Ethics in a Market Economy

ETHICS AND FINANCE

Why Ethics and Morality are Inherent to a Market Economy

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1. *Introduction*

Buying something in the supermarket, working in an assembly shop or making a decision to purchase bonds and shares: every action leaves a footprint in the market. People are part of a system which takes care of producing and distributing values. They influence it as consumers, employees, entrepreneurs, managers or investors. A benefit calculation and attitude of responsibility determine their action. Whether people act on an egoistic or on an altruistic respectively charitable motivation doesn't matter as long as their actions follow a code of ethics. The most important principle lies in not taking advantage of one's neighbour or put-ting their livelihood at risk. No matter from which perspective we look at the market, the economy is an integral part of our life. As formulated by Alfred Herrhausen, this leads to the central question whether a market system can represent a moral economic order under the conditions of human nature and the scarcity of resources (cf. Herrhausen 1984).

As postulated by Adam Smith, the father of classical economics, a society can only achieve growing prosperity if the economic man can simultaneously increase wealth through work and participation (cf. Smith 1776/1976). As a theologian and moral philosopher, Smith believed that people act out of empathy and care for their fellow human beings. This conviction has shaped Smith' economic theory. Yet how much do we care about respect and empathy today? Does the big picture still influence our daily decisions?

In the bigger picture, society for example cares about global warming and climate change leading to changes in the existential basis primarily of future generations. But in everyday life, such worries are blanked out. Although everyone knows that private transport produces more harmful emissions per head than local public transport, people still use their cars even for the shortest of distances. People do not behave coherently.

The same can be said about incoherent claims around our current financial climate: no-body wants unstable banks yet everyone wants to yield high interest rates. Thus demands that people should be held responsible for their actions are shaping the political debate about the last financial crisis. Those who generate returns should also bear the risk. Correctly set incentives respectively channel the efficient use of resources which can be judged positively in welfare economic terms. Otherwise there is the risk of moral hazard arising. Accordingly, the rescue and nationalisation of the banks by the taxpayer are subject to critical debate. The assessment of risk and opportunity, however, is a very complex subject, not just in times of crisis.

Beside economic conditions, also personal convictions and needs play a prominent role. Traditional behaviour patterns, influenced by different cultures, influence the way money is handled to a great extent. Thus it can still be observed, even today, that in cultures with a Catholic Christian character bonds are preferred to shares. This phenomenon traces back to the Church's twelfth century decree on the prohibition of interest which was officially lifted in 1830 but continues to exist to the present day in the form of zero bonds. In contrast, shares are favoured in the Anglo-Saxon Protestant world. The North Americans' affinity to shares illustrates the optimism of the early settlers and pioneers who set out at the time to build a new world through the acceptance of risk and uncertainty.

The North Americans were convinced that they could create a better life for themselves in the New World than in Europe. The spirit of optimism and adventure of those days find their continuation in today's stock exchanges. However, families who suffered huge losses under the German hyperinflation of the 1920s even today still react with great sensitivity to the danger of inflation and volatility. In the long term, the investors' behaviour will only change if the interdependence of politics, society and the economy is institutionalised (cf. Eucken 1999).

2. Moral Foundations Have Deep Historical Roots

> "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it" (Smith 1759: 9).

With this quote Adam Smith recognised the importance of a moral foundation for individuals in the market economy as long as 250 years ago. The subject is still of great social and political interest, especially after the sub-prime crisis of 2008. There was an explicit call for greater moral self-control, since without it the whole system was at risk and opportunistic behaviour appeared to be the dictate of the moment. There was the risk that well-understood self-interest would turn into egoism. For this reason, an enlightened sense of social responsibility is an important part within a market economy, the absence of which cannot be absorbed by legislation and control. In general, market interventions lead to a loss of prosperity, choice and individual freedom (cf. Kahl 1956).

The idea of the market economy will be demonstrated by the social market economy as set out by Ludwig Erhard. We will here define the word "social" in greater detail. To quote John F. Kennedy, it is not a matter what the state can do for each individual but what the individual can do for the community to bring forward its prosperity (cf. Kennedy 1961). Economic subjects participating in the market must not see themselves only as individual utility maximisers if the "invisible" coordination of their action plans is to succeed but they also have to understand themselves as actors who are dependent on one another (cf. Friedman 2004). There exist, in a certain sense, a mutual contract between them based on ethical principles and respect for others. Such guiding principles "invisibly" contribute to a general increase in prosperity and freedom.

