Why Should the Economy Care About Virtues?

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We should care about the ethics of the market economy even beyond good conduct. The primary challenge regarding the ethical aspects of the market economy does not lie in moral issues but in keeping the economy going, prospering with virtue. One of the main ideas of a market economy is that firms and individuals have to be independent, assuming responsibility for their own success, prosperity and good conduct. The economic discourse might do a better job in understanding these ethical issues by reappraising the importance of virtue ethics.

Greed Is Not Good – And Has Never Been

Adam Smith never meant that greed should be considered as a virtue -a laudable trait of character. Even less did he think that individual greed would – with a little help from the famous *invisible hand* - promote the best interests of the economy and society. In addition to being a distinguished political economist, Smith was also one of the most prominent moral philosophers of his time and a keen scholar of ancient ethics of virtue. To him, greed was a vice similar to the way we think of it. What Smith really said was that self-interest is a vital and healthy driving force behind economic activity. But he also stressed that even virtue was needed in order for the economy to flourish. Self-Interest would, according to Smith, need to be *enlightened*, virtuous or accompanied by virtue in order to be able to promote even public interest and facilitate good functioning of the economy and society.

There does not, however, seem to be any enlightenment or virtue in the current picture of self-interest, as shown by recent corporate scandals. The scandals have clearly fueled both academic and popular discussions recently about ethics and the economy. The popular voice has been demanding responsibility from corporate leaders, and it has also been suggested that the opportunism and greed inherent in the market economy has to be restrained in one way or another. Less noted is the fact that, in most corporate scandals, the managers have done something completely different from the regular business dealings of the market economy. They were busy cooking the books in order to be able to bail out their managerial options, using corporate funds to renovate their homes or increase each others' wages by exorbitant sums on highly questionable grounds.

We have to remind ourselves that those presuppositions, upon which we refer to call such actions scandalous, are the normal procedures and ways in which the market economy functions on a daily basis. Agreements and commitments are generally kept. The extent of free riding and deceptive behavior in the whole economy is extremely limited, even when monitoring is limited and cannot possibly penetrate to all the dealings and contracts made (as the corporate scandals have paradoxically also shown). Besides, with investors now monitoring the activities of their companies' managers more actively in the future, one real, and somewhat comforting, lesson from the corporate scandals is that the market economy in itself is not immoral.

So, the problem with greed is not only that it is wrong in the moral sense, but also the fact that greediness seems to be a lousy strategy in business.[1] Being greedy is not about being courageous or entrepreneurial: it's simply bad judgment, wanting and trying to have more than one's fair and due share. Greed disrupts trust which is of vital importance in economic transactions. Greed is doomed to fail under civilized conditions and a functioning market. What Smith had in mind was that good morals and an efficient market economy are in a way destined to go hand in hand.

Economics is Applied Ethics

One way of stating the interdependence of economics and moral philosophy is to say that the former is a branch of the latter (although some economists, most notably Gary Becker, have tried to suggest that this relationship should perhaps be understood the other way round). However, it is sometimes hard to discern any explicit ethical content in modern economics. Economists and moral philosophers have severe difficulties in speaking the same language. The basic idea of self-interest in economics is far nearer to brutal opportunism than enlightened self-interest. In search of its moral dimension, modern economics has veered more towards hard sciences such as biology, applied mathematics and neuroscience than to moral philosophy, let alone the moral writings of the founders of economics.

Still, if we feel that the idea of self-interest is somewhat gloomy, it might be rewarding to investigate what Smith exactly meant with enlightenment of self-interest. Smith's *The Theory of Moral Sentiments* contains in this sense an interesting feature, which deserves special attention. Among theories which clearly appealed to him were ancient stoic virtue ethics.[2] The general idea of self-interest in virtue ethics could be stated as follows: Each individual is formally taken as an egoist. This is because the purpose of a human life is to lead a good, meaningful and successful life, which is something that no one else can do for you. You have to live your life yourself. But, since material wealth is at most a necessary, though never a sufficient, condition for happiness and a good and meaningful life, the ingredients of a good life cannot be selected from the shelves of a department store. They are instead interconnected to the life you lead and the things you choose to do in your life. In trying to lead a good life, you may notice that your own interests and the interests of others are not easily or clearly discernable from each other. A good and successful life presupposes care and concern for others and the practice of virtues, such as integrity, justice and courage. Therefore, virtuous self-interest is enlightened.[3]

After Smith, interest in what we today call Virtue Ethics faded away for some 170 years as Smith's great contemporaries, Hume, Bentham and Kant, formed the basic ideas of the two major lines of thought of modern moral philosophy, namely *consequentialism* (or utilitarism) and *deontology* (or Kantianism). According to the former, the goodness of actions is to be determined solely from their good or bad consequences, and no action is good or bad in itself. In contrast, according to Kantian ethics, actions *are* good or bad in themselves; the goodness of an action is determined solely by the moral principles followed in acting. Exemplified in crude (and perhaps far too simplifying) terms, the consequentialist allows you to lie, if it has good results (e.g., lives are saved), whereas a deontologist says simply that lying is wrong, no matter what the consequences of telling the truth might be. Economics got built on the consequentialist tradition. There was no more room left for stoic considerations of virtue. From Hume onwards the classical view of enlightenment of self-interest consisted of opportunism which could occasionally give room to altruism and feelings of sympathy and benevolence. The questions concerning how, why and when these feelings manifested themselves were left open, as they still more or less happen to be. No wonder, that 150 years after Smith, John Maynard Keynes would doubt the capability of self-interest of the capitalists to be enlightened enough to be able to promote public interest, and regarded it wiser that the state seek to promote the public interest directly.

