company (cause fit). Furthermore, the self-image of the company and the external image of the customer must be compatible (brand fit). Also, the two partners—commercial and non-commercial—must fit together (partner fit). These alignments are the necessary foundation for the companies to benefit over the long term and in a sustainable manner (see Figure 6.12).

6.3.2.2.3 Integrative theories

According to Garriga and Melé (2004), integrative CSR theories concern the integration of social demands into a company's business practices. The

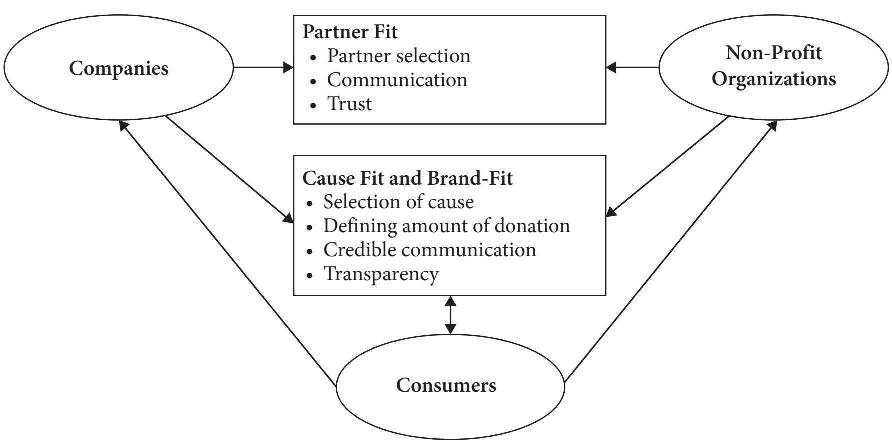


Figure 6.12 Preconditions for the success of CRM cooperation
Source: Meffert and Holzberg (2009, p. 51).

assumption here is that the economy depends to a large extent on society for its existence, stability, and growth. The logical claim, then, is that companies should act in accordance with society's interests. What a company has to do to meet these social demands therefore depends on the respective environment, i.e. the respective social situation and the prevailing values and norms in the relevant society.

Two important theories that can be assigned to the integrative flow of CSR are issue management and stakeholder management (Garriga and Melé, 2004).

Issue management is defined as the totality of processes through which a company identifies, evaluates, and meets social and political concerns (Wartick and Rude, 1986). A company that conducts issue management tries to develop effective and systematic strategies to find answers to various ecological and social questions.

Issue management addresses the idea of social responsiveness. This concept presumes that there is a gap between what the public expects from a company and the company's actual performance. Ackerman (2000, p. 92) describes this gap as a "zone of discretion"—the area in which those corporate activities lie that are neither regulated nor illegal or sanctioned and hence ambivalent as regards the signals coming from the environment. Such areas usually open up when a norm undergoes a transformation, which is tied to changing public expectations. This opens up room to maneuver, which the companies detect and analyze so that they can then tactically position themselves. In general, they can do one of two things in reacting to changing expectations: They can either adjust their own standards early on to stand out from the status quo or they do not change anything and wait until new standards become binding (Ackerman and Bauer, 1976). Issue management should serve as an early warning and detection system for both potential threats and opportunities. At the same time, it is meant to act as an integrative intermediary within the company to deal systematically with conflicting internal and external demands (Wartick and Rude, 1986). Jones (1980, p. 65) emphasizes the process of corporate responsibility, not the outcome. Companies thus should not be judged by the result, but by the way in which the result is achieved. Decisions should be fairly negotiated in consultation with the various points of view. Here, the focus is more on the process of implementing CSR than the final result.

A widely adopted CSR approach is stakeholder management. The term stakeholder comes from management theory. It connotes interest groups that are directly affected by a company's activities. The term stakeholder is distinct from shareholder, even though a shareholder of a company can also be considered one of its stakeholders. Freeman defines stakeholders as "any

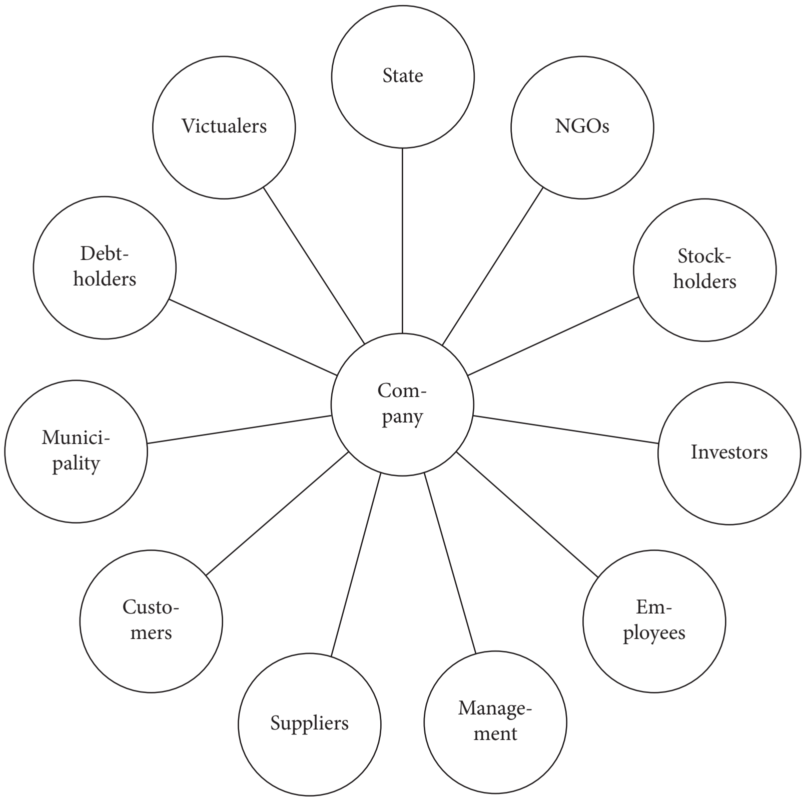


Figure 6.13 Stakeholder groups

group or individual who can affect or is affected by the achievement of the organization's objectives" (Freeman, 1984, p. 46). Figure 6.13 shows different groups that can be stakeholders in a company.

In principle, the stakeholder approach rests on the basic idea that a consideration of stakeholder interests leads to more successful and risk-aware corporate management. It is assumed that managers generally focus their activities on the shareholders, while neglecting other relevant stakeholder groups. In doing so, they ignore opportunities and risks in their business environment.

The stakeholder approach asks which groups companies depend on (descriptive approach) and who can make legitimate demands on the company (normative stakeholder approach). The instrumental stakeholder approach takes a look at how these interest groups can exert a positive or negative influence on a particular company activity. In most cases, the various stakeholder theories cannot be distinctly attributed to one of the different approaches, but rather have different elements.

Generally speaking, a dialogue with stakeholders can help to better understand the demands that are placed on companies by their environment, which are often quite diffuse. At the same time, it can also help to ensure that stakeholders are better aware of the dilemmas that companies face, for instance by way of conflicting expectations (Kapstein and Van Tulder, 2003, p. 208).

Normative stakeholder theory, which deals primarily with the ethical justification of stakeholder claims, can also be counted as an ethical theory (Garriga and Melé, 2004). Freeman (1984, p. 249) speaks of a fiduciary relationship not only between the company and its shareholders but also its stakeholders. The normative foundation of the claims is based on two core ideas (Donaldson and Preston, 1995, p. 67): Stakeholders are defined by their claim to and interest in a company, irrespective of whether the company also has a functional interest in the stakeholders. The interests of the stakeholders thus have intrinsic value, such that every concern is entitled to consideration, whether or not it is relevant to the pursuit of the shareholders' interests.

Although Garriga and Melé do not explicitly refer to creating shared value (CSV), it, too, can be understood as an integrative theory of entrepreneurial responsibility. It does not attempt to legitimize CSR either ethically or instrumentally, but as a monistic construct in the unification of economic and moral interests. Michael Porter and Mark Kramer define their concept of shared value as: "creating economic value in a way that *also* creates value for society by addressing its needs and challenges" (Porter and Kramer, 2011). A fuller definition reads:

> The concept of shared value can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. Shared value creation focuses on identifying and expanding the connections between societal and economic progress. (Porter and Kramer, 2011, p. 66)

The concept is based on the notion of value, which is defined as benefit *relative* to costs. Benefit is not defined as an absolute which is desirable regardless of cost. This distinguishes the concept from unconditional objectives, such as those of some aid organizations. Whatever serves the economic goals and competitiveness of a company and promotes the economic and social conditions of a community is thus beneficial. A central aspect of this approach is not to practice corporate responsibility on the periphery—for example philanthropically—but to integrate it into the core business. To do this, Porter and Kramer plead for renouncing a narrow view of value creation as an optimization of short-term financial performance. Corporate responsibility as value creation in a broader sense puts the focus on new consumer needs or environmental requirements. These, in turn, require value creation over the longer term and in a more sustainable manner.

According to Porter and Kramer, the concept of shared value can only be successfully implemented if managers acquire some new skills. On the one hand, they need to be able to better recognize social needs. On the other, they must understand the "true" basis of their company's productivity and develop the ability to collaborate across the boundaries between profit and non-profit transactions. Figure 6.14 shows which areas affect a company's productivity and where shared value potential is therefore to be realized. In order to implement this new concept of capitalism—which should be able to satisfy the new social conditions—it is above all necessary to redefine the purpose of companies. Here, it is no longer profit per se, but the creation of shared value. Porter and Kramer also expect this to bring new legitimacy to the economy.

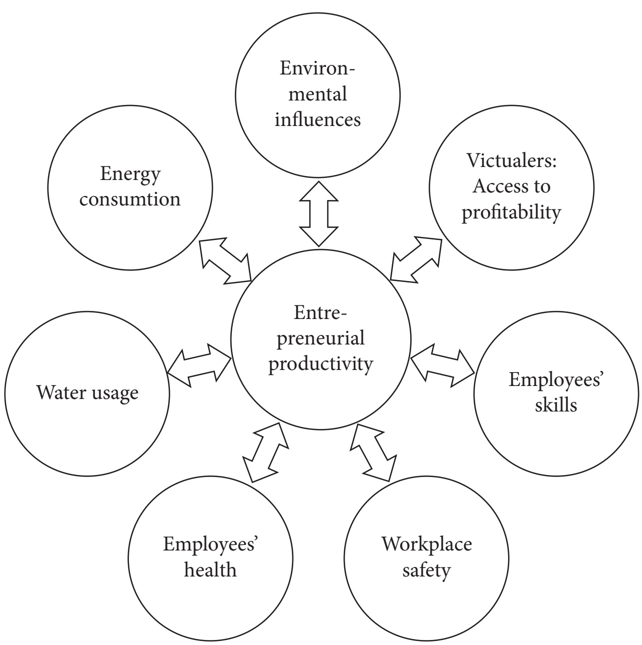


Figure 6.14 Influences on productivity
Source: Porter and Kramer (2011).

First of all, the authors demand a renunciation of neoclassical thinking when it comes to weighing conflicts of objectives. Heretofore, the entrepreneurial assumption of social responsibility has been that it is an obstacle to business. They also reject the concept of externalities which can be internalized by taxes and advocate that companies should understand social grievances as the cause of internal costs, which must be avoided in their own interest. As the basis of their theory, Porter and Kramer identify the deep roots companies have within prosperous communities. One may deduce from this fact that companies act in their self-interest when they promote their surroundings. According to Porter and Kramer, the far-reaching consequences that the environment has on the productivity and innovative power of companies have been greatly underestimated.

They cite three specific ways for creating shared value:

First, a new understanding of products and markets, according to which companies should ask themselves to what extent their product promotes the well-being of their consumers. Through the development of non-traditional markets (e.g. made up of low earners or disadvantaged groups), social needs could be satisfied, and the potential of new markets could be exploited.

Second, the redefinition of productivity in the value chain holds particular promise because it involves a range of social concerns—from the consumption of natural resources such as water to the working conditions at suppliers and energy consumption from the shipment of raw materials and goods. Not only does the realization of savings or the improvement of conditions benefit the affected parties, but it also translates into cost reductions for the company. As an example, the authors cite Walmart. In 2009, the supermarket chain was able to save 200 million dollars by reducing packaging materials and reorganizing transport routes. Another real-world example from Porter and Kramer is described in practice box 6.9: WaterHealth International.

The third point the authors mention is the promotion of cluster development. As companies are significantly influenced by the surrounding infrastructure, they directly benefit from the existence of business associations, a solid education system, quality standards, and public goods such as clean water and fair competitive conditions. The pursuit of these goals promotes companies and society alike. The development of clusters is particularly important where a misleading regulatory framework imposes uncertainties and risks. Porter and Kramer suggest that initiatives are particularly successful when different partners (different companies, but also NGOs) join forces.

Practice box 6.9 WaterHealth International

According to the WHO, one in three people worldwide does not have access to clean and safe drinking water (WHO, 2019). Increasingly, not only NGOs are trying to tackle this problem, but also private sector entities. One of these is WaterHealth International, a US company that builds decentralized water treatment and supply plants and sells water primarily in developing countries. Its target is to provide safe and affordable drinking water for over 100 million people globally by the year 2022. It is a profit-oriented company whose business activities are conducted entirely under market conditions. The sources of financing that the company uses are end customers, private donations, sponsors, institutional investors, conventional investors, and risk funds. Jobs in water treatment are created on site. Since 2012, more than 500 "WaterHealth Centers" and more than 300 water vending machines have been built (mostly in India but also in Ghana and Nigeria). According to its own account, each WaterHealth Center can serve between 15,000 and 25,000 people. In total WaterHealth International's purification systems can currently deliver about 2 million liters of water per day and serve more than 5 million people. More than 500 jobs were created for low earners in the construction and maintenance of the WaterHealth Centers.

In recent years, WaterHealth International has received several accolades and certificates for its business model and projects. Among others, the company's project in Karnataka, India received Gold Standard Water Benefit Certificates "for implementing safe and clean drinking water" and won the Unilever Global Development Award for "demonstrating positive impact towards achieving United Nations Sustainable Development Goals (SDG)" in 2017 (WaterHealth International, 2020b).

Sources:

International Finance Corporation (IFC) (2009). *WaterHealth Inc. IFC Project Information & Data Portal*. Last accessed August 6, 2020 at: https://disclosures.ifc.org/#/projectDetail/SPI/29090

Root, Rebecca (2019). Are water ATMs dispensing a viable solution to clean water? *Devex*, October 1. Last accessed August 6, 2020 at https://www.devex.com/news/are-water-atms-dispensing-a-viable-solution-to-clean-water-95564

WaterHealth International (2020a). *About Us*. Last accessed August 6, 2020 at: https://waterhealth.com/

WaterHealth International (2020b). *Awards and Accolades*. Last accessed August 6, 2020 at: https://waterhealth.com/awards-and-accolades/

World Health Organization (WHO) (2019). 1 in 3 people globally do not have access to safe drinking water. News release by Nada Osseiran and Yemi Lufadeju, June 18. Last accessed August 6, 2020 at: https://www.who.int/news-room/detail/18-06-2019-1-in-3-people-globally-do-not-have-access-to-safe-drinking-water-%E2%80%93-unicef-who

To create shared value, certain conditions are necessary for companies. These can be established by governments. According to Porter and Kramer, bad regulations could make conflicts of interest between economic and social goals unavoidable. Instead, regulations should aim to promote innovation and long-term goals. This may be achieved through (a) clear and measurable social objectives, (b) setting standards without prescribing in detail how they are to be achieved, (c) introducing universal performance reports and benchmarks, and (d) timely reporting of results. In addition, there are stringent anti-corruption practices.

