

Beyond Utilitarianism and Deontology: Ethics in Economics

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ABSTRACT *This article starts from a methodological position that fact and value are mutually related, both in the real world and in economic analysis. It then discusses deontological ethics. This approach is concerned with equality and dignity, as expressed in right and norms, and how these rights and norms constrain individual choices. Deontology is thus different from the utility maximisation of utilitarian ethics, where ethics appears in utility functions as moral preferences. The paper then argues that, although deontology does better than utilitarianism in analysing ethics in economics, it has its own weaknesses. These weaknesses require another theory of ethics for economics, virtue ethics, which emphasises the interrelatedness of agents and commitment to shared values beyond the rules that a society has institutionalised. Virtue ethics internalises morality not as a preference or a constraint, but through the practices in which agents are related in their pursuit of value added.*

1. Introduction

This article discusses the relationship between economics and ethics¹ in different ethical theories. It starts from the position, recently defended in this journal by Vivian Walsh (2000, 2003) and Hilary Putnam (2003), that fact and value are mutually related, both in the real world and in economic analysis. I will not repeat their eloquent arguments, but refer the reader to the discussion in this journal (Vol. 15, No. 3) on Walsh's article.

Following Walsh and Putnam, I reject the dichotomy (adhered to in much of mainstream economic analysis) between fact and value, between positive and normative economics, and between descriptive and prescriptive analysis – in other words, between the famous Humean 'is' and 'ought'. Of course, there

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¹There is a subtle but important difference between the concepts of 'morality' and 'ethics', which will be adhered to in this contribution. Morality is about the actual beliefs or specific actions of individuals in terms of good and bad, whereas ethics is more general and concerns a reflection on the reasons for or against certain moral beliefs or actions.

is a fundamental difference between distinguishing facts and values (which is necessary for conceptual reasons as well as for doing justice to the different meanings of these concepts) and placing them in a dichotomous relation. The problem with a dichotomous positioning of fact and value, and subsequently, the economy and morality, is that one excludes the other and is also favoured over the other, often without any ground other than that the favoured notion is not the unfavoured notion. 'A' is favoured merely because it is not 'not-A', and 'not-A' remains empty, deriving its meaning wholly from what has been termed as 'A', the better side of the opposition. Some examples of this are the dichotomies between reason and emotion, between market and state, and between self-interest and altruism (see van Staveren, 2001, pp. 89–90). Contrary to such dichotomies, values are part of economic analysis, alongside and frequently intertwined with facts, rather than being separated from facts in the form of policy recommendations following a supposedly value-free analysis. This connection between facts and values becomes most visible in economic terms such as 'well-behaved utility functions' and 'robust model estimations', as well as in some theoretical notions such as 'freedom of choice', 'equilibrium', and efficiency as being 'optimal'.

Importantly, this does not imply or suggest that economics (or any of the other social sciences) is not objective, or that it does not try to uphold scientific standards of objectivity. But objectivity is a fallible epistemic value. Even in the so-called 'hard sciences' the notion of objectivity as relying on observables has had to be adjusted over the past decades, as Putnam (2002) reminds us. Following this line of thought, Amartya Sen (1993) has proposed talking about 'positional objectivity', which acknowledges the social positioning of economists in relation to a particular discourse. Positional objectivity in economics also carries an ethical position. The purpose of this paper is to make these theoretical positions explicit, by analyzing them in the light of two ethical theories – deontology (derived from Immanuel Kant) and virtue ethics (initiated by Aristotle). The next section discusses deontology and its applications in economics; Section 3 will do the same for virtue ethics. The paper ends by arguing that while both ethical approaches have a legitimate place in economics, virtue ethics deserves more attention from economists than it hitherto has received.

2. From Utilitarianism to Deontology

As is generally known, utilitarianism allows individual agents to have moral preferences and to act in the interest of others, when action toward others generates a net utility gain for the individual (Becker, 1996). However, in welfare economics the original Benthamite utilitarian principle of comparing individual utility (the greatest happiness for the greatest number) is rejected. In its place is the Paretian principle, which states that we can only identify situations where no one can be made better off without making someone else worse off. The Paretian principle rejects redistributions (because someone is made worse off and individual utilities cannot be compared), thus removing the moral basis of utilitarianism from welfare economics (Hausman & McPherson, 1996). By so absorbing morality into subjective and incomparable individual preferences, neoclassical economics has

effectively removed ethical evaluation from welfare analysis. This has resulted in many critiques from both inside and outside economics; it has also led to the application of different ethical approaches to the discipline (McCloskey, 1985; Sen, 1987; Hausman & McPherson, 1996; Wilber, 1998; van Staveren, 2001). A major alternative to utilitarianism, which has attracted the attention of many economists, is deontology.