But what about if the idea of enlightened self-interest is the key to understanding both the ethics of the market economy and the driving force of entrepreneurship? Smith did advocate an idea of universal entrepreneurship, meaning that, in a way, everyone should consider himself as an entrepreneur, as in the end everyone is responsible for one's own good life. The kind of self-interest we choose does matter: sheer opportunism seems to lead to gloomy and in many ways an insane society as well as a stagnant economy. Choosing enlightened or virtuous self-interest makes it easier to see how acting according to self-interest leads to happiness, prosperity, and the good life. We should care about ethics of the market economy even beyond good conduct. The primary challenge with the ethical aspects of the market economy does not lie in moral issues but in keeping the economy going, prospering with virtue. One of the main ideas of a market economy is that firms and individuals have to be autonomous, assuming responsibility over their own success, prosperity and good conduct. The discussion about corporate responsibility tries to illustrate and meet the ethical challenge at the level of the firm.

Corporate Responsibility: The Basics

Recent layoffs in Finnish companies have been both defended and strongly criticized using arguments of corporate responsibility. This is just one example of a bigger problem: Almost everyone seems to think that corporate responsibility is an issue of utmost importance, but the discussions revolving around it tend to be notoriously shallow or confusing. Without doubt one of the reasons behind this phenomenon is the fact that there appears to be no consensus on what kind of ethical thinking corporate responsibility should be based on. I shall return to the ethics of corporate responsibility later, after I have laid out its very basics. It is generally accepted that corporate responsibility can be divided into three subcategories: economic, social and environmental responsibility.

Economic responsibility means simply that firms have to be economically autonomous. There is no alternative to being genuinely profitable in an economically sustainable way. If a firm is run badly or in an economically unsustainable fashion, there is and should not be anyone backing it up. Of course in reality there are plenty of examples of different kinds of intervention. Governments are keen to subsidize even unsustainable businesses for political reasons. Creditors may sometimes have their own reasons to postpone bad news. Strictly taken, such measures ought to be taken as violations of corporate responsibility.

As firms have been given large freedom to act in ways they regard to be the best, they also have to bear their social responsibility, by honoring and showing special concern for the individuals and communities who are involved in, or in other ways concerned by, the existence and functioning of the firm. Another way of putting this is that in addition to its shareholders, the company has to care about its stakeholders, of which the most central are its personnel, customers and suppliers and the local communities in their different manifestations. In addition to that the firm has to obey the laws, show good conduct and follow good practices. The firm is expected to take its very own initiative in caring about its stakeholders. Personnel are in this respect a special challenge to the managers of a firm because they comprise, in the end, an instrumental relation with the firm and its operations by definition. The purpose of a firm is to do good, and successful action in its field of business and personnel is for the firm a means of trying to achieve its end. Workers exist for the firm, not the other way round. This is why it has to be possible to, e.g., lay off workers. But it is also the reason why firms have to show genuine and special concern for their workforce. Bad news has to be told honestly, clearly and on good, solid grounds.

Nowadays it is common for firms to add to their social responsibility all operations which are not directly linked to their core business. The downside of this is that firms tend to confuse marketing and social responsibility with each other. Companies which show bad conduct by, for example, laying off workers may at the same time bolster their achievements in the field of social responsibility by supporting, e.g., the arts or sports. In the realm of social responsibility, the golden rule of marketing, namely that "Image is everything," does not apply.

Although stakeholders have ways to retaliate when being mistreated, the environmental side-effects of corporate operations are genuine externalities. The environment does not complain or go on strike if treated badly. Assuming environmental responsibility successfully requires special attention and, as experience has shown, mutually agreed norms and standards, compliance to which is monitored and enforced with sanctions. The discussion and theories of corporate responsibility have given a boost to the traditional idea of corporate environmental responsibility by giving it new tools such as certification and reporting systems.

The Philosophy of Corporate Responsibility

Economics is built on consequentialistic ethics. Applied to corporate responsibility, this leads straightforwardly to shareholder value thinking. This is because, despite the evolving reporting systems on issues of corporate responsibility, the results in the fields of economic, social and environmental responsibility are not commensurable.

Taking on corporate responsibility must result in economic gain, and violating it must result in economic damage. The firm is guided towards responsible actions either through the wishes of its customers and investors or through extensive monitoring of the firms operations by the authorities and a sharp use of sanctions when needed. Needless to say, the first option is far too optimistic, and the second one makes the world look gloomier than it actually is.