6.3.2.2.4 Political Theories

In the wake of progressive globalization and the increasing social influence of companies, instrumental CSR theories, which are based on neoclassical foundations, have been supplemented in recent decades by a new approach—political CSR (Garriga and Melé, 2004). According to neoclassical CSR theories, it is the job of companies to maximize profit on behalf of shareholders and, moreover, to use CSR practices for this very purpose. It is the task of politics to solve social problems. In contrast, political CSR theories focus on the interdependencies between business and society as well as the standing of companies in society and their attendant obligations (Garriga and Melé, 2004). These theories are underpinned by the license to operate. According to this concept, which is also called social license, a company must further acquire the recognition and acceptance of society in addition to the official and legal licenses of government authorities (Nielsen, 2013). This approach can be grounded in the sociological concept of New Institutionalism, whereby companies are social institutions that require institutional legitimacy in order to survive (Powell and Di Maggio, 1991).

The legitimacy of companies is increasingly being called into question by stakeholders. A company obtains a license to operate when it takes into account the tacit or explicit claims of stakeholders and assumes the responsibility ascribed to it. The requirements that a company must meet in order to obtain a license to operate always depend on the current context in which the company operates. What might have been necessary for a company in the 1980s to gain legitimacy is not comparable with what is required today. New responsibilities have come to light along with the increasing number of social issues beyond the influence of national governments.

Three different theories of political CSR are discussed in more detail below: corporate constitutionalism, integrative social contract theory, and corporate citizenship.

In the 1960s, the idea of corporate constitutionalism emerged. It views companies as social institutions that cannot exist independently of society.

The power–responsibility equation (Davis, 1968, p. 48) states that as the power of companies grows (e.g. their influence on political decisions), so does their level of responsibility. This implies that companies should use their power and influence in a socially responsible manner if they want to retain them (Davis, 1960).

Furthermore, the Iron Law of Responsibility (Davis, 1973) states that companies that do not perceive the social responsibilities arising from their position of power will lose their power to others who take on this responsibility. As the company's standing in society grows, so do its duties and responsibilities. Conversely, this means that an entrepreneur who does not make use of his or her position of power in a socially desirable way will lose it, because other social forces will then assume this responsibility. Davis cites unemployment as an example: Here, the state curtailed companies in their freedom and thus also in their power. Since they themselves failed to counter the growing unemployment associated with technology, the state took on this task by intervening in the freedom of companies through regulations such as protection against dismissal and unemployment insurance to be paid by the employer.

This linkage—which is not meant as a normative statement, but only as an analytical prediction—squarely calls the classical economic doctrine into question. The latter can no longer consist solely of complying with the law if it leads to a substantial loss of market power (Davis, 1968, 1973). Only by assuming the responsibility that arises from their position of power can companies obtain their license to operate.

Under conditions of "pure" competition, Davis remarks, companies have no responsibility towards society other than to offer their goods at the lowest possible price. The power–responsibility equation would be zero—where there is no power, there are no obligations. However, Davis further argues, pure competition does not correspond to the (current) reality in which companies have lofty corporate values and thus have a decisive influence on society. This is also why the rules of pure competition do not have free rein (Davis, 1968). On the other hand, it also cannot be the responsibility of companies to deal with all social concerns, such as health care, the prevention of juvenile delinquency, or social welfare simply because they have considerable economic resources. The economy, Davis sums up, is merely one institution in a pluralistic society that must take responsibility for social problems.

Integrative social contract theory posits that the relationship between companies and society is determined by an implicit social contract. Due to their necessary consent, companies consequently have implicit obligations towards society. According to Donaldson and Dunfee (1994, 1999), this consent is required at two levels: on the theoretical macrosocial level and on the practical microsocial level, such as in a local community. The rules and norms by which companies obtain their social legitimacy are negotiated in a process.

The macrosocial contract provides the framework for local negotiation processes. This framework is formed by so-called "hypernorms." Donaldson and Dunfee define these as fundamental principles by which all other norms are to be assessed (2000, p. 441). A norm or a microsocial contract is therefore legitimate exactly when there is agreement with the hypernorms. According to Donaldson and Dunfee, hypernorms can be recognized in the congruence of religious, political, and philosophical theories (Donaldson and Dunfee, 2000).

As the term suggests, corporate citizenship (CC) understands the individual company as a civic member of society, who performs civic duties, engages in civic discourse, and is socially committed. Nonetheless, this description should not belie the fact that CC encompasses a multitude of concepts. Indeed, it is not easy to differentiate it from CSR. Both terms often serve as overarching concepts for a range of entrepreneurial activities which seek to promote public welfare. In Germany, CSR has largely become the generic term. It is accompanied by a narrower definition of CC, as elucidated below (Schrader et al., 2011). An official statement of the World Economic Forum of 2002 entitled "Global Corporate Citizenship: The Leadership Challenge for CEOs and Boards," which was signed by 46 managers of multinational companies, shows just how wide-ranging the interpretation of CC is. The term global corporate citizenship covers both sustainable activity in the core business, good relations with stakeholders, and the assumption of ultimate responsibility by company boards (World Economic Forum, 2002).

From Garriga and Melé's (2004) perspective, the CC concept has been given a boost by the crisis of the welfare state and advancing globalization. A number of multinationals now have accumulated greater economic and social power than some governments. CC specifically responds to these new circumstances.

According to Schrader et al. (2011), if the three sectors—state, economy, and civil society—are taken as adjacent fields, the different approaches to CC can be illustrated as different locations within these three sectors: CC in the narrower sense at the intersection with civil society, CC in the broader sense at the intersection of civil society and the state, and CC in the broadest sense at the intersection of civil society and the state and in the core business of the company (see Figure 6.15).

According to the understanding of CC at the intersection with civil society, the company is dedicated to social concerns (Schrader et al., 2011). This can be done, for example, through corporate giving or corporate volunteering.

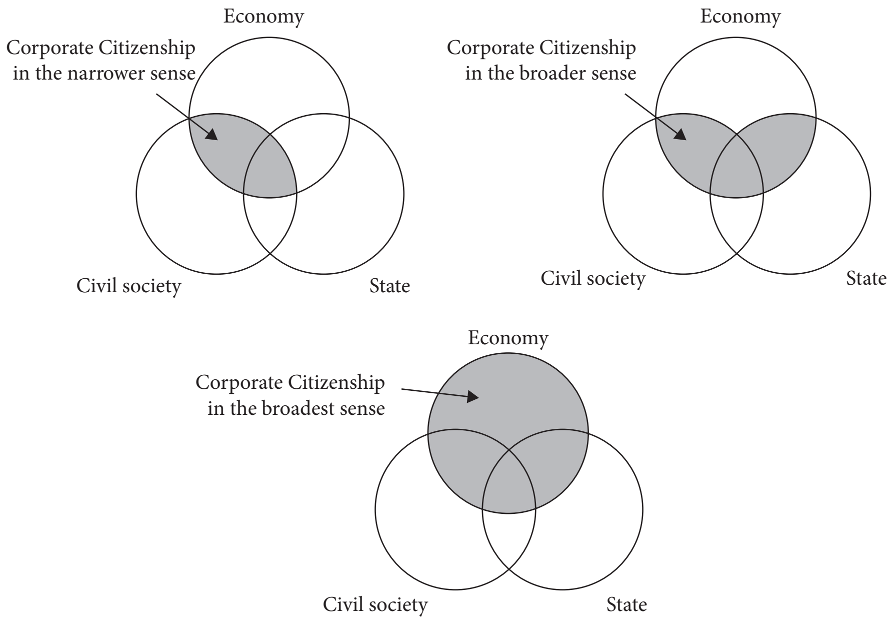


Figure 6.15 Corporate citizenship in the narrower, broader, and broadest sense
Source: Schrader et al. (2011).

Corporate giving takes various forms, such as donations or sponsorship for public welfare purposes (Schrader et al., 2011). These benefits can take the form not only of cash payments, but also include benefits in kind such as the provision of infrastructure. Unlike conventional sponsoring as a marketing instrument, donations and sponsoring within the framework of CC are often long-term in nature.

CC in the narrower sense also includes corporate volunteering. The employees of companies are committed to a socially desirable purpose. The company, for its part, encourages this commitment through paid leave for a specific purpose, integrating their commitment into their jobs, or making the company's own infrastructure available for its employees' civic engagement. One example of this are so-called action days, during which a company's staff may help to build a local playground, for instance.

CC in the narrower sense largely coincides with the concept of entrepreneurial philanthropy, according to which the entrepreneur also assumes certain responsibilities in its local region (Garriga and Melé, 2004).

According to Schrader et al. (2011), companies demonstrate civic engagement at the intersection with the state when they assume joint regulatory responsibility. It is typical that laws and norms do not always take into account current social and business conditions and requirements. Therefore, companies can also work towards a change in the regulatory framework within the scope of CC. This can be done, for example, by initiating a public discourse or by using already present lobbying work for a socially desirable purpose. A company can also assume regulatory responsibility by undertaking self-regulatory measures, for example in the form of voluntary self-regulation at the corporate or industry level.

From the standpoint of Dirk Matten and Andrew Crane, CC starts where politics fails to protect citizenship (Matten and Crane, 2005, p. 174). This view stems from the fact that some companies are gradually supplanting the formerly most powerful institutions, i.e. governments. It therefore overlaps with the CSR concept of corporate constitutionalism.

In the broadest sense of CC, the core business of a company is also included in CC activities. The focus here is on all aspects of sustainability in the production of goods and services. This means in particular that possible externalities, i.e. effects on third parties, are taken into account in the planning and implementation of business activities. Guidelines in this regard can be found, for example, in the United Nations Global Compact (UN Global Compact, 2015).

6.3.3 Criticism

The assignment of the various CSR theories to the approaches described above is hardly clear-cut. There are rather numerous overlaps and conceptual disagreements. Despite this taxonomic confusion, however, there are basic theoretical assumptions that have a decisive influence on how CSR is viewed. These basic positions are currently being mapped out in order to ultimately criticize the individual CSR perspectives.

6.3.3.1 Criticism of ethical and instrumental theories

At first glance, instrumental and ethical theories are diametrically opposed. While instrumental theories give absolute priority to corporate goals and CSR merely functions as an instrument for reputation management or profit maximization, ethical or normative theories are based on the intrinsic and morally legitimate duties that a company has towards society. Ethical theories therefore make demands on companies to act morally and, if necessary, to forgo dividends, especially where economic and ethical goals conflict (or seem to conflict) with each other.

This results in problems for both theoretical approaches. All ethical CSR theories provide a normative justification for corporate responsibility, which gives rise to obligations that go beyond economic concerns. This widespread postulate of the primacy of ethics over a pure profit orientation can often be found in CSR reports. However, it leads to a problem that has already been explained in detail, namely when implementation is not incentive based. Over the long run, competing companies that make moral commitments upfront run the risk of falling behind. Therefore, morality which solely depends on individual actions will disappear over time, unless the actors manage to transform these actions into greater profits for their company (a possibility that ethical CSR theories ignore). If the actors fail to do this, they may suffer competitive disadvantages and be eliminated from the market. Ethical CSR theories thus neglect the practical constraints of a competitive market economy, which explains why their moral appeals often fall on deaf ears.

Instrumental CSR theories, by contrast, often face the criticism that management theory imperatives are applied to the moral sphere without reflection, even though they are not intended for this purpose. Many representatives of instrumental CSR refer to the state for ensuring a regulatory framework, which brings about socially desirable results. In this case, the individual actors and companies do not have to make moral commitments in advance. Milton Friedman (1970) advocates this view. He criticizes the arbitrary assumption of social responsibility by corporate managers, since they are neither (democratically) legitimated nor competent to assume social responsibility that goes beyond their core business. Corporate philanthropy is therefore an arbitrary redistribution at the discretion of management, which violates its duty to company owners to increase profits.

Disagreement exists as to whether Friedman's point of view should be attributed to instrumental or ethical CSR. On the one hand, to his way of thinking the only legitimate justification for CSR lies in its instrumental, i.e. profit-making, advantage for a company. Here, he agrees with management-based theories that construct CSR as a business case. Garriga and Melé (2004) count Friedman's CSR concept among the instrumental theories. On the other hand, Friedman's position rests on the conviction that social welfare is best promoted not by corporate management, but by the regulatory framework established by the legislature. Indeed, for Friedman, it is a moral imperative for companies to refrain from corporate philanthropy. His CSR theory is thus inherently normative and must, strictly speaking, be attributed to ethical theories.

Nevertheless, the aspect of systematically situating moral claims at the regulatory, not the company, level provides a point of departure for criticizing the instrumental view of CSR. Recent decades have been marked by serious structural changes and shifts in power. The traditional system, in which the responsibilities for social welfare lie with powerful nation states, has thus begun to falter. The inevitable result is a power vacuum. On the one hand, the governments of nation states that used to have the power and the obligation to take on social responsibilities are forfeiting these competencies. On the other, multinational companies are emerging that operate in different jurisdictions. Their considerable scope for action calls into question the effectiveness of the national regulatory power. In addition, companies sometimes become so big and important that they can have great influence on the welfare of a society and on politics, e.g. as the most important employer or payer of corporate tax in a municipality. In this context, one can certainly question the exclusive attribution of responsibility to nation states. The issue of corporate responsibility in society is therefore a central question of CSR theory which has by no means been conclusively answered.

6.3.3.2 Criticism of integrative theories

Integrative CSR theories are an attempt to unite instrumental and ethical approaches. Here, the demand is made that companies act in accordance with the interests of society. One of the most prominent CSR theories that can be classified under this theoretical approach is stakeholder management theory. In essence, this theory contends that the company's interests are best promoted by taking the demands of stakeholders into account, as it can lead to new opportunities and risks can be minimized.

On closer inspection, however, the stakeholder theories fall into either instrumental or normative theories. The above-mentioned problem of implementation or of a hasty spurning of responsibility (by not taking the current circumstances into account) holds true. Stakeholder theories, therefore, cannot be understood as a true synthesis.

A similar criticism also applies to the CSV approach. Even if Porter and Kramer present their concept as a novelty that is to replace all CSR concepts, CSV can nevertheless be located between the poles of instrumental and ethical CSR. As in the concept of shared value, win-win situations are aimed at which both increase the company's profits and satisfy social needs. Similarly, the emphasis on the implementation of particularly worthwhile social value creation in the core business clearly points to a departure from the promotion of social purposes that are detached from the company's core competencies. The social purpose is not to be promoted for the sake of charity, but out of a deeper understanding of competition and value creation—even if Porter and Kramer do not quite understand what this deeper understanding should consist of.