From an economic perspective it is not, however, unlikely that moral standards have developed out of a stream of human experience in the course of centuries or millennia as the result of an evolutionary process and have forced back so-called "negative external effects" while simultaneously producing a positive influence on the actors in economic life. That is what Adam Smith suggests in his work The Theory of Moral Sentiments. According to Smith, there is therefore a causal connection between moral standards as market rules and our own practiced behaviour. Furthermore, a functioning system of institutional rules must be implemented within an economy so that its actors have normative foundations for doing business. That does not mean an interventionist state but rather a sovereign state which provides the legal framework conditions for the market actors which are necessary to guarantee fair competition or, indeed, appropriately safeguard the possibilities of entering or leaving the market. An efficient competitive order guarantees economic freedom (cf. Habermann 2005: 127ff.).

3. Profits and Morality

It is not fundamentally reprehensible to do something for egoistical reasons if a positive result for other people is also achieved at the same time. Here is a simple example: Let us assume that someone is queueing in front of a ticket machine and he is in a hurry. Therefore, he provides assistance to help the person standing in front of the machine having difficulties.

Equally two parties could firmly pursue their own interests in negotiating a contract by not taking advantage of the other party so that a fair contract for both parties is achieved. Adam Smith had a simple explanation in his classic liberalism for this mechanism which is not, however, sufficient for the solution of modern problems in society as a whole. Smith advocated the position of the "invisible hand" which leaves it up to the acting forces to regulate themselves. Here, however, the growing complexity of economic relationships has to be taken into account. No one will necessarily want to trust today that all possible conflict situations can be resolved effectively by themselves because individual egoism is allowed a corresponding momentum. To this extent the consideration that certain fields in society should be meaningfully regulated should not be fundamentally rejected. It is the case, on the other hand, that the trust which has been lost in the course of the financial crisis will not be regained through the introduction of regulations, or at least not by that means alone. On the contrary, the endeavour should not just be to promote own interests through the enforcement of regulations but to work meaningfully for the purposes of society.

In cases of conflict, a decision with which the attempt is made not to increase the pain of others through our own actions is also always a decision with a moral quality. In some cases one can only prevent additional pain for one person and not for everyone. Following Freud, we consider the pain inflicted on us by other people, in comparison to the unavoidable disasters through external and internal nature, as fundamentally avoidable and thus as being particularly painful. Transferring to a corporate strategic decision which has negative consequences for its staff, that means to credibly communicate and justify that these negative consequences, e.g. by a good information policy. Arbitrariness and randomness should be rigorously avoided particularly with regard to unpopular decisions like dismissals. Unpopular decisions might have to be taken to maintain a company during a crisis.

Even if a company stands for a certain corporate culture and certain corporate values such as trust, security and discretion, there is always a residual risk corporate decisions neglect these norms. The suspicion may arise that these moral values are just preached by the management without any practical consequences. Perceived divergences between written words and commitments on the one hand and living practices on the other hand may disappoint and frustrate customers and the public (cf. Kummert 2013).

Fundamental trust in the reliability of companies depends on the extent to which such a suspicion has developed. People first and foremost trust other people not companies as institutions. People develop trust when they see how others brings to life abstract values through their own behaviour. When we endeavour to say what we think and when we endeavour to do what we say and then also to be what we do, then, Alfred Herrhausen believed, we should have a chance to develop credibility and the mistrust of what we say should also disappear as credibility grows (Herrhausen 1989).

4. *Individual Responsibilities and the Challenge of Globalisation*

To stay with the example of the social market economy, the latter evidently implies an ethic of responsibility, which cannot be prescribed by the sovereign state but rather has to be developed by the actors themselves. The Enlightenment idea of man is based on a mature, free and responsible citizen. Thus it is a cornerstone of the social policy, for example, that private initiative and self-provision is based on freedom rather than an omnipresent all-providing state restricts this freedom.

Other important elements of this model are monetary stability as the guarantor of efficiency and justice, a competitive order guided by the ideal of open markets which are indispensable for free price setting, as well as a liberal economic policy which refrains the state from market intervention. But this does not mean that the social market economy is a pure liberal market economy but which is deliberately socially accompanied. But, how do we responsibly make use of this economic power? As stated by Alfred Herrhausen, what happens in any place in the world has an immediate direct influence on many other places in the world, and looked at in this way it is already global, it is already a world in which we live and in which we therefore cannot just feel responsibility for ourselves but at the same time have to do so for everyone else as well (Herrhausen 1989).