As a matter of fact, it is quite difficult to speak about firms taking on their corporate responsibility in the light of pure consequentialist ethics. The responsibility of a firm is to provide returns to and increase the value of its shareholders' investments. The social and environmental parts of the responsibility are, strictly speaking, not assumed by the firm but by customers and investors, or alternatively by the legislators and the enforcers of the law. The real world has reminded us that customers and investors lack information or are not sufficiently capable of appraising the level of a firm's responsibility in its operations. The markets are in most cases imperfect and the market power of the firm does not always even give the consumers a fair chance to vote through their choices. In addition, it might also be said that concentrating on the maximization of sheer asset value is too abstract an end for most corporate managers. Focusing solely on equity prices easily blurs the manager's grasp of what the firm really does. Too many failed options programs and scandals speak for themselves. It seems clear that another form of ethics is needed to be able to account for corporate responsibility in full.

Kantian ethics better suits the discussion about responsibilities and duties. Moreover, it is the standard idea of ethics in Finland, mediated by the Lutheran church for hundreds of years. The core idea of deontologic ethics is that ethical conduct is valuable in itself, not because it is profitable to comply with ethical norms. Your duties are your duties as an individual vis-à-vis another individual. You have to keep your promises. You are not allowed to lie, no matter what the consequences are. It is not difficult to see that Kantian ethics is more genuinely "ethical" in the very sense of the word than consequentialist ethics. Still, Kantian ethics is very demanding, both ethically and intellectually. Therefore it manifests itself in principles, norms and especially laws. In the Kantian perspective, corporate responsibility has to be taken on irrespective of the consequences. The problem is, however, that this easily leads to a conflict with the consequentialist or utilitarian logic of economics, which does not acknowledge the possibility that actions might be valuable in themselves, and wants to separate means and ends. In economics, there are only good and bad consequences. In the worst case, corporate responsibility becomes a burden for standard business operations which often involve trade-offs between bad and even worse outcomes. From a Kantian perspective it is simply wrong to lay off people, even if doing so bolsters the competitiveness of the firm in the longer run. Ethics is still widely regarded negatively as a counterforce to the free market economy, viewed as a more or less immoral system. Less popular is the more positive standpoint that moral responsibility is an integral part of the freedom to act by individuals within the market.

Corporate Responsibility: The "Case" of Finland

In the last two decades we have witnessed a major liberalization of markets and economic systems. Finland is an interesting example of this development. In the early 1980s, the Finnish economy was still essentially a "mixed economy," which combined market elements with central planning. The Finnish state was by far the largest industrialist, capitalist and entrepreneur in the country. Co-operative firms grew to become large and strong. Business responsibility was, to a large extent, assumed collectively and politically. Moreover, lending regulations gave the banks both considerable power and responsibility over the firms.

In the middle of the 1980s, the financial sector was deregulated, and both market deregulation and new enterprises paved the way towards free market competition in most sectors of the economy. Competition intensified, promoting higher productivity. The deep depression in the early 1990s was a test for Finnish corporate responsibility. The Finnish economy did not pass this test. Neither firms nor individuals were fully ready to or capable of assuming economic and social responsibility for the depression, and the state had to intervene one more time.

After the depression, Finland woke up to a globalizing economy. The marriage of politics and the economy was more or less over. Shareholder value was the tone of the corporate responsibility discussion of the 1990s. It even reached Finland, although it was met with some suspicion. Its main line was that special concern was not needed for issues of corporate responsibility. Corporate responsibility was thought to manifest itself as a side-effect of a well-run business, and all the relevant information would be reflected reliably in asset prices. This idea was proven to be far too theoretical and optimistic by the stunning corporate scandals of Enron and WorldCom, for example. It is worth noting that the Finnish corporate sector has not experienced any severe scandals whereas countries such as Sweden, Germany and the Netherlands have. As a counterforce to the scandals, the social and stakeholder responsibility was emphasized and the conduct of firms is nowadays monitored from several directions. Firms today practically have to legitimize their existence on a daily basis to shareholders as well as stakeholders.

Is Moral Philosophy a Key to Corporate Responsibility?

One more problem in discussing corporate responsibility is the fact that it is questionable whether corporations and firms actually are moral agents and *can* have morals. A flaw in a firm's morals is always either a flaw in the way the firm is organized or a flaw in an individual's conduct or judgment. In both cases the decisions are always in the end made by individuals and ethical questions always concern the individual's character. The character of an individual is decisive not only for the morals of the economy but also for its success. The idea of enlightened self-interest combines efficiency, morality and happiness. As a result we get two versions of capitalism: Virtuous Capitalism which is agile, effective and morally sane and Brute Capitalism, where opportunism sets the standards and which is doomed to slow growth. Virtuous Capitalism resembles the form of capitalism Adam Smith advocated. The return of virtue to economics may be anticipated.

Footnotes

[1] See Gustafsson (2002)

[2] See Smith, p.256&314-347.

[3] For a fuller and better account, see Annas (1993), pp.223-322.