Just the same, when the authors speak of "the right kind of profits" there is clearly an ethical component. What is more, numerous terms used to differentiate conventional CSR concepts are normatively charged. Consider, for example, when the authors speak of the need to turn away from short-term profit maximization. The concept is based on the strong assumption that

Table 6.5 Pros and cons of CSR

Pros	Cons
CSR as an investment in a company's reputation (Homann and Lütge, 2013)	Embezzlement of shareholder funds by managers who pursue CSR to improve their own social status (Friedman, 1970)
CSR as an effective tool for successful interaction with stakeholders	Managers' lack of ability to deal effectively with social problems (Friedman, 1970)
Positive effects of CSR on the bottom line of companies (Margolis and Walsh, 2003; Orlitzky et al., 2003)	Politics and civil society are responsible for solving social problems (Friedman, 1970)
The assumption of ecological responsibility can minimize risks through the future enactment of stricter laws and legal prosecution against certain practices (Vogel, 2005)	CSR is a trendy concept; due to a lack of real transparency and verifiability it can be used for very different purposes
Empirical studies show that CSR and a company's financial performance (CFP) are positively correlated (Orlitzky et al., 2003; Orlitzky, 2008). As far as the causal connection is concerned, the authors conclude that both CFP is a cause of CSR and vice versa (Orlitzky et al., 2003; Orlitzky, 2008). CSR and CFP probably reinforce each other in a positive upward spiral (Waddock and Graves, 1997). There is little evidence that CSR limits a company's ability to create value (Margolis and Walsh, 2003)	Other studies have not been able to show a positive correlation between CSR and the financial performance of a company (Vogel, 2005)

investments by companies that simultaneously promote social needs are generally more profitable, innovative, and sustainable than businesses that only aim at maximizing profits. This claim, though, is not entirely obvious (see Table 6.5). Furthermore, the difference between economic value creation and shared value can only be seen as a marginal difference, but not as an (alleged) categorical difference.

6.3.3.3 Criticism of political theories

Political CSR theories justify corporate responsibility in the context of a transformation towards a globally networked world in which the regulatory power of nation states is becoming weaker and weaker. This regulatory responsibility would now be transferred at least in part to multinational corporations, which would have to assume this new task in order to maintain their social legitimacy. In doing so, they become decisive actors in a process that was traditionally supported by largely democratically legitimized governmental bodies.

True enough, the question of legitimacy can also be reversed: How can responsibility be derived from the mere fact of having power? And is it even desirable for regulatory power to lie in the hands of actors that traditionally are not democratically legitimized? For his part, Milton Friedman clearly rejects the arbitrary philanthropic actions of companies because of their lack of traditional political legitimacy. It is the task of political CSR to come up with answers to these objections.

6.3.3.4 Pros and cons of CSR

CSR has become an integral part of the corporate philosophy and strategy of numerous companies. Moreover, the concept has become a permanent fixture of political discourse, and the public has been aware of the issue of corporate responsibility for years. Still, the extent to which the concept of CSR is ultimately meaningful, useful, and beneficial remains open to debate.

Table 6.5 gives an overview of the most common arguments used for and against CSR. Whether or not one supports them, they all need to be grappled with.

6.3.4 Corporate social irresponsibility

The term corporate social irresponsibility (CSIR) refers in the first place to major corporate scandals (Jones, 2013). Examples include the environmental disaster surrounding the oil drilling platform Deepwater Horizon in the Gulf of Mexico in 2010 (see practice box 6.10) or the financial crisis triggered by the collapse of Lehman Brothers. In fact, the analysis of corporate scandals is an important aspect of CSR research, as it can provide important insights into misguided incentives or absent compliance. For example, the analysis of the banking crisis has helped identify a number of inherently risky practices. Consequently, it is now possible (at least in theory) to introduce institutional changes that will make the system less susceptible to risk in the future.

CSIR can also be understood as a negative definition of corporate responsibility. CSR from this perspective means that a company tries to remedy misconduct (D'Anselmi and Di Bitetto, 2013). The question that presents itself here is how a company can permanently avoid irresponsible action. Thus, the CSIR concept overlaps areas of risk concepts. Dealing with this question seems to be of little interest at first and certainly not relevant to the effective external presentation of a company. From a theoretical point of view, however, it is a logical step to first uncover and abolish harmful practices. Thus, the avoidance of CSIR is necessarily part of a company's core business and clearly differentiated from CSR concepts, which see the assumption of social obligations as a purely voluntary supplement.

Practice box 6.10 Deepwater Horizon

Timeline

On April 20, 2010, explosions and fires occurred on the Deepwater Horizon oil platform in the Gulf of Mexico, 49 miles off the coast of Louisiana. Natural gas reached the platform in large quantities from the oil well and ignited there. Emergency systems failed and eleven people were killed. At the time of the accident, the source had just been tapped and final tests to check the tightness of a cement barrier had been carried out. Two days later, the platform sank during the fire-fighting operation; a week after the explosion, oil spillage into the sea was confirmed. The well was not closed until several months later on July 15, after several failed attempts. In mid-September, the coastguard also confirmed that no more oil was escaping from the well.

The environmental damage

About 4.9 million barrels of crude oil leaked out, corresponding to 780 million liters. The coastlines of five US states were affected, making the Deepwater Horizon the biggest maritime oil disaster in history.

Participating companies

BP explored the oil deposit and planned the exploitation. It was the main owner of the oilfield, the legal operator of the platform, and thus chiefly responsible for the work and the safety precautions. As the largest provider of offshore drilling vessels and platforms worldwide, Transocean leased the Deepwater Horizon platform to BP. The company was responsible for operating the platform and provided most of the crew. Halliburton was responsible for the cement work at the borehole and equipping the oil rig with monitoring equipment for the deposit. Cameron was the manufacturer of the blowout preventer. Anadarko and MOEX were co-owners of the Macondo oilfield.

Some causes of the disaster

Deficient workmanship on the cement barrier and deficient training of personnel in execution of the negative pressure test and in response to a “blowout” were identified as causes of the disaster. There were already gas failures days before, but they were noticed too late. A failure of the blowout preventer was another cause of the disaster. This happened against the background of high time pressure due to delay in opening (planned March 8) and overrun of budget ($58 million over budget). BP was also criticized for a lack of communication with the companies involved, especially with regard to the risks of the project

Continued

Practice box 6.10 Continued

Costs incurred by BP

BP incurred total costs of approximately 55.5 billion dollars by 2015 (BP Annual Report, 2015, p. 42).

Spill response	14.3 billion dollars
Environmental restoration	8.6 billion dollars
Litigation and claims	22.6 billion dollars
Clean Water Act penalties	4.1 billion dollars
Other fines	4.5 billion dollars
Functional costs	1.4 billion dollars

Reputational damage for BP

Since 2001, BP had tried to promote a new image ("Beyond Petroleum" instead of "British Petroleum," see also Section 6.3.4.2). In the course of the debate on climate change, attempts were made to position the company as a pioneer in the field of renewable energies. This was to be underscored, among other things, by a new logo, resembling a sun or sunflower. The Deepwater Horizon scandal led to calls for boycotts.

Legal consequences for BP

BP was no longer allowed to conclude any new contracts with the US government between November 2012 and 2014. On July 12, 2010, the US Secretary of the Interior imposed a moratorium on offshore drilling. On October 12, 2010, it was finally lifted after the introduction of increased security measures. In addition, the former Mineral Management Service split into the Bureau of Ocean Energy Management, the Bureau of Safety and Environmental Enforcement, and the Office of Natural Resources Revenue.

Sources:

BP (2015). Annual Report and Form 20-F 2015. Last accessed June 2, 2017 at: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/investors/bp-annual-report-and-form-20f-2015.pdf

Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE) (2011). Report Regarding the Causes of the April 20, 2010 Macondo Well Blowout. Last accessed June 2, 2017 at: http://docs.lib.noaa.gov/noaa_documents/DWH_IR/reports/dwhfinal.pdf

Environmental Protection Agency (EPA) (2015). Deepwater Horizon—BP Gulf of Mexico Oil Spill. Last accessed June 2, 2017 at: https://www.epa.gov/enforcement/deep-water-horizon-bp-gulf-mexico-oil-spill#settlement

National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling (2011). Deep Water: The Gulf Oil Disaster and the Future of Offshore Drilling. Last accessed June 2, 2017 at: https://www.gpo.gov/fdsys/pkg/GPO-OILCOMMISSION/pdf/GPO-OILCOM MISSION.pdf

From a philosophical point of view, this approach can be justified by Karl Popper's critical rationalism: According to his theory of "negative utilitarianism," the consequences of an action constitute—as in classical utilitarianism—the assessment standard. But the aim is no longer to increase the happiness of all, but to avoid suffering. CSIR can be understood in a similar way (D'Anselmi and Di Bitetto, 2013).

The primary objective of CSIR is to identify and analyze the causes of malicious practices in a company in order to then find out how these practices can be systematically altered or wholly eliminated. This can be done, for example, on the basis of corporate-conduct guidelines such as the checklist of the Global Reporting Initiative (an excerpt from the guidelines to sustainability reporting of the Global Reporting Initiative can be found in Table 6.6).

D'Anselmi and Di Bitetto provide four values that can guide the process of identifying CSIR practices within the company. The aim is (1) to stand up for the unknown stakeholder, who cannot defend her position herself, for example an unborn child who will be significantly affected by air and water pollution. As a second guideline, (2) the authors cite the selective disclosure of company information. The aim is to raise awareness of the operations in a straightforward and unembellished way in internal and external communication. The value of the implementation (3) stands in sharp contrast with the policy of announcements. Tied to this is the development of ways to measure performance. Among other things, a code of ethics can be used. The implementation of micro-ethical standards (4), for example, can consist in steering clear of false information or of denigrating competitors (under micro-ethical the authors understand small everyday decisions that can be made in line with moral standards).

The term CSIR is informed by a constructive approach to cleansing the core structures of a company from illegal or immoral practices. The intention is not just to avoid damage to third parties, but also to minimize the risks to a company.

In connection with CSIR, the concept of corporate misconduct or corporations as psychopaths is sometimes discussed. It is worth mentioning here for reasons of completeness. Analogous to an individual, a corporation is certified as having failed to behave in accordance with standards, accompanied by the inability to recognize and regret inherent misconduct (Brueckner, 2013). This is underpinned by the view that companies have an independent will, act deliberately, and can also be held accountable according to certain moral principles. The idea is based on a virtue-ethical approach of corporate responsibility, which can be attributed to ethical CSR approaches and which generally stress the voluntary nature of CSR as a civic virtue. It

Table 6.6 Excerpt from the reporting principles and standard disclosures of the Global Reporting Initiative

Category	**Economic**		**Ecological**	
Aspects	• Economic performance • Market presence • Indirect economic effects • Procurement		• Materials • Energy • Water • Biodiversity • Emissions • Waste water and rubbish • Products and services • Compliance • Transport • Supplier's evaluation regarding ecological aspects • Complaints procedure regarding ecological aspects	
Category	**Societal**			
Subcategories	Working practices and humane employment	Human rights	Society	Product responsibility
Aspects	• Employment • Employer–employee relationship • Safety and health at work • Education and training • Diversity and equal opportunity • Equal salary for women and men • Evaluation of suppliers regarding working practices • Complaints procedures regarding working practices	• Investments • Equal treatment • Freedom of association and right to collective bargaining • Child labor • Forced or compulsory labor • Safety practices • Rights of the indigenous population • Scrutiny • Evaluation of suppliers regarding human rights • Complaints procedures regarding human rights	• Local communities • Fight against corruption • Politics • Anti-competitive behavior • Compliance • Evaluation of suppliers regarding societal effects • Complaints procedures regarding societal effects	• Customer health and safety • Labeling of products and services • Marketing • Protection of customer data • Compliance

Source: Global Reporting Initiative (2019).

should be noted that when attributing personal psychopathological behaviors to a company, the structural conditions and constraints are systematically ignored. This approach, therefore, only has descriptive or analytical benefits. Proponents of a structural economic-ethical approach come to different conclusions regarding the phenomenon "corporations as psychopaths": They argue that the misconduct of companies shows that institutional guidelines should be used to ensure sanctions for such behavior. Ideally, then, misconduct would never even arise.

6.3.4.1 Corporate hypocrisy

In psychological research, the term hypocrisy refers to behavior in which a person wants to appear moral without having to bear the costs (Batson et al., 1997). In moral matters, he might set more lenient standards for himself than for others, which is further reflected in his judgments of behavior (Valdesolo and DeSteno, 2007). The various definitions all characterize an attitude that is consistent with the principle of "preaching water, but drinking wine." Similarly, Wagner et al. (2009) define corporate hypocrisy as exemplified when a firm claims to be something that it is not. Furthermore, the authors assume that companies as well as individuals can be accused of hypocrisy if inconsistencies exist between the way they present themselves and how their actions are perceived.

In general, the phenomenon of corporate hypocrisy can be treated in two ways: On the one hand, the hypocritical behavior of companies can be detected and analyzed in order to develop avoidance strategies. There is a large overlap here with CSIR. On the other hand, a spotlight can be put on the recipients of the hypocritical behavior, such as the customer, the business partner, or the public at large. The relevant questions are to what extent stakeholders classify a company as hypocritical and how companies can work to change this perception. This second approach predominates in corporate hypocrisy research. In an experimental study, for example, Wagner et al. (2009) found that, when there are conflicting perceptions about a company, those with a proactive communication strategy are assumed to behave more hypocritically than those with a reactive communication strategy. Kotchen and Moon (2011) investigated a possible connection between corporate misconduct (CSIR) and corporate responsibility (CSR) based on data from almost 3,000 companies. Their analyses showed a positive correlation: Those companies that do more "harm" are also doing more good. The authors interpret this link as a compensation strategy: Companies would have a particular incentive to become involved in CSR activities if they could compensate for behavior that is perceived as irresponsible. This strategy falls into the category of corporate hypocrisy.

The problem of corporate hypocrisy becomes especially apparent when one realizes that a company with CSR standards will sooner or later find itself in situations where hypocrisy is indispensable due to the different and sometimes contradictory demands of the various stakeholders (La Cour and Kromann, 2011; Cho et al., 2015). Imagine a company that sets itself the goal of implementing the highest environmental standards at all of its production sites, while also guaranteeing its employees long-term contracts and a pension. These different demands can quickly come into conflict, however, when there is a slump in orders and thus a loss of revenue. If the financial means are not available to implement new environmental standards *and* appropriately endow employees, violating of one of the established standards is inevitable. Indeed, the different claims can even contradict each other: The expansion of a production plant would create jobs but would also mean an additional emissions burden at the site. When deciding on a measure, the company then automatically finds itself in tight spot. For instance, the company that decides against expanding a production plant due to environmental constraints, which then leads to job cuts, can be perceived as hypocritical by the affected workforce.

Accordingly, one can understand corporate hypocrisy as the frequently occurring downside of CSR. It is only when a company makes a commitment to socially responsible action that expectations are built up, which poses the risk that the company might violate its own standards. In this case, the company is not only guilty of wrongdoing (whether from a judicial or moral standpoint), but it also bears the burden of being perceived as a hypocrite. One example of this is VW's emissions scandal: In addition to the systematic manipulation of the test results of diesel motors, there was the outrage and the associated damage to the VW Group's image. It was so extensive because the carmaker had claimed to be the world leader in environmentally friendly technologies and was even awarded a sustainability prize (Plungis, 2015; Lynes, 2015).

Researchers recognize corporate hypocrisy as an opportunity precisely because it can uncover contradictions in a company's CSR policy. Christensen et al. (2013) argue, for example, that a discrepancy between words and deeds (i.e. corporate hypocrisy) is not necessarily bad. In fact, it bears the potential to stimulate improvements in the area of CSR. While the ideals formulated in CSR communication can rarely be fully met, they nevertheless serve as important catalysts for social change.