The deontological approach to ethics regards morality as a duty, or a moral rule that ought to be followed. Deontological ethics is about following universal norms that prescribe what people ought to do, how they should behave, and what is right or wrong. It is a morality of principles, not of consequences. Moreover, deontology resides in reason, not in utility-providing feelings. Reason is considered to be the source of moral rules, expressed through the human will. In deontological ethics, the moral problem is considered to be a rational problem that involves finding the right moral rule. It was Immanuel Kant who formulated the best-known principle for rule-setting in his Categorical Imperative: ‘Act only according to that maxim by which you can at the same time will that it should become a universal law’ (Kant, 1998, p. 422). This maxim may be based on rights, a belief in fairness, an intrinsic valuation, or something else, as long as there are universalisable moral duties. For example, the right of female employees to equal wages for equal work implies that employers have a duty not to discriminate on the basis of gender; a belief that people deserve some minimum living standard may lead to the formulation and enforcement of a minimum wage; and respect for the intrinsic value of the ecosystem may lead to a moral duty of recycling. An important implication of deontological ethics, emphasised by Kant himself, is that human beings are considered to be equal and therefore should never be turned into means for other people’s ends; people should always be regarded as ends in themselves. This implies mutual respect and the protection of human dignity, which in turn assumes moral limits to human behaviour or a bottom-line of what is acceptable, irrespective of the economic consequences of such moral norms.

2.1 Deontology in Economic Theory: Opposition

At first sight, deontology and economics do not seem to be compatible. Whereas economics is concerned with behaviour characterised by choices and ends, deontology is concerned with behaviour characterised by duties and limitations. While economics is about markets and allocation problems, deontology implies a rule-setting authority and distribution problems. It appears that economic behaviour and moral rules are in opposition, and that little room exists for deontology in economics. But this may be too hasty an observation. As is widely acknowledged among economists, an economy can function only when certain normative requirements are fulfilled. Partly, these requirements can be understood as rights, such as property rights and contractual rights. Another requirement concerns norms. These can be formal or informal norms – expressed in formal institutions, such as the welfare state, or informal institutions, such as culturally-shaped styles of human resource management in firms.

Rights and norms have been widely understood to influence the economic behaviour of individual agents, firms, and the state. They have been taken up in a wide variety of economic traditions, including the mainstream through new institutional economics, public choice theory, and the field of law and economics. Deontological notions such as ‘rights’, ‘dignity’, ‘equality’, ‘obligations’, and ‘norms’ appear more prominently in heterodox traditions such as political economy, (old) institutional economics, Post Keynesianism, and socio-economics, as well as in cross-cutting areas such as feminist economics and ecological economics. The common ground is a recognition that rights and norms affect economic behaviour as constraints on choice. The mainstream limits deontological ethics to a relatively small set of rights concerning property and contracts, which enable markets to develop and to function. Extensions, as in the new institutional economics, concern additional constraining moral rules that arise from formal as well as informal institutions, such as state regulations and group norms. In this way, moral rules limit choices, but these limits are necessary to ensure that people are free to trade and that they will not reduce other people’s freedom to trade. Such constraints are often concerned with ensuring free markets; they range from protecting property rights to rules for free competition, such as anti-trust laws, prohibitions on insider trading, and anti-dumping regulations. These are all examples of deontological ethics – universal moral rules that are enforced through legal measures. They express the Kantian idea of equality applied to markets, thereby ensuring fair competition.