Globalisation challenges politics and society as it changes shortage ratios worldwide. Four times as much labour is available in the world economy today than there was in 1980. It is the availability of simple, not highly productive workforce, which has enormously in-creased. The challenges to the occupational flexibility and mobility of less qualified workers in the developed countries in particular are correspondingly great. In many cases they can-not maintain their absolute income in their traditional workplaces and their position in the income structure even less so. Thus, warnings about increasing inequality cannot simply be rejected. The state has to withdraw where it reduces the achievement motivation and engage itself where it supports growth strengths and equal opportunity, such as for example through the qualification of people or intergenerational justice. In times of globalisation following Ludwig Erhard's model of the social market economy meets this expectations. Here the social market economy places its trust in the primacy of the market and the personal responsibility of consenting citizens without forgetting that the state has to set rules for the best possible incentives for market forces and is also called upon to be involved in the task of enabling all willing citizens to take part in it (Habermann 2005: 38ff.).

5. *The Market Economy as a Consensual Economic Order*

Since the times of Adam Smith, modern economists advocate the hypothesis that the market economy is superior to all the other concepts. Even though Adam Smith and his successors did not put it in these words, they would claim that the market economic order serves mutual interest and is based on an idea of freedom and equality (cf. Eucken 1999: 15f). In recent times it was Friedrich A. von Hayek who defends this claim emphatically and with thorough arguments. Like the constitutional economists he uses the game metaphor to illustrate his arguments against the background of social theory (cf. Vanberg 2011: 12f.). According to Hayek (1979), it is best thought of as a game which can be called the game of catallaxy, in order to understand the functioning of the market system, which not only leads to the creation of order, but also to a large rise in the proceeds which people obtain from their efforts.

The term catallaxy is derived from the ancient Greek word "katallatein", which means both "bartering" or "trading" and "to admit into the community" and "turn an enemy into a friend" (cf. Vanberg 2011: 12f.). It had been this dual meaning, Hayek notes, which led him to propose "that we call the game of the market, through which we bring the stranger to be friendly with and useful to us, the game of catallaxy" (Hayek 2004: 195). What the term catallaxy – game or exchange – highlights is that the market is an arena for voluntary exchange and cooperation based on rules and contracts. The market price is the economic price for which a good or service is offered in the competitive marketplace. Or, expressly in Hayek's words:

> "The chief cause of the wealth-creating character of the game is that the returns of the efforts of each player act as the signs which enable him to contribute to the satisfaction of needs of which he does not know, and to do so by taking advantage of conditions of which he also learns only indirectly through their being reflected in the prices of the factors of production which they use. It is thus a wealth-producing game because it supplies to each player information which enables him to provide for needs of which he has no direct knowledge and by the use of means of the existence of which without it he would have no cognizance, thus bringing about the satisfaction of a greater range of needs than would otherwise be possible" (Hayek 1979: 115).

To sum up these constitutional economic considerations Hayek advocates the hypothesis that people have rational grounds to engage in the catallaxy game and to agree to the rules of the game (cf. Hayek 2002: 104ff.). The market economic order is to be recognised as a just order (cf. Vanberg 2011: 14f.).

6. Conclusion

From the beginning, the guiding principle of the market economy was established as a compromise and thus open to conflict. Following Alfred Müller-Armack (1956), the basic idea is to combine the principle of freedom in the market with social equalisation. The basic conflict arises because the of the market economy are constitutive and, in the majority of cases, diverge from those which are justified on the grounds of the welfare state. Moral categories have been integrated in the set of rules governing economic life in the market economy. Morality then lies in the rules of the game and competition takes place in the moves of the game.

Additionally, responsible entrepreneurs should have a character, which is guided by the entrepreneurial virtues. These virtues are among others integrity and honesty, thrift and moderation, resolve and foresight, order, diligence as well as decency. Their virtues strengthen their own credibility and build the trust, which is indispensable for good business relationships. These virtues are not imposed or enforced from the outside but arise from mutual recognition of the economic actors. If no prior understanding between the actors on the market exists, Honneth (2013) specifies the conditions, that they should treat each other not just as egocentric utility maximisers but respect one another as trustworthy contractual partners, what happens in the market would be under constant threat of the danger of deceit and distrustfulness. In view of today's challenges in the market economy it is therefore high time to remember a tradition in which the market is interpreted as a morally demanding undertaking of modern societies contingent on many factors.

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