6.3.4.2 Greenwashing

Greenwashing is a form of corporate hypocrisy that has been discussed in the context of CSR for some time. The term, which is widely used not only in the context of CSR research but also in public, describes the practice of a company to paint itself in an environmentally friendly way without having the results to justify it. Depending on the exact definition, greenwashing includes covering up environmentally harmful behavior through "green" initiatives or an emphasis on sustainability activities which, in fact, have no effect. Some authors like biologist and activist Jay Westerveld, who coined the term greenwashing in 1986, go so far as to accuse companies of greenwashing if an environmental measure also has financially positive aspects (Becker-Olsen and Potucek, 2013). For instance, Westerveld accuses hotels of greenwashing when they represent the reuse of towels as a conservation measure when the real reason is to reduce costs. However, such a strict ethics of ultimate ends is not especially prevalent in CSR research. Becker-Olsen and Potucek (2013) describe greenwashing as a practice of spuriously emphasizing environmentally friendly efforts, whereby more resources are actually used to portray the company as environmentally friendly (i.e. in marketing) than to protect the environment itself. This definition also has its detractors, however. First of all, the relationship between expenditures on advertising and environmental protection measures can be questioned. What should the expenditure ratio for a company be for it to start marketing its environmental protection initiatives? And why should we presuppose an assessment criterion other than the effect of the measure? Here, too, an ethics of ultimate ends is at hand, which nonetheless requires further justification.

The BP "Beyond Petroleum" initiative offers a vivid example of greenwashing. Sustainable energies still account for a tiny fraction of the company's revenue and the company also neglects its fiduciary duty with regard to hazardous technologies (see practice box 6.11: Beyond Petroleum). The company's shift towards promoting sustainable energy is therefore likely due more to marketing considerations,

Practice box 6.11 Beyond Petroleum

Timeline

1996: BP is the first oil company to withdraw from the Global Climate Coalition, a coalition of companies that denied climate change and inter alia lobbied against the Kyoto Protocol.

Continued

Practice box 6.11 Continued

1997: BP officially acknowledges the problem of climate change.

1998: BP wants to reduce its greenhouse gas emissions by 10 percent compared to 1990 by 2010 (BP, 1998, p. 9).

1999: BP acquires solar panel manufacturer Solarex for 45 million dollars. The company has 20 percent market share (BP, 1999, p. 26). BP had been in the solar business since 1981 (Electronics and Power, 1981).

2000: Acquisition of oil producers ARCO (34 billion dollars) and Burmah Castrol (BP, 2000, p. 4-5).

2000: New corporate identity: BP Amaco is renamed BP. "British Petroleum" becomes "BP—Beyond Petroleum."

2002: Award: Britain's Most Admired Company (BSI, 2013).

2005: Foundation of "BP—Alternative Energy" (BP, 2005, p. 16), with the goals of (1) an investment of 1.8 billion dollars over the next three years, (2) 8 billion dollars investment by 2015, (3) a coverage of the areas solar, wind, hydrogen, and gas power, and (4) the hiring of 2,500 workers in these areas.

2005: Explosion at a Texas refinery due to lack of maintenance. 15 dead, 170 injured.

2006: Leak in a pipeline in Prudhoe Bay in Alaska due to lack of maintenance: "An internal inquiry at BP after the Alaska spill came to some alarming conclusions. The internal investigation found that the company had a pattern of . . . intimidating workers who raised safety or environmental concerns. It said managers shaved maintenance costs by using aging equipment for as long as possible" (Cherry and Sneirson, 2011, p. 997).

2006: Acquisition of Orion Energy and Greenlight Energy to gain expertise in wind power. Cooperation with General Electric in hydrogen technology.

2008. Entry into biofuel (plan to invest 1 billion dollars) by purchasing shares in Tropical BioEnergia. Cooperation with Verenium Corporation and cooperation with DuPont (since 2003).

2009: Closure of solar production plants in Maryland and Madrid → Production only in China and India (due to high costs).

2010: Deepwater Horizon disaster in 2011: Sale/dissolution of the solar division.

2011: Purchase of Companhia Nacional de Açúcar e Álcool (CNAA) for 705 million dollars → Production of biofuels.

2013: Attempt to sell the wind division; despite offers no sale.

2015: Quote from the Annual Report (BP, 2015, p. 40): "BP has the largest operated renewables business among our oil and gas peers. Our activities are focused on biofuels and onshore wind."

The campaign

The goals were the creation of a corporate identity after many mergers and the creation of a positive image with the intention to differentiate themselves from the competition (especially in the service-station business). The marketing expenses amounted to 200 million dollars and included a name change from "British Petroleum" to "Beyond Petroleum." The old shield logo was replaced by the sunburst logo known as "Helios." The Helios Award was awarded to employees who had rendered outstanding service to the company and the "Helios House" was constructed as an energy-efficient filling station (Cherry and Sneirson, 2011, p. 1002). Campaign taglines such as "It's a start" are to make it clear that at least small steps were being taken.

BP was able to achieve marketing success through the Beyond Petroleum campaign. In 2001, *PR Week* named the campaign the Brand Development Campaign of the Year and the Internal Communication Campaign of the Year (PR Week, 2001). In 2002, BP was "Britain's Most Admired Company." Furthermore, the greenhouse gas reduction targets of 1998 could be achieved. They went down from 82.8 million metric tons of carbon dioxide equivalents to 81.7 in 2004 (BP, 2004), to 64.9 in 2010 (BP, 2010), to 55.8 in 2015 (BP, 2015) and to 51.7 in 2019 (BP, 2019). BP was recognized for the signal effect it has produced as being the first oil company to recognize the danger of climate change. Until 2013, the company could also show a strong growth in wind power and until sale, also in biofuel and solar energy.

A case of greenwashing?

Only minimal investments were made in renewable energy compared to oil and gas. These amounted to 8.3 billion dollars in eight years, while investments in oil regularly exceeded 25 billion dollars per year. In the core business, there were many (environmental) disasters that could have been avoided. Oil sands were degraded and fracking was undertaken in sensitive areas. No long-term commitments were made and today, biofuel is virtually the only portion of the company dedicated to non-fossil fuels. The company has not published any clear vision, but has mainly acquired existing companies.

Sources:

BP (1998). *Annual Report and Accounts 1998*. Last accessed June 2, 2017 at: http://library.nioc.ir/free-e-resources/BP%20Annual%20Report%20and%20Accounts/Annual_Report_1998.pdf

BP (1999). *Annual Report and Accounts 1999*. Last accessed June 2, 2017 at: http://library.nioc.ir/free-e-resources/BP%20Annual%20Report%20and%20Accounts/Annual_Report_and_Accounts_1999.pdf BP (2000). *Annual Report and Accounts 2000*. Last accessed June 2, 2017 at: http://library.nioc.ir/

Continued

Practice box 6.11 Continued

free-e-resources/BP%20Annual%20Report%20and%20Accounts/Annual_Report_and_Accounts_2000.pdf

BP (2004). *Annual Report and Accounts 2004*. Last accessed June 2, 2017 at: http://library.nioc.ir/free-e-resources/BP%20Annual%20Report%20and%20Accounts/BP_ARA_2004_annual_report_and_accounts.pdf BP (2005). *Annual Report and Accounts 2005*. Last accessed June 2, 2017 at: https://ddd.uab.cat/pub/infanu/43618/iaBPa2005ieng2.pdf

BP (2010). *Annual Report and Form 20-F 2010*. Last accessed June 2, 2017 at: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/investors/bp-annual-report-and-form-20f-2010.pdf

BP (2015). *Annual Report and Form 20-F 2015*. Last accessed June 2, 2017 at: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/investors/bp-annual-report-and-form-20f-2015.pdf

BP (2019). *BP Sustainability Report 2019*. Last accessed July 23, 2020 at: https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/sustainability/group-reports/bp-sustainability-report-2019.pdf

BSI (2013). *Britain's Most Admired Companies (BMAC)*. Last accessed on June 2, 2017 at: https://www.bsigroup.com/en-GB/about-bsi/media-centre/Britains-Most-Admired-Companies-BMAC/

Cherry, Miriam A. and Sneirson, Judd F. (2011). Beyond Profit: Rethinking Corporate Social Responsibility and Greenwashing after the BP Oil Disaster. *Tulane Law Review*, 85(4), 983–1038.

Electronics and Power (1981). BP and Lucas Form Solar Company. *Electronics and Power*, 27(3), 204. Last accessed on June 2, 2017 at: http://ieeexplore.ieee.org/stamp/stamp.jsp?arnumber=05185626

PR WEEK (2001). *PR WEEK AWARDS 2001: PR Week Award Winners 2000–2001*. February 19, 2001. Last accessed on June 2, 2017 at: http://www.prweek.com/article/1238330/pr-week-awards-2001-prweek-award-winners-2000–2001

Since the 1980s and 1990s, the public's awareness of sustainability and ecology has grown considerably—first, in Western industrialized countries, but now also in many other parts of the world. In the wake of several environmental scandals, a spotlight was shone on the environmental impact of industry. This gradually led to a demand for goods produced in an ecologically and resource-friendly manner. What was an initially small alternative movement eventually experienced a boom. A point was then reached when companies could hardly afford to ignore sustainability aspects when dealing with end customers. Corporate scandals such as Volkswagen's diesel emissions scandal demonstrate that a company's public image does not always coincide with the facts. Here, too, the increased sustainability demands on companies provide fertile ground not only for actual efforts to produce in a more resource-friendly manner, but also for greenwashing. Accordingly, the accusation of greenwashing mostly arises in relation to consumers. As the criticism goes, they have been misled into believing that the respective company has been reducing its harmful impact on the environment (e.g. by reducing energy consumption or better filtering emissions in air and water).

Numerous greenwashing allegations are also the product of inadequate definitions of what is "green" or "environmentally friendly." One attempt to establish clear standards here is the European Commission's Integrated Product Policy (IPP) initiative. The aim is to cover the entire product cycle and to exploit the potential for minimizing environmentally harmful influences. Serving as instruments of the initiative are, among other things, voluntary agreements, standardization, and new labels for the orientation of consumers. These clearer standards with precisely defined criteria are also in the interest of companies, for they safeguard against accusations of greenwashing. Exceedingly high demands on a company's sustainability policy can bring its initiatives to a halt. If a committed company is suspected of greenwashing because its measures do not go far enough or are not being implemented quickly enough, this can lead the company to pull back entirely and discontinue the measures. Unambiguous labels can help companies avoid such scrutiny. While they certainly increase customer confidence in the product overall, they are nevertheless also prone to abuse.

Cases abound of label fraud (see practice box 6.12: Label fraud). When quality seals such as the Blue Angel, the certificate for the protection of humans and the environment, are misappropriated as a fig leaf, one sometimes speaks of bluewashing.

Practice box 6.12 Label fraud

Example 1: The "Neuland" Seal

Issuer: Deutscher Tierschutzbund, Bund für Umwelt und Naturschutz Deutschland, Arbeitsgemeinschaft bäuerliche Landwirtschaft

The case

A farmer from Lower Saxony, one of Neuland's largest suppliers, bought conventionally fattened birds for many years, slaughtered them and sold them as certified poultry to butchers through Neuland's distribution company. With the farmer's own fattening process, he systematically kept more animals than allowed per the Neuland guidelines for a certain area.

In the course of uncovering the case, the farmer accused Neuland of demanding delivery quantities that could only be met by circumventing the Neuland

Continued

Practice box 6.12 Continued

regulations. He also spoke of special provisions that enabled him to purchase older chicks from conventional fattening farms, so that they lived under Neuland conditions for only half of their lives.

Incurred damage

Consumers were deceived by the product and thus paid more for a conventional product. The farmer's short notice of termination resulted in a loss of revenue the following Christmas season totaling the amount of unmet demand.

Consequences

The Ministry of Agriculture of Lower Saxony announced additional inspections. The responsible managing director of Neuland GmbH was replaced; now the association is headed by sponsoring associations.

Example 2: Certified Sustainable Palm Oil

Issuer: Round Table on Sustainable Palm Oil (RSPO)

The case

According to the NGOs "Milieudefensie" and "Friends of the Earth Europe," the Malaysian palm oil producer and RSPO co-founder of the IOI Corporation did not comply with legal requirements and the standards of the RSPO: In Indonesia, illegal clearing and planting took place, destroying tropical forests and draining peat bogs. In addition, clearing was carried out despite the "zero-burning policy." The NGOs uncovered the practices by means of aerial photographs and there were also complaints from locals. In 2015, the sustainability consultancy "Aidenvironment" officially filed a complaint against IOI.

Incurred damage

The rainforest was damaged through illegal deforestation and clearing.

Consequences

In March/April 2016, IOI was finally excluded from the RSPO and may no longer sell its products under the seal. As a result, the largest palm oil buyers and food multinationals Unilever, Kellogg Company, and Mars Inc. terminated their cooperation with IOI. It remains possible that other companies will also no longer purchase IOI products. IOI announced the launch of a corrective action plan.

Sources:
Furlong, Hannah (2016). Unilever, Kellogg, Mars Drop Major Palm Oil Supplier After RSPO Revokes Its Certification. *Sustainable Brands*, April 4. Last accessed June 2, 2017 at: http://www.sustain-

ablebrands.com/news_and_views/supply_chain/hannah_fur-long/unilever_kellogg_drop_major_palm_oil_supplier_after_rspo

IOI Group (2016a). *Statement by IOI Chief Executive Officer on RSPO Suspension*. Last accessed June 2, 2017 at: http://www.ioigroup.com/Content/NEWS/NewsroomDe- tails?intNewsID=778

IOI Group (2016b). *IOI Withdraws Legal Challenge Against RSPO Board's Decision*. Last accessed June 2, 2017 at: http://www.ioigroup.com/Content/NEWS/Newsroom- Details?intNewsID=804

Kunze, A. (2014a). Der Betrug am guten Gewissen. *Die Zeit*, April 16. Last accessed March 29, 2017 at http://www.zeit.de/2014/17/neuland-gefluegel-mas- sentierhaltung

Kunze, A. (2014b). Im Misthaufen. *Die Zeit*, April 24. Last accessed March 29, 2017 at http://www.zeit.de/2014/18/neuland-betrug-gefluegelfleisch

Kunze, A. (2014c). Hähnchen zählen. *Die Zeit*, April 30. Last accessed March 29, 2017 at http://www.zeit.de/2014/19/neuland-gefluegel-betrug

Kunze, A. (2015). Neuland wechselt Führung aus. *Die Zeit*, January 7. Last accessed March 29, 2017 at http://www.zeit.de/wirtschaft/2015-01/tierschutz-fleisch-neu-land-verein

Milieudefensie and Friends of the Earth Europe (2010). *Too Green to be True*. Last accessed June 2, 2017 at: http://www.foei.org/wp-content/uploads/2014/01/Too_Green_to_ be_True0310.pdf

Sustainable Brands (2016). *RSPO Introduces Voluntary Advanced Add-On Criteria for Sustainable Palm Oil. Supply Chain*. Last accessed June 2, 2017 at: http://www.sustainable-brands.com/news_and_views/supply_chain/sustainable_brands/rspo_introduces_vo-luntary_advanced_add-criteria_sust

The Greenwashingindex.com is taking another approach: Consumers can use this portal to evaluate the advertising of companies with regard to greenwashing. This resulting index is intended to provide information about a company's environmental friendliness. The evaluation criteria include the degree of implication, exaggeration, or even clarity of the claimed product properties, since vague statements are difficult to verify.