Recent laws on corporate governance in the US and Europe, enacted after the WorldCom, Enron, Parmalat, and Ahold scandals, are an example of how deontological ethics has been applied to policy issues in a way that goes beyond ensuring fair competition. For example, the 2002 Sarbanes-Oxley Act seeks to limit the negative side effects of competition, such as manipulation of financial results, and hence, share values. This law recognises that equal participation in markets not only requires competition-enhancing rules, but also rules to reduce the power-seeking and rent-seeking behaviour that comes inevitably with competitive processes, as Joan Robinson (1933) warned about. It is in the heterodox tradition that such negative side effects of free markets are explicitly recognised, in particular side effects on workers, through exploitation and unemployment. Therefore, heterodox traditions allow for an even larger role for deontology in economics. They understand moral rules as serving not only the development of markets and fair competition, but also serving to limit negative externalities due to competition. In other words, moral rules are understood as promoting positive freedom. For example, moral rules supporting positive freedom imply redistribution in order to ensure a minimum livelihood for all, or to use the Kantian language of human dignity, to guarantee a universal decent livelihood.

Whereas the mainstream recognises an important role for moral rules in the economy, one of ensuring the Kantian principle of equality between humans, heterodox traditions acknowledge the need for moral rules in the economy in order to do justice to the Kantian principle of human dignity. Seen in this way, the moral disagreement between the mainstream and heterodoxy is not only between utilitarianism and deontology, but also about the extent to which deontology has a place in economics. Whereas in the mainstream view, moral rules serve

only as preconditions for markets to function (protecting negative freedom), heterodox perspectives hold that additional moral rules are required to promote positive freedom, ensuring that people will benefit from markets to make a decent living. And if they cannot, they should be able to rely on state support to sustain their human dignity. From a mainstream, utilitarian, perspective, of course, these additional moral rules will adversely affect incentives and create inefficiencies. However, recent developments in endogenous growth theory, the idea of a developmental state, and the concept of social capital provide two deontological arguments against this critique.

First, the criticism involves a misconception of deontology. Deontological ethics does not harm incentives, as people voluntarily follow a universalisable moral rule (as is explained by the Categorical Imperative). Morality is a matter of finding the right rule; it is not affected by desire, weakness of will, or laziness. A moral rule is followed as a duty, although it needs to be backed-up by authority. Therefore, following rules will not necessarily lead to disincentives to produce, as people are led by the agreed moral rule and not by their desires. In economics, this problem has been addressed through the concept of meta-preferences, or preferences of preferences (Sen, 1987; George, 2001). The idea of following meta-preferences or agreed moral rules, even when these may go against one's desires, may sound idealistic; yet it is quite common. For example, many rich people who see wealth taxes rising will not decide to emigrate to tax havens or put all their money on a foreign bank account, partly because they agree with the underlying morality of raising the living standards of the poor in their country. They do not want to live in an impoverished society, or they may fear increasing crime rates resulting from a widening gap between rich and poor.

Second, the enforcement of rights and norms in an economy may not reduce efficiency, but may instead reduce negative externalities. An economy embedded in a normative institutional setting that furthers equal access to resources, partly through public goods such as education and health care, is likely to expand its productive base. Wider access to resources will increase economic participation and reduce idle resources. Land reform and universal access to education have been shown to be a major force behind the economic success of the Asian tigers, mainly through increasing returns to human capital (Aghion, 1998). At the same time, redistributive and protective economic institutions, such as industrial policy, infant industry protection, social welfare, and collective bargaining have been argued to be behind the success of the now-developed countries after the Second World War (Chang, 2002). In other words, deontological ethics, with its moral rules for constraining economic behaviour, may help to increase welfare, rather than reduce it, in a real-world context of externalities and power-seeking behaviour.

2.2 Deontological Economics and its Limitations

Deontological ethics locates morality in universal moral rules, even when they imply a reduction in utility. The rules constrain economic behaviour to enhance negative freedom (in mainstream economics) or to promote positive freedom (in heterodox traditions). In both cases, moral rules seek to realise some form of

justice in the economy, either by ensuring equal participation in markets through enhancing competition, or by ensuring a decent livelihood for everyone through redistribution. It seems clear that moral rules play an important role in the economy and that deontological ethics has a legitimate role in economic theory.

However attractive this moral theory may seem, it has several shortcomings. First, not all moral problems can be solved by rules. Human life is too complex to be reduced to a set of rights and duties (Anscombe, 1997). Indeed, as Walsh (2003, p. 285) has concluded, deontology is limited to issues of the will. It excludes vulnerabilities of human life that are outside the reach of the human will, such as scarcity of means and various contingencies to which social and economic life is so vulnerable. So morality needs to involve more than universalist reasoning and a steadfast