Reputational risks arise whenever a company fails to meet either its own standards of social responsibility or those that have been placed on it from the outside. This especially applies to failures in the area of environmental friendliness, since the impact here is quite visible.

6.3.5 CSR from an experimental perspective

Bénabou and Tirole (2010) analyze the psychological mechanisms underlying individual and corporate responsibility. They interpret these mechanisms as a complex interplay of genuine altruism, material incentives, and concern for one's self- or public image. In order to distinguish between ineffective and effective CSR activities, these mechanisms would have to be analyzed on a case-by-case basis. At the same time, experiments in social research can help us to better understand the motives of certain actions. There are instructive findings in experimental economics and social psychology on the individual motives of prosocial behavior. For instance, people who want to invest in sustainability and environmental protection tend to take measures that are visible to the outside world (Ariely et al., 2009). They might buy an electric vehicle or install solar panels on the roof of their houses. By contrast, even if they are more effective, less visible measures such as investing in better thermal insulation are being implemented much less frequently.

If a company or a state organization wants to intervene in this area to bring about more effective environmental protection, they must first analyze the extent to which social prestige or self-image plays a role. These findings can then yield specific guidelines. For example, measures which are not readily taken by the actors because of their limited visibility might be promoted by external incentives. In offering monetary incentives, another phenomenon should be considered that is also well known in social research: the crowding-out effect. Here, an intrinsic motivation to do good is suppressed by additional monetary incentives. In this instance, too, it is necessary to understand the motives for taking socially responsible action. If an action is mainly the result of genuine altruism, then no additional extrinsic incentives are necessary. Indeed, they may even be counterproductive. If an action to promote a common good (e.g. clean air) is motivated by its positive impact on the public image of an actor (e.g. company), then measures to improve external communication (such as sustainability awards) can create additional incentives.

Furthermore, Bénabou and Tirole reflect on the development of the asset of “prestige,” the augmentation of which is sought by every company that conducts CSR. They characterize the pursuit of social prestige as a zero-sum game, or, in other words, as a positional good. This means that an improvement in an actor’s social standing is always at the expense of the standing of the actor’s neighbors or competitors. The actor seeks to stand out from them, for example through a conspicuous investment in sustainability. If the competitor follows suit, making a similar commitment to some social purpose to improve its own public image, the actors find themselves at the same level. Neither, then, benefits from a prestige advantage over their competitor. Evidence from several experiments by Monin and colleagues (Monin, 2007; Monin et al., 2008) shows that study participants in morally contentious situations are primarily interested in punishing unflinching moral actors. They want to prevent their own identities—conveyed by their self- and public image—from being downgraded by the shining example of another. Such effects can also be quite positive, however. Thus, one can easily conceive of a sustainability “arms race” between competing actors, in which the external impact, for instance, of maintaining clear air or saving energy continuously improves.

In addition, Bénabou and Tirole fundamentally inquire about the usefulness of CSR with regard to the goal of achieving socially desirable ends. In their view, all CSR activities can basically be understood as manifestations of three different approaches: First, CSR can consist of companies taking a longer-term perspective on their business. Second, CSR can be implemented by a company on behalf of its stakeholders. Third, CSR can manifest itself as corporate philanthropy. As explained earlier, it still has not been clearly shown that there is a positive correlation between CSR and financial growth. It is particularly important to analyze which one of the three forms of CSR companies advocate. For example, corporate philanthropy, in which profits are sacrificed for a good cause on the initiative of the company owner, generally results in less revenue.

It is difficult to predict how the CSR movement will develop in the long run. There may come a time when reputational gains resulting from CSR activities evaporate because most companies adopt corporate social and ecological responsibility as a common practice. In the future, customers and business partners may take CSR for granted. On the other hand, one can argue that with constantly advancing (environmental) technology there will always be new opportunities for a company to distinguish itself as a socially responsible actor. The competition for social prestige will remain intense for the foreseeable future.

Note

1. See on the principal-agent theory Jensen and Meckling (1976) and Meyer (2004).

References to Chapter 6

Section 6.1

Bauer, Silvia C. (2013). Datenschutzrechtliche Compliance im Unternehmen. In: G. Wecker and B. Ohl (Eds.), *Compliance im Unternehmen*. Wiesbaden: Springer.

Bundeskriminalamt (BKA) (2019). *Korruption. Bundeslagebild 2018*. Wiesbaden: Bundeskriminalamt. Last accessed August 6, 2020 at: https://www.bka.de/SharedDocs/Downloads/DE/Publikationen/JahresberichteUndLagebilder/Korruption/korruptionBundeslagebild2018.pdf?__blob=publicationFile&v=6

Deloitte (2019). *The Future of Compliance 2019: Herausforderungen und Trends*. Last accessed July 29, 2020 at: https://www.compliance-manager.net/sites/default/files/dateien/future_of_compliance_2019_deloitte.pdf

Ernst & Young (2017). Human Instinct, Machine Logic: Which Do You Trust Most in the Fight Against Fraud and Corruption? Europe, Middle East, India and Africa Fraud Survey 2017. Last accessed July 29, 2020 at: https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/digital/ey-emeia-fraud-survey-2017.pdf

Göbel, Elisabeth (2010). *Unternehmensethik: Grundlagen und praktische Umsetzung*. Stuttgart: UTB.

Handelsblatt (2016). Lagarde prangert Bestechungsgelder an. May 11. Last accessed July 28, 2020 at: https://www.handelsblatt.com/finanzen/geldpolitik/iwf-lagarde-prangert-bestechungsgelder-an/13584226.html

Hogan Lovells (2019). High Seas: Steering the Course II—Navigating Bribery and Corruption Risk in 2020. Last accessed July 29, 2020 at: https://stc.hoganlovellsabc.com/#

Hugger, Heiner and Simon, Stefan (2014). Compliance im Personal-Management: Erforderliche Aufsichtsmaßnahmen in Unternehmen unter Berücksichtigung arbeits- und datenschutz- rechtlicher Aspekte. In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

Institut der Wirtschaftsprüfer in Deutschland e. V. (2010). Entwurf IDW Prüfungsstandard: Grundsätze ordnungsmäßiger Prüfung von Compliance Management Systemen (IDW EPS 980). Last accessed June 2, 2017 at: http://elektronische-steuerpruefung.de/manage-ment/idw-eps-980-compliance-management-systeme-entwurf.pdf

Kaptein, Muel (2014). Effektive Business Codes: Inhalt und Bedingungen. In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

Keuchel, Jan (2002). Aufseher nehmen Exportwirtschaft ins Visier. *Handelsblatt*, October 14. Last accessed June 2, 2017 at: http://www.handelsblatt.com/archiv/bribery-payments-in-in-distributable-international-supervisor-enter-export-business-ship-ins-visier/2203170.html

Kleinfeld, Annette and Müller-Störr, Clemens (2014). Effektives Compliance-Management durch interaktive Schulung und Kommunikation. In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

Moosmayer, Klaus (2015). *Compliance: Praxisleitfaden für Unternehmen* (3rd Ed.). Munich: Beck.

Muth, Christian (2014). Third Party Due Diligence—Hintergrundrecherchen und der "need to know." In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

PrivazyPlan (2020). Article 5, EU GDPR: Principles Relating to Processing of Personal Data. Last accessed July 28, 2020 at: https://www.privacy-regulation.eu/en/article-5-principles-relating-to-processing-of-personal-data-GDPR.htm

Schach, Annika and Christoph, Cathrin (2015). *Compliance in der Unternehmenskommunikation: Strategie, Umsetzung und Auswirkungen*. Wiesbaden: Springer.

Securities and Exchange Commission (2002). Sarbanes-Oxley Act. Last accessed June 2, 2017 at: https://www.sec.gov/about/laws/soa2002.pdf

Statista (2020). Höhe der vom Bundeskartellamt Verhängten Bußgelder von 1993 bis 2018. Last accessed July 28, 2020 at: https://de.statista.com/statistik/daten/studie/158809/umfrage/vom-bundeskartellamt-verhaengte-bussgelder/#professional

Transparency International (2019). Corruption Perceptions Index. Last accessed July 28, 2020 at: https://www.transparency.org/en/cpi/2019/results

Transparency International (2020). What Is Corruption? Last accessed July 28, 2020 at: https://www.transparency.org/en/what-is-corruption

Tur, Kenan (2014). Effektive Hinweisgebersysteme: Eigenschaften, Implementierung, Management. In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

Viebranz, Jörg, Oppitz, Susanne, and Müller, Stephanie (2014). Kommunikation und eLearning: Integraler Bestandteil erfolgreicher Compliance. In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

Volz, Michael (2014). Zentrale rechtliche Felder von Compliance: Ein Überblick. In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

Weidenbach, Georg (2014). Die existenzsichernde Bedeutung von Compliance im Kartellrecht. In: J. Wieland, R. Steinmeyer, and S. Grüninger (Eds.), *Handbuch Compliance-Management*. Berlin: Erich Schmidt Verlag.

Wertekommission (2015). Führungskräftebefragung 2015. Last accessed June 2, 2017 at: http://www.wertekommission.de/fuehrungskraeftebefragung/

Section 6.2

Axios; The Harris Poll (Eds.) (2019). The 100 Most Visible Companies. The Axios Harris Poll 100. Last accessed July 6, 2020 at: https://theharrispoll.com/HarrisPoll_Axios_MostVisible_2019.pdf.

Birsch, Douglas and Fielder, John (Eds.) (1994). *The Ford Pinto Case: A Study in Applied Ethics, Business, and Technology*. Albany, NY: SUNY Press.

Brown, Allison J. (2020). "Should I Stay or Should I Leave?": Exploring (Dis)continued Facebook Use After the Cambridge Analytica Scandal. *Social Media + Society*, 6(1), 1–8.

Burkhart, Dagmar (2006). *Eine Geschichte der Ehre*. Darmstadt: Wissenschaftliche Buchgesellschaft.

Cadwalladr, Carole and Graham-Harrison, Emma (2018). Revealed: 50 Million Facebook Profiles Harvested for Cambridge Analytica in Major Data Breach. *The Guardian*, March 17. Last accessed July 11, 2020 at: https://www.theguardian.com/news/2018/mar/17/cambridge-analytica-facebook-influence-us-election

Coase, Ronald H. (1960). The Problem of Social Cost. *Journal of Law and Economics*, 3, 1–44.

Confessore, Nicholas and Hakim, Danny (2017). Data Firm Says 'Secret Sauce' Aided Trump; Many Scoff. *The New York Times*, March 6. Last accessed July 11, 2020 at: https://www.nytimes.com/2017/03/06/us/politics/cambridge-analytica.html

Davies, Harry (2015). Ted Cruz Campaign Using Firm that Harvested Data on Millions of Unwitting Facebook Users. *The Guardian*, December 11. Last accessed July 11, 2020 at: https://www.theguardian.com/us-news/2015/dec/11/senator-ted-cruz-president-campaign-facebook-user-data

Dowie, Mark (1977): Pinto Madness. Mother Jones, September/October 1977, pp. 18-32. Last accessed on August 4, 2020 at: https://www.motherjones.com/politics/1977/09/pinto-madness/

Facebook (2018a). Suspending Cambridge Analytica and SCL Group From Facebook. Paul Grewal. March 17. Last accessed July 11, 2020 at: https://about.fb.com/news/2018/03/suspending-cambridge-analytica/

Facebook (2018b). Facebook Launches New Initiative to Help Scholars Assess Social Media's Impact on Elections. April 9. Last accessed July 11, 2020 at: https://about.fb.com/news/2018/04/new-elections-initiative/

Facebook (2019). Facebook Reports Fourth Quarter and Full Year 2018 Results. Menlo Park, CA, United States. Chan, Vanessa, press@fb.com. January 30. Last accessed July 11, 2020 at: https://investor.fb.com/investor-news/press-release-details/2019/Facebook-Reports-Fourth-Quarter-and-Full-Year-2018-Results/default.aspx

Facebook (2020). Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2019. Commission File Number: 001–35551. Form 10-K, 1/30/2020. Last accessed July 11, 2020 at: http://d18rn0p25nwr6d.cloudfront.net/CIK-0001326801/45290cc0-656d-4a88-a2f3-147c8de86506.pdf

Federal Trade Commission (FTC) (2019). FTC Imposes $5 Billion Penalty and Sweeping New Privacy Restrictions on Facebook. FTC settlement imposes historic penalty, and significant requirements to boost accountability and transparency. Gruendwald Henderson, Juliana, Kaplan, Peter, Office of Public Affairs. July 24. Last accessed July 11, 2020 at: https://www.ftc.gov/news-events/press-releases/2019/07/ftc-imposes-5-billion-penalty-sweeping-new-privacy-restrictions

Friedman, Milton (1970). The Social Responsibility of Business is to Increase Its Profits. *The New York Times Magazine*, September 13, 122–6.

Friedman, Milton (1971). *Kapitalismus und Freiheit*. Stuttgart: Seewald Verlag.

Grassegger, Hannes and Krogerus, Mikael (2016). Ich habe nur gezeigt, dass es die Bombe gibt. *Das Magazin*, 48, December 3. Last accessed July 11, 2020 at: https://web.archive.org/web/20170127181034/https://www.dasmagazin.ch/2016/12/03/ich-habe-nur-gezeigt-dass-es-die-bombe-gibt/

Griffin, Andrew (2018). Delete Facebook campaign takes off—but actually removing your data might prove more difficult than it seems. *Independent*, March 21. Last accessed July 11, 2020 at: https://www.independent.co.uk/life-style/gadgets-and-tech/news/delete-facebook-cambridge-analytica-campaign-deactivate-data-remove-hide-privacy-a8266671.html

Haley, Paul and Palepu, Krishna (2003). The Fall of Enron. *Journal of Economic Perspectives*, 17(2), 3–26.

Harvard University (2008). The MBA Oath—Responsible Value Creation. Last accessed June 2, 2017 at: http://mbaoath.org/wp-content/uploads/2009/06/MBA-Oath-to-Sign.Pdf

Hirsch, Dennis (2019). Data Ethics: Risk Management for the Algorithmic Age. *Risk Management*, November 1. Last accessed July 11, 2020 at: http://www.rmmagazine.com/2019/11/01/data-ethics-risk-management-for-the-algorithmic-age/

IHK-Gesetz—Gesetz zur vorläufigen Regelung des Rechts der Industrie- und Handelskammern (2017). Last accessed June 2, 2017 at: https://www.hk24.de/servicemarken/ueber_uns/rechtsgrundlagen/Gesetzliche_Regelungen/bundeskammergesetz/1148972

IHK Nürnberg (2012). Leitbild des Ehrbaren Kaufmanns. Last accessed June 2, 2017 at: https://www.ihk-nuernberg.de/de/IHK-Magazin-WiM/WiM-Archiv/WIM-Daten/2012-11/Berichte-und-Analysen/leitbild-des-ehrbaren-kaufmanns.html

Isaak, Jim and Hanna, Minna J. (2018). User Data Privacy: Facebook, Cambridge Analytica, and Privacy Protection. *Computer*, 51(8), 56–9.

Jensen, Michael and Meckling, William (1976). Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure. *Journal of Financial Economics*, 3(4), 305–60.

Kosinski, Michal, Bachrach, Yoram, Kohli, Pushmeet, Stillwell, David, and Graepel, Thore (2014). Manifestations of User Personality in Website Choice and Behaviour on Online Social Networks. *Mach Learn*, 95(3), 357–80.

Leitbild für verantwortliches Handeln in der Wirtschaft, Verantwortlich Handeln—eine Initiative deutscher Unternehmen (2010). Last accessed June 2, 2017 at: http://www.trumpf.com/fileadmin/DAM/trumpf.com/Unternehmen/Leitbild_fuer_verantwortliches_Handeln_in_der_Wirtschaft.pdf

Lütge, Christoph (2019). *The Ethics of Competition: How a Competitive Society is Good for All*. Cheltenham, UK and Northampton, MA, USA: Edward Elgar Publishing.

Lütge, Christoph and Strosetzki, Christoph (Eds.) (2017). *Der ehrbare Kaufmann: Zwischen Bescheidenheit und Risiko*. Heidelberg: Springer.

MacAskill, Andrew (2018). What are the links between Cambridge Analytica and a Brexit campaign group? *Reuters*, August 21. Last accessed July 11, 2020 at: https://www.reuters.com/article/us-facebook-cambridge-analytica-leave-eu/what-are-the-links-between-cambridge-analytica-and-a-brexit-campaign-group-idUSKBN1GX2IO

Mayer, Roger, Davis, James, and Schoorman, David (1995). An Integrative Model of Organizational Trust. *The Academy of Management Review*, 20(3), 709–31.

Meyer, Matthias (2004). *Prinzipale, Agenten und ökonomische Methode: Von einseitiger Steuerung zu wechselseitiger Abstimmung*. Tübingen: Mohr Siebeck.

Mirhaydari, Anthony (2018). Facebook stock recovers all $134B lost after Cambridge Analytica data scandal. *CBS News*, May 10. Last accessed July 11, 2020 at: https://www.cbsnews.com/news/facebook-stock-price-recovers-all-134-billion-lost-in-after-cambridge-analytica-datascandal/

O'Neil, Cathy (2016). *Weapons of Math Destruction. How Big Data Increases Inequality and Threatens Democracy*. New York: Crown Books.

Ripperger, Tanja (1998). *Ökonomik des Vertrauens: Analyse eines Organisationsprinzips*. Tübingen: Mohr Siebeck.

Risso, Linda (2018). Harvesting Your Soul? Cambridge Analytica and Brexit. In Christa Jansohn (Ed.), *Brexit Means Brexit? A Symposium*. Mainz, December 6–8, 2017. Akademie der Wissenschaften und Literatur (The Selected Proceedings of the Symposium, Akademie der Wissenschaften und der Literatur (Academy of Sciences and Literature)), pp. 75–87.

Rosenberg, Matthew, Confessore, Nicholas, and Cadwalladr, Carole (2018). How Trump Consultants Exploited the Facebook Data of Millions. *The New York Times*, March 17. Last accessed July 11, 2020 at: https://www.nytimes.com/2018/03/17/us/politics/cambridge-analytica-trump-campaign.html

Rosenberg, Scott (2019). Facebook's reputation is sinking fast. March 6. Last accessed July 11, 2020 at: https://www.axios.com/facebook-reputation-drops-axios-harris-poll-0d6c406a-4c2e-463a-af98-1748d3e0ab9a.html

Salinas, Sara (2018). Cambridge Analytica is shutting down, says the 'siege of media coverage' drove away clients. *CNBC*, May 2. Last accessed July 11, 2020 at: https://www.cnbc.com/2018/05/02/cambridge-analytica-is-shutting-down-wsj.html

Schwalbach, Joachim and Klink, Daniel (2012). Der Ehrbare Kaufmann als individuelle Verantwortungskategorie der CSR-Forschung. In: A. Schneider and R. Schmidpeter (Eds.), *Corporate Social Responsibility*. Heidelberg: Springer.

Senate Committee on the Judiciary; Senate Committee on Commerce, Science, and Transportation (2018). Facebook, Social Media Privacy, and the Use and Abuse of Data. Joint Full Committee Hearing. Last accessed July 11, 2020 at: https://www.judiciary.senate.gov/meetings/facebook-social-media-privacy-and-the-use-and-abuse-of-data

Slawson, Nicola (2018). Faceblock campaign urges users to boycott Facebook for a day. *The Guardian*, April 7. Last accessed July 11, 2020 at: https://www.theguardian.com/technology/2018/apr/07/faceblock-campaign-urges-users-boycott-facebook-for-one-day-protest-cambridge-analytica-scandal

Statista (Ed.) (2020a). Number of social media users worldwide from 2010 to 2023 (in billions) [Graph]. Statista. Updated April 1, 2020. Last accessed July 11, 2020 at: https://www.statista.com/statistics/278414/number-of-worldwide-social-network-users/

Statista (Ed.) (2020b). Most popular social networks worldwide as of April 2020, ranked by number of active users (in millions) [Graph]. Statista. Updated July 7, 2020. Last accessed July 11, 2020 at: https://www-statista-com.eaccess.ub.tum.de/statistics/272014/global-social-networks-ranked-by-number-of-users/

Suchanek, Andreas (2004). Gewinnmaximierung als soziale Verantwortung von Unternehmen? Milton Friedman und die Unternehmensethik. In: I. Pies and M. Leschke (Eds.), *Milton Friedmans ökonomischer Liberalismus* (pp. 105–24). Tübingen: Mohr Siebeck.

Trump, Kris-Stella (2018). Four and a half reasons not to worry that Cambridge Analytica skewed the 2016 election. *The Washington Post*, May 23. Last accessed July 11, 2020 at: https://www.washingtonpost.com/news/monkey-cage/wp/2018/03/23/four-and-a-half-reasons-not-to-worry-that-cambridge-analytica-skewed-the-2016-election/

Weisbaum, Herb (2018). Trust in Facebook has dropped by 66 percent since the Cambridge Analytica scandal. *NBC News*, April 18. Last accessed July 11, 2020 at: https://www.nbcnews.com/business/consumer/trust-facebook-has-dropped-51-percent-cambridge-analytica-scandal-n867011

World Values Survey (2015). Trust. Last accessed June 15, 2016 at: http://www.worldvaluessurvey.org/WVSOnline.jsp

Zuckerberg, Mark (2018). "I want to share an update on the Cambridge Analytica situation." Facebook Post. Menlo Park, CA, United States, March 21. Last accessed July 11, 2020 at: https://www.facebook.com/zuck/posts/10104712037900071

Section 6.3

Ackerman, Robert W. (2000). How Companies Respond to Social Demands. *Harvard Business Review*, 51(4), 88–98.

Ackerman, Robert W. and Bauer, Raymond A. (1976). *Corporate Social Responsiveness: The Modern Dilemma*. Reston, VA: Reston Publishing.

amfori (2020). Our Members. Accessed July 31, 2020 at: https://www.amfori.org/content/our-members

Ariely, Dan, Bracha, Anat, and Meier, Stephan (2009). Doing Good or Doing Well? Image Motivation and Monetary Incentives in Behaving Prosocially. *American Economic Review*, 99(1), 544–55.

Atterton, Peter (2007). A Duty to be Charitable? A Rigoristic Reading of Kant. *Kant Studien*, 98(2), 135–55.

Batson, C. D., Kobrynowicz, D., Dinnerstein, J. L., Kampf, H. C., and Wilson, A. D. (1997). In a Very Different Voice: Unmasking Moral Hypocrisy. *Journal of Personality and Social Psychology*, 72(6), 1335–48.

Beauchamp, Tom and Bowie, Norman (1979). Ethical Theory and Its Application to Business. In: Tom Beauchamp and Norman Bowie (Eds.), *Ethical Theory and Business*. Englewood Cliffs, NJ: Pearson.

Becker-Olsen, Karen and Potucek, Sean (2013). Greenwashing. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Beise-Zee, Rian (2013). Cause-Related Marketing. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Bénabou, Roland and Tirole, Jean (2010). Individual and Corporate Social Responsibility. *Economica*, 77(305), 1–19.

Bowie, Norman E. (1998). A Kantian Theory of Capitalism. *Business Ethics Quarterly*, Special Issue 1, 37–60.

Brueckner, Martin (2013). Corporations as Psychopaths. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Carnegie, Andrew (1889). The Gospel of Wealth. In: J. F. Wall (Ed.) (1992), *The Andrew Carnegie Reader*. Pittsburgh: University of Pittsburgh Press.

Carroll, Archie B. (1991). The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders. *Business Horizons*, 34(4), 39–48.

Cho, C. H., Laine, M., Roberts, R. W., and Rodrigue, M. (2015). Organized Hypocrisy, Organizational Façades, and Sustainability Reporting. *Accounting, Organizations and Society*, 40, 78–94.

Christensen, Lars T., Morsing, Mette, and Thyssen, Ole (2013). CSR as Aspirational Talk. *Organization*, 20(3), 372–93.

Dahlsrud, Alexander (2008). How Corporate Social Responsibility Is Defined: An Analysis of 37 Definitions. *Corporate Social Responsibility and Environmental Management*, 15(1), 1–13.

D'Anselmi, Paolo and Di Bitetto, Massimiliano (2013). Irresponsibility. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Das Gupta, Ananda (2013). Business Case. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Davis, Keith (1960). Can Business Afford to Ignore Social Responsibilities? *California Management Review*, 2(3), 70–6.

Davis, Keith (1968). Understanding the Social Responsibility Puzzle. *Business Horizons*, 10(4), 45–50.

Davis, Keith (1973). The Case for and against Business Assumption of Social Responsibilities. *Academy of Management Journal*, 16(2), 312–22.

Donaldson, Thomas and Dunfee, Thomas W. (1994). Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory. *Academy of Management Review*, 19(2), 252–84.

Donaldson, Thomas and Dunfee, Thomas W. (1999). *Ties That Bind: A Social Contracts Approach to Business Ethics*. Boston, MA: Harvard Business Press.

Donaldson, Thomas and Dunfee, Thomas W. (2000). Precis for Ties That Bind. *Business and Society Review*, 105(4), 436–43.

Donaldson, Thomas and Preston, Lee E. (1995). The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications. *Academy of Management Review*, 20(1), 65–91.

European Commission (2011). *Communication from the commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. A Renewed EU Strategy 2011–14 for Corporate Social Responsibility* (S. 4–5). Last accessed June 2, 2017 at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52011DC0681

Frederiksen, Claus S. (2010). The Relation Between Policies Concerning Corporate Social Responsibility (CSR) and Philosophical Moral Theories: An Empirical Investigation. *Journal of Business Ethics*, 93(3), 357–71.

Freeman, R. Edward (1984). *Strategic Management: A Stakeholder Approach*. Boston: Pitman.

Friedman, Milton (1970). The Social Responsibility of Business Is to Increase Its Profits. *The New York Times Magazine*, September 13, 122–6.

Garriga, Elisabet and Melé, Domènec (2004). Corporate Social Responsibility Theories: Mapping the Territory. *Journal of Business Ethics*, 53(1), 51–71.

Gibson, Kevin (2000). The Moral Basis of Stakeholder Theory. *Journal of Business Ethics*, 26(3), 245–57.

Global Reporting Initiative (2019). Linking Cass-CSR 4.0 and the GRI Sustainability Reporting Standards. Last accessed August 3, 2020 at: https://www.globalreporting.org/standards/resource-download-center/?g=8664fd50-355c-4c93-95bc-b71db933edc3

Homann, Karl and Lütge, Christoph (2013). *Einführung in die Wirtschaftsethik*. Münster: LIT.

Johnson, David and O'Conner, Siobhan (2015). These Charts Show Every Genetically Modified Food People Already Eat in the U.S. *Time*, April 30. Last accessed June 2, 2017 at: http://time.com/3840073/gmo-food-charts/

Jones, Brian (2013). Corporate Social Irresponsibility. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Jones, Thomas M. (1980). Corporate Social Responsibility Revisited, Redefined. *California Management Review*, 22(3), 59–67.

Kagan, Shelly (1989). *The Limits of Morality*. Oxford: Oxford University Press.

Kapstein, Muel and van Tulder, Robert (2003). Toward Effective Stakeholder Dialogue. *Business and Society Review*, 108(2), 203–24.

Kotchen, Matthew J. and Moon, Jon J. (2011). *Corporate Social Responsibility for Irresponsibility* (No. w17254). Cambridge, MA: National Bureau of Economic Research.

KPMG (2017). The KPMG Survey of Corporate Responsibility Reporting 2017. Last accessed July 23, 2020 at: https://assets.kpmg/content/dam/kpmg/be/pdf/2017/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf

La Cour, Anders and Kromann, Joakim (2011). Euphemisms and Hypocrisy in Corporate Philanthropy. *Business Ethics: A European Review*, 20(3), 267–79.

Lea, David (2004). The Imperfect Nature of Corporate Responsibilities to Stakeholders. *Business Ethics Quarterly*, 14(2), 201–17.

Lin-Hi, Nick (2009). *Eine Theorie der Unternehmensverantwortung. Die Verknüpfung von Gewinnerzielung und gesellschaftlichen Interessen*. Berlin: Erich Schmidt Verlag.

Locke, John (1764). *Two Treatises of Government*. London.

Lynes, Jennifer (2015). VW committed the cardinal sin of greenwashing: Lying. *The Globe and Mail*, September 14. Last accessed June 2, 2017 at: https://www.theglobeandmail.com/report-on-business/rob-commentary/volkswagen-committed-the-cardinal-sin-of-greenwashing-lying/article26500698/

Margolis, Joshua D. and Walsh, James P. (2003). Misery Loves Companies: Rethinking Social Initiatives by Business. *Administrative Science Quarterly*, 48(2), 268–305.

Matten, Dirk and Crane, Andrew (2005). Corporate Citizenship: Toward an Extended Theoretical Conceptualization. *Academy of Management Review*, 30(1), 166–79.

Matten, Dirk and Moon, Jeremy (2008). "Implicit" and "Explicit" CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility. *Academy of Management Review*, 33(2), 404–24.

Meffert, Heribert and Holzberg, Martin (2009). Cause-related Marketing: Ein scheinheiliges Kooperationskonzept? *Marketing Review St. Gallen*, 26(2), 47–53.

Mill, John Stuart (1863). *Utilitarianism*. London: Parker, Son and Bourn.

Monin, Benoit (2007). Holier than Me? Threatening Social Comparison in the Moral Domain. *Revue internationale de psychologie sociale*, 20(1), 53–68.

Monin, Benoit, Sawyer, Pamela J., and Marquez, Matthew J. (2008). The Rejection of Moral Rebels: Resenting Those Who Do the Right Thing. *Journal of Personality and Social Psychology*, 95(1), 76–93.

Nielsen, Anne E. (2013). License to Operate. In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

Nozick, Robert (1974/2006). *Anarchie, Staat, Utopia*. Munich: Olzog.

Orlitzky, Marc (2008). Corporate Social Performance and Financial Performance. In: A. Crane, A. McWilliams, D. Matten, J. Moon, and D. Siegel (Eds.), *The Oxford Handbook of Corporate Social Responsibility*. Oxford: Oxford University Press.

Orlitzky, Marc, Schmidt, Frank L., and Rynes, Sara L. (2003). Corporate Social and Financial Performance: A Meta-Analysis. *Organization Studies*, 24(3), 403–41.

Parkan, Baris (2008). On Multinational Corporations and the Provision of Positive Rights. *Journal of Business Ethics*, 85(1), 73–82.

Plungis, Jeff (2015). Volkswagen emissions scandal: Forty years of greenwashing—the well-travelled road taken by VW. *The Independent*, September 25. Last accessed June 2, 2017 at: http://www.independent.co.uk/news/business/analysis-and-features/volkswagen-emissions-scandal-forty-years-of-greenwashing-the-well-travelled-road-ta- ken-by-vw-10516209.html

Ponemon Institute LLC (2019). *2019 Intangible Assets Financial Statement Impact Comparison Report. Global Edition*. Last accessed July 23, 2020 at: https://www.aon.com/getmedia/60fbb49a-c7a5-4027-ba98-0553b29dc89f/Ponemon-Report-V24.aspx

Porter, Michael and Kramer, Mark R. (2011). The Big Idea: Creating Shared Value. *Harvard Business Review*, 89(1/2), 62–77.

Powell, Walter W. and Di Maggio, Paul J. (Eds.) (1991). *The New Institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.

PwC (2018). *Workforce of the Future: The Competing Forces Shaping 2030*. Last accessed January 5, 2021 at: https://www.pwc.com/gx/en/services/people-organisation/workforce-of-the-future/workforce-of-the-future-the-competing-forces-shaping-2030-pwc.pdf

Rawls, John (1979). *Eine Theorie der Gerechtigkeit* (translated by Hermann Vetter). Berlin: Suhrkamp Verlag.

Scherer, Andreas and Patzer, Moritz (2011). Corporate Social Responsibility. In: M. Aßländer (Ed.), *Handbuch Wirtschaftsethik*. Stuttgart: Metzler.

Schrader, Ulf, Roloff, Julia, Scherer Andreas Georg, Patzer, Moritz, Kell, Georg, Aßländer, Michael S., and Schenkel, Markus (2011). Konzepte der Unternehmensverantwortung. In: M. Aßländer (Ed.), *Handbuch Wirtschaftsethik*. Stuttgart: Metzler.

Singer, Peter (1972). Famine, Affluence, and Morality. *Philosophy & Public Affairs*, 1, 229–43.

Smith, Adam (1776/1990). *Der Wohlstand der Nationen: eine Untersuchung seiner Natur und seiner Ursachen* (5th Ed.) (Edited by H. C. Recktenwald). Munich: DTV.

Solomon, Robert (2003). Victims of Circumstances? A Defense of Virtue Ethics in Business. *Business Ethics Quarterly*, 13(1), 43–62.

Taylor Nelson (2001). *The European Survey on SRI and the Financial Community*. London.

Thomsen, Christa (2013). Sustainability (World Commission on Environment and Development Definition). In: S. Idowu, N. Capaldi, and L. Zu (Eds.), *Encyclopedia of Corporate Social Responsibility*. Heidelberg: Springer.

UN Global Compact (2015). *Leitfaden für ein nachhaltiges Wirtschaften*. Last accessed June 2, 2017 at: https://www.unglobalcompact.org/docs/publications/UN_Global_Compact_Guide_to_Corporate_Sustainability_DE.pdf

United Nations (1987). *Report of the World Commission on Environment and Development: Our Common Future*. Oxford: Oxford University Press. Last accessed April 24, 2020 at: http://www.un-documents.net/wced-ocf.htm

Valdesolo, Piercarlo and DeSteno, David (2007). Moral Hypocrisy, Social Groups and the Flexibility of Virtue. *Psychological Science*, 18(8), 689–90.

Varadarajan, P. Rajan and Menon, Anil (1988). Cause-Related Marketing: A Coalignment of Marketing Strategy and Corporate Philanthropy. *The Journal of Marketing*, 52, 58–74.

Vogel, David (2005). Is there a Market for Virtue? The Business Case for Corporate Social Responsibility. *California Management Review*, 47(4), 19–45.

Waddock, Sandra A. and Graves, Samuel B. (1997). The Corporate Social Performance–Financial Performance Link. *Strategic Management Journal*, 18(4), 303–19.

Wagner, Tillman, Lutz, Richard J., and Weitz, Barton A. (2009). Corporate Hypocrisy: Overcoming the Threat of Inconsistent Corporate Social Responsibility Perceptions. *Journal of Marketing*, 73(6), 77–91.

Wartick, Steven and Rude, Robert (1986). Issue Management: Corporate Fad or Corporate Function? *California Management Review*, 29(1), 124–40.

World Economic Forum (2002). *Global Corporate Citizenship: The Leadership Challenge for CEOs and Boards*. Last accessed June 2, 2017 at: http://www.paricenter.com/library/papers/future02.pdf

Business Ethics: Interdisciplinary Perspectives and Future Challenges

Over the years, business ethics has become an established discipline, which is taught in many business schools around the globe, often as a mandatory class. But its success reaches far beyond being an academic subject. Throughout the corporate world, and despite undisputable delays, sometimes mere lip service and real setbacks, business ethics, together with its sister enterprises like CSR, Corporate Citizenship, or Compliance, has seen a huge boost in terms of being respected and taken seriously. In spite of the necessary criticism against corporate practices that business ethicists daily raise, one should also not overlook this positive development.

What has become clear during this development, is that business ethics—both in theory and practice—needs to be conducted as an interdisciplinary enterprise. While it started out partly as a philosophical, partly as a management studies subdiscipline, it cannot be taught or practiced anymore without having competencies in economics, philosophy, psychology, management studies, and sometimes even other fields in your team—whether it is an academic research team, a corporate department team or other. This volume focuses on exactly this way of doing business ethics: in an interdisciplinary manner.

And business ethics needs to go forward in the same way with regard to other relevant topics that have sprung up during the last years: Among these are, in particular, digital ethics and ethics of digitization, ethics of artificial intelligence and related issues. Especially AI ethics has recently received huge attention on a global scale in a relatively short span of time, with new research institutes opening worldwide. And in all these new areas, it is very important to include a business ethics angle within the ethical perspective. After all, the chief actors to implement ethics in the area of AI and digitization will not chiefly be government agencies, non-profits, or NGOs. It will be companies, sometimes new, sometimes long-established ones, who will have to set up ethical guidelines, practices, or management systems to deal with these new challenges. A new field such as Corporate Digital Responsibility

Business Ethics: An Economically Informed Perspective. Christoph Lütge and Matthias Uhl, Oxford University Press (2021).
 DOI: 10.1093/oso/9780198864776.003.0008

might develop along these lines, the details of which will have to be worked out within the coming years.

Business ethics will deal with those challenges. It will certainly become more quantitative in many respects, such as in the way that ethics, integrity, or compliance get measured. But it should never be omitted or neglected that there is a non-quantitative, non-reducible part of business ethics as well: It needs to take an angle of critical reflection which too often gets lost in the way of doing research within narrow disciplinary fields. Business ethics needs to go beyond that—now and in the future.

Glossary

Absolute poverty: The United Nations defines it as "a condition characterized by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information." The current international poverty line is $1.90 a day. The criterion is not subject to change with economic growth. It is contrasted with → Relative poverty.

Allocation: The division of the flow of scarce resources among alternative product uses. It is contrasted with → Distribution.

Antitrust law: A collection of laws that regulates the conduct and organization of companies to promote competition to the consumers' benefit.

ATTAC: The abbreviation stands for "Association pour la Taxation des Transactions Financières et pour l'Action Citoyenne." It is a non-governmental organization critical of globalization and headquartered in Paris.

Battle of the Sexes: Two-player coordination game with two pure Nash equilibria. Players have contradictory preferences for a particular coordination solution.

Behavioral economics: Traditional economics assumes that decision-makers are fully aware of the costs and benefits associated with all possible actions. Behavioral economics adds insights from neighboring social and behavioral sciences to improve predictions on behavioral change and to identify supposedly irrelevant drivers of decision-making. An important tool of behavioral economists is → Experimental economics.

Behavioral ethics: The study of systematic and predictable ways in which individuals make ethical choices and judge others' ethical choices. An important tool of behavioral ethicists is → Experimental ethics.

Bluewashing: The accusation against companies that quality seals such as the Blue Angel, the certificate for the protection of humans and the environment, are misappropriated as a fig leaf.

Bounded ethicality: An instance of the concept of bounded rationality in the domain of ethics. It posits that psychological processes that underlie ethical decision-making often lead to behavior that is inconsistent with the decision-maker's own ethical standards.

Bribery: "The offering, promising, giving, accepting or soliciting of an advantage as an inducement for an action which is illegal or a breach of trust." (→ Transparency International)

Brundlandt Report: A report officially entitled *Our Common Future* published in 1987 by the United Nations World Commission on Environment and Development.

The Commission was chaired by former Norwegian Prime Minister Gro Harlem Brundtland. The report is known for its definition of sustainable development.

Cartel: An association or agreement of companies with the intention of restricting competition and maintaining prices at a high level.

Categorical imperative: In the *Groundwork of the Metaphysics of Morals*, the German philosopher Immanuel Kant (1724–1804) has given three formulations of the categorical imperative. Most philosophers who are attracted to Kantian ethics are so because of the second one, the Humanity Formulation "So act that you use humanity, whether in your own person or in the person of any other, always at the same time as an end, never merely as a means."

Cause-related marketing (CRM): The combination of the sale of a good or service with fundraising for a specific cause.

Chief Compliance Officer (CCO): The top manager of a company responsible for overseeing and managing compliance issues within the company. She usually reports to the → Chief Executive Officer (CEO).

Chief Executive Officer (CEO): The chairman of the board of directors or general manager of a company or the sole authorized signatory.

Classical value paradox: The gap between the utility and the exchange value of a good posed a problem for classical economics for a long time. While water, for instance, has a high utility and a low exchange value, diamonds are just the opposite. The paradox can only be solved with the concept of → Marginal utility, which sees the individual benefit of a good tied to its available quantity.

Code of ethics: Many companies adopt them to help their employees understand what is considered right and wrong and apply this understanding to their daily decisions.

Competition: A state that induces people's effort to meet the criteria that are relevant for determining who gets what.

Compliance: The adherence to legal or self-imposed rules. Compliance considers these rules as exogenously given.

Compliance risks: The negative consequences that a company suffers in case of compliance violations. They can consist in monetary fines, exclusions from certain markets, and reputational damages.

Comprehensive Economic and Trade Agreement (CETA): A free-trade agreement between Canada and the European Union.

Consequentialism: The group of normative ethical theories that derive the moral value of an action solely from the consequences this action brings about.

Cooperation Game: In a pure coordination game, no diverging interests exist between the players. The equilibrium is self-enforcing, i.e. no player has an incentive to deviate from the coordination solution.

Corporate citizenship: The social commitment of companies, whereby they present themselves as "good citizens." Another characteristic of professionally structured corporate citizenship is strategic cooperation with governmental or non-governmental organizations, for example in the form of → Public–private partnerships (PPPs).

Corporate ethics: A subfield of business ethics that deals with the question of which ethical values companies should satisfy.

Corporate ethics as management of moral risks: The inclusion of moral considerations into a company's risk management for economic interest.

Corporate ethics as profit maximization: The view that the exclusive responsibility of a company lies in meeting the long-term interests of its shareholders. A prominent proponent of this view was the US-American economist Milton Friedman (1912–2006) who argued: "The social responsibility of business is to increase its profits." See also → Shareholder approach.

Corporate hypocrisy: The accusation against companies that they present themselves more morally than they actually are.

Corporate social irresponsibility (CSIR): The focus is on avoiding unethical behavior instead of promoting ethical behavior. Its primary objective is to identify and analyze the causes of malicious practices in a company to then find out how these practices can be systematically altered or wholly eliminated.

Corporate social responsibility (CSR): A concept that describes a company's commitment to responsibly manage the social, environmental, and economic impact of its operations. It addresses the question of what rules a company should impose on itself in this respect.

Corruption: "The abuse of entrusted power for private gain." (→ Transparency International)

Creating shared value (CSV): Policies and practices enhancing a company's competitiveness while at the same time promoting the economic and social conditions in the communities in which it operates. The concept was introduced by Michael Porter and Mark Kramer in 2006.

Crowding-out effects: In economics, the term traditionally describes the displacement of private economic activities through state intervention. In behavioral ethics, it is used to describe the displacement of intrinsically motivated ethical behavior by external institutions. Monetary incentives for blood donations, for instance, can crowd out people's motivation to donate blood for altruistic reasons and paradoxically decrease the total supply.

CSR pyramid: It describes the different levels of corporate responsibility. Economic responsibility forms the foundation of the pyramid. The next level is legal responsibility, followed by ethical responsibility. Philanthropic responsibility represents the top of the pyramid.

Data privacy: The proper handling of data including consent, notice, and regulatory obligations. Questions often circle around the sharing of data with third parties and the collection and storage of data.

Deontology: The group of normative theories that derives the ethical status of an action not solely from its consequences but considers some actions as intrinsically good or bad. The ethical theory of the German philosopher Immanuel Kant (1724–1804) is the most famous deontological ethical theory. Kant argued that in order to act morally, people must act from duty and that the motives of the decision-maker make an action right or wrong.

Descriptive ethics: The study of people's actual beliefs about morality irrespective of whether these beliefs are justified.

Dictator game: A popular experimental instrument in which one participant (the dictator) receives a monetary endowment and then decides to what extent she wants to split this endowment with another participant (the recipient). It is a derivative of the → Ultimatum game.

Diffusion of responsibility: People's preference to share responsibility for an ethically difficult decision. It can occur vertically, when intermediaries can take over "dirty work" or horizontally, when people fail to behave ethically, because they count on others to do so on their behalf.

Discourse ethics: The group of normative theories that bases the ethical rightness of certain statements on the criterion of whether they were derived from a rational discourse. A famous proponent is the German philosopher Jürgen Habermas (b. 1929).

Distribution: The division of final goods among different people. It is contrasted with → Allocation.

Dualism: A structure of thought that negotiates a desirable social state in the tension between two opposing poles. Dualistic business ethics assumes that there is a fundamental trade-off between economics and ethics. It is contrasted with → Monism.

Dual process theory: The distinction between "System 1" and "System 2" thinking. System 1 operates automatically and effortlessly, while System 2 allocates attention to the effortful mental activities that demand it. Behavioral ethics assumes that people often give System 1 responses that could be called moral heuristics to ethical problems. A famous proponent is the Israeli psychologist Daniel Kahneman (b. 1934).

Due diligence: Careful examination and analysis of a company, especially with regard to its economic, legal, tax, financial, and ethical circumstances.

Efficiency: The productive use of resources to achieve goals. While economic efficiency requires the most economical instruments be chosen, ecological efficiency requires the sustainable use of resources.

Equality: It may be distinguished from efficiency in the evaluation of social welfare and refers to the "just" distribution of income and wealth.

Ethical relativism: A theory from → Metaethics stating that there are no absolute truths in ethics. Whether an action is ethically right depends on the contingent moral norms of the actor or the society in which the action is practiced. It is contrasted with → Ethical universalism.

Ethical theories of CSR: The group of CSR theories that focus on the ethical prerequisites which they see as the basis of the relationship between companies and society. These approaches are represented by philosophers who extend classical theories of normative ethics to the behavior of companies. Compare with → Integrative theories of CSR and → Political theories of CSR.

Ethical universalism: A theory from → Metaethics stating that some system of ethics applies universally for everybody in a similar situation. The → Categorical imperative is an example for a supreme principle of morality that binds all rational persons. It is contrasted with → Ethical relativism.

Ethics: The scientific theory of morality. Ethics can be categorized in → Metaethics, → Normative ethics, and → Descriptive ethics.

Ethics of behavior: see → Individual ethics.

Ethics of conditions: see → Order ethics.

Experimental economics: A field of economics that uses controlled, scientific experiments to test what choices people actually make under given circumstances. It is often used to test economic theories that are typically untestable with non-experimental observational data. It is an important method used in → Behavioral economics.

Experimental ethics: The empirical study of moral intuitions, judgment, and behaviors with the help of controlled, scientific experiments. It uses experimental data to substantiate, undermine, or revise ethical theories. It is an important method used in → Behavioral ethics.

Explicit CSR: CSR is considered an explicit instrument of corporate policy. It is usually oriented towards a liberal market economy where greater entrepreneurial freedom exists. The concept is more strongly represented in the USA than in Europe. It is contrasted with → Implicit CSR.

Fair price: A price that is not the result of the confluence of supply and demand on the market but that is based on normative criteria, e.g. that the human labor contained in a product determines its value.

Ford Pinto scandal: One of the most severe and notorious scandals in automotive history. The case involves the explosion of Ford Pinto automobiles because of a defective fuel system design and the revelation that Ford had based its decision not to upgrade the fuel system on a cost–benefit analysis. It is often considered as the event that gave birth to → Corporate ethics.

General Data Protection Regulation (GDPR): A regulation of the European Union harmonizing the rules governing the processing of personal data by private and public data processors.

Globalization: There are many definitions of the term. Some focus on the economic perspective and, accordingly, understand globalization as the spread of Western market models across the globe. Other definitions include not only economic but also political, technical, and cultural phenomena.

Greenpeace: A non-governmental organization that stresses the need to maintain a balance between human progress and environmental conservation. Members take active but nonviolent measures against what are regarded as threats to environmental safety. It is headquartered in Amsterdam.

Greenwashing: A critical term for the efforts of a company to appear environmentally friendly in the public eye without there being a sufficient basis for this.

Growth: The increase in the inflation-adjusted market value of the production of goods and services in an economy.

Harm principle: Society is only allowed to prevent individual actions that harm others. The state should not be allowed to stop an individual's actions that affect only herself (even if they are harmful to the actor herself). It was formulated by the British philosopher John Stuart Mill (1806–1873).

Homo economicus: A decision-maker who rationally maximizes her benefits. The homo economicus is a methodological postulate of consistent decision-making. What constitutes a benefit to the decision-maker is entirely subjective.

Honorable businessman: A collection of correct or desired behaviors of entrepreneurs or managers. These basic ethical rules—often in the form of codes of conduct—contain above all appeals to the business elites to embody certain virtues in their actions.

Human dignity: The belief that all people hold a special value that is solely tied to their humanity.

Human rights: Rights inherent to all human beings without discrimination. They include, inter alia, the right to life and liberty, freedom from slavery and torture, freedom of opinion and expression.

Implicit CSR: CSR is understood as an implicit element of the institutional framework of a company. It is oriented towards a social market economy where the state is stronger involved in economic and social issues. The concept is more strongly represented in Europe than in the USA. It is contrasted with → Explicit CSR.

Incomplete contracts: Contracts are incomplete in a number of ways Performance and counter-performance are often not precisely defined and enforcing fulfillment in court is often too expensive. Incomplete contracts thus lead to more uncertainty, the danger of greater dependencies, and opportunities for exploitation. The advantage of incomplete contracts is that they allow for greater flexibility.

Individual ethics: Classical Western ethics is a paradigmatic ethics of behavior. The moral norms are aimed at the individual and are intended to give more or less concrete instructions on how he or she should behave ethically. The conditions under which the individual should perform an action are often neglected. See also → Order ethics.

Inequality: The unequal distribution of wealth, income, and opportunity between different groups within a society.

Instrumental rationality: The adoption of suitable means to achieve a given end. This idea is reflected in economics in the frequently used concept of efficiency ("doing the things right"). A complementary concept is → Value rationality.

Integrative theories of CSR: The integration of social demands into a company's business practices. The assumption is that companies depend on society for their existence and that accordingly companies should act in accordance with society's interests. Compare with → Ethical theories of CSR and → Political theories of CSR.

International Monetary Fund (IMF): An international organization to promote economic stability and growth. It is headquartered in Washington, DC.

License to operate: see → Political theories of CSR.

Marginal utility: The change of utility derived from an increase in the consumption of a good. Usually, the marginal utility of a good is assumed to diminish as consumption increases.

Markets: The place where supply and demand for a particular good meet.

Metaethics: The attempt to understand the metaphysical, epistemological, semantic, and psychological presuppositions of ethics and the different forms of moral justification.

Methodological individualism: A methodological precept for the social sciences that amounts to the claim that social phenomena must be explained by showing how they result from individual actions. It was introduced by the German sociologist and economist Max Weber (1864–1920)

Modern societies: Societies that are characterized by the fact that people are increasingly able to gain control of the conditions of their actions, by people's diverse individual lifestyles, and by exponentially growing material wealth.

Monism: The dualistic conflict is avoided from the outset. In monistic business ethics, ethics and economics are considered two sides of the same coin. The question of implementation of a desired ethical solution is considered from the beginning with reference to the principle "ought implies can." It is contrasted with → Dualism.

Morality: The complex of rules and norms that determine or are supposed to determine people's actions, i.e. the subject matter of ethics.

Nash equilibrium: A combination of chosen strategies in non-cooperative games where no player has an incentive to unilaterally deviate from her chosen strategy. The concept was proposed by US-American mathematician John Forbes Nash Jr. (1928–2015).

Negative liberty: The freedom of interference by other people. The concept was introduced by the British philosopher Isaiah Berlin (1909–1997). It is contrasted with → Positive liberty.

Normative ethics: The branch of ethics that is concerned with the criteria of what is right and wrong.

Order ethics: According to order ethics, the fundamental problem of a plurality of moral values in modern societies requires a normative criterion that relies on consensus seeking. The key idea of order ethics is to look out for strategies on the level of rules or the level of the conditions of actions that enable win-win solutions for all affected parties.

Pareto efficiency: A situation where no individual can be better off without making at least one individual worse off. The concept is named after the Italian engineer and economist Vilfredo Pareto (1848–1923). According to the US-American economist James M. Buchanan (1919–2013) Pareto efficiency is a far-fetched external efficiency ideal. He calls for economists to rather focus on the criterion of → Pareto improvement.

Pareto improvement: A new situation where some individuals will gain and no individuals will lose as compared to the initial situation. The criterion of Pareto improvement puts the focus on mutual improvements through acts of exchange and is therefore in contrast to the idealistic criterion of → Pareto efficiency.

Pareto-optimum: see → Pareto efficiency.

Political theories of CSR: The group of CSR theories focusing on the interdependencies between business and society. The approach is grounded in the sociological concept claiming that companies are social institutions that require institutional legitimacy in order to survive ("license to operate"). Compare with → Ethical theories of CSR and → Integrative theories of CSR.

Positive liberty: The possession of the capacity to act upon one's free will. The concept was introduced by the British philosopher Isaiah Berlin (1909–1997). It is contrasted with → Negative liberty.

Postulate of incentive-compatible implementability: The idea that morality cannot be permanently enforced against an actor's self-interests and that moral actions therefore have to be re-conceptualized as self-interested actions. Monistic business ethics tries to comply with this postulate.

Premodern societies: Societies that are characterized by a predetermined order of man and society, by their organization according to estates, by the vilification of economic activity that is targeted towards growth, and by a low degree of mobility combined with high measures of social control.

Prisoner's dilemma: A situation where individual decision-makers acting in their own self-interest do not produce the optimal outcome according to their own standards. Despite the fact that both players cooperating is Pareto efficient, the only → Nash equilibrium is when both players defect. It is one of the most well-known concepts in modern game theory.

Public–Private Partnership (PPP): A contractually regulated cooperation between the public sector and private companies to promote a special purpose.

Rationalist model of moral judgment: According to this model of moral judgment people weigh right and wrong, benefit and harm, fairness and unfairness and then arrive at a well-calibrated judgment. An alternative concept is the → Social intuitionist model of moral judgment.

Reflective equilibrium: The end-point of a deliberative process in which we reflect on and revise our beliefs about an area of inquiry. The idea is that we test given beliefs that we hold against the other beliefs we hold, seeking coherence among the widest set of beliefs by revising and refining them at all levels. The term was coined by the US-American philosopher John Rawls (1921–2002).

Relative poverty: A condition where a household income is a certain percentage below the median income. It shows the proportion of people who are relatively left behind. The criterion is subject to change with economic growth. It is contrasted to → Absolute poverty.

Reputation: Represents a kind of capital for establishing business relationships and thus for saving transaction costs. An individual actor or even a company can build up their reputation by adhering to moral principles such as integrity and fairness, and even by choosing to not erode this capital when there is an opportunity to engage in opportunistic conduct.

Revealed preferences: According to this logic, a decision-maker does not prefer good A over good B, because it maximizes her utility. It is rather concluded from observing her choose good A over good B that her utility function must be constructed such that it implies a preference of good A over good B.

Sarbanes-Oxley Act: A federal law passed in 2002 that established sweeping auditing and financial regulations for public companies. It sought to restore investor confidence in the wake of substantial cases of corporate crime.

Self-binding: A decision-maker commits herself to an action by creating circumstances that force her from the outside to stick to her decision. Others can be signaled behavior patterns that would otherwise be untrustworthy. Strategic opportunities in the present are thus created by restricting one's own freedom of action in the future.

Shareholder approach: The idea that the primary responsibility of businesses is to to act in the interest of its owners. See also → Corporate ethics as profit maximization. It is contrasted with the → Stakeholder approach.

Social contract theory: The group of normative theories that derive moral obligations from the (often fictitious) agreement among citizens to form the society in which they live.

Social intuitionist model of moral judgment: The model is social in emphasizing the importance of social and cultural influences on moral judgments. It is intuitionist in stating that moral judgments are the result of intuitions, i.e. quick and automatic evaluations followed by slow post-hoc rationalizations.

Social welfare functions: A function that ranks social states for any pair of social states as better, worse, or indifferent. The function is individualistic in aggregating the respective welfare levels of the individual members of the society.

Stag Hunt: A cooperation problem in game theory that describes a conflict between safety and social cooperation. The stag hunt differs from the prisoner's dilemma in the existence of two Nash equilibria: when both players cooperate and both players defect. It goes back to a parable of the Genevan philosopher Jean-Jacques Rousseau (1712–1778).

Stakeholder approach: The idea that companies have responsibilities to any individual or organization having a vested interest in the activities of the company ("stakeholders"). It is often contrasted with the → Shareholder approach.

Subjective benefit: The homo economicus maximizes her own benefit. What constitutes this benefit can only be judged by the individual herself. It can, for instance, also consist in increasing the material wealth of others. Mathematically, however, this is still modeled as the maximization of the decision-maker's own utility.

Sufficiency: The idea that the use of certain resources has reached an adequate level. Within the scope of sustainable consumption, the term usually connotes self-limitation through non-consumption. It is contrasted with → Efficiency.

Sustainability: Traditionally, the conservation of natural resources to secure the existence of future generations. Today, the ecological perspective is often complemented with an economic and a social one. Economic sustainability requires that a society's actions do not endanger the underlying basis of its economy. Social sustainability refers to the harmonious coexistence of social groups in a society. The concept is closely linked to the → Triple-bottom-line approach.

Temporally consistent behavior: If an actor decides at the start of the planning horizon to have a higher payment surplus in a later period at the expense of a lower payment surplus in an earlier period, she will maintain this choice even after the earlier period begins and the lower payment surplus comes within reach.

Temporally inconsistent behavior: If an actor decides at the start of the planning horizon to have a higher payment surplus in a later period at the expense of a lower payment surplus in an earlier period, she will reverse this choice when the earlier period begins and the lower payment surplus comes within tempting reach.

Time discounting: In economics, a decision-maker's impatience is captured by the idea that the more distant the realization of benefits is, the less these benefits are worth from today's perspective. The smaller the decision-maker's discount factor is, the higher is the relative importance she ascribes to current gains.

Transatlantic Trade and Investment Partnership (TTIP): A planned free trade and investment protection agreement in the form of an international treaty between the European Union and the USA.

Transparency International: An international non-governmental organization founded in 1993. Its purpose is the worldwide fight against corruption and the prevention of criminal offenses related to corruption. It is headquartered in Berlin.

Triple-bottom-line approach: In this tripartite conception, the dimensions of economy, ecology, and society ("profit, planet, people") stand side by side as equal bearers of sustainable development.

Trolley problem: A moral thought experiment that describes an ethical dilemma. It is considered to represent a clash between utilitarianism and deontological ethics. The modern version of the problem was introduced in 1967 by the British philosopher Philippa Foot (1920–2010).

Trust: From an economic perspective, trust lowers transaction costs. The essence of trust is "reciprocal altruism" which means that performance and counter-performance are temporally and factually decoupled and not explicitly secured by a contract.

Trust game: An experimental paradigm in which a first participant receives an endowment and can send it to a second participant. The sent amount is then multiplied. The second participant can now send back any fraction of this multiplied amount to the first participant.

Ultimatum game: A famous experimental paradigm that models a simple take-it-or-leave-it bargaining situation. One participant (the proposer) receives a monetary endowment and suggests its division between herself and another participant (the responder). If the responder accepts the division, both earn the respective amount. If the responder rejects, both earn nothing. The game was introduced in 1982 by the German economist Werner Güth (b. 1944) and colleagues.

Utilitarianism: A form of → Consequentialist ethics stating that an action is ethically right if it maximizes the sum of the well-being of all those affected. The founder of utilitarianism was the English philosopher Jeremy Bentham (1748–1832).

Value rationality: The reasonableness of a certain goal. In this context, it is possible to speak of effectiveness ("doing the right things"). A complementary concept is → Instrumental rationality.

Veil of ignorance: A way of working out basic intuitions and structures of a just society. It is a hypothetical state in which choices about social justice and resource allocation are made fairly, if a person must decide on society's rules without knowing what position she will occupy in that society. The concept was suggested by the US-American philosopher John Rawls (1921–2002) in his influential *A Theory of Justice* (1971).

Virtue ethics: One of three major approaches in → Normative ethics. It may, initially, be identified as the one that emphasizes the virtues, or moral character, in contrast to the approach that emphasizes duties or rules (see → Deontology) or that emphasizes the consequences of actions (see → Consequentialism).

Want/should self: The distinction captures the intrapersonal conflict that exists within the human mind. → Bounded ethicality arises from the temporal inconsistencies between the contextual trichotomy of our "should"-driven predictions and recollections and our "want"-driven actions.

"Whistleblowing" system: A system that allows employees and suppliers to report observed misconduct to a body outside the company hierarchy, i.e. to someone other than one's superior. Its aim is to identify and clarify compliance violations in the company at an early stage. It is an important tool of → Compliance.

World Bank: A multinational development bank whose original purpose was to finance the reconstruction of states devastated by the Second World War. It is headquartered in Washington, DC.

Index

Note: Tables, figures, and boxes are indicated by an italic "*t*", "*f*", and "*b*", respectively, following the page number.

For the benefit of digital users, indexed terms that span two pages (e.g., 52–53) may, on occasion, appear on only one of those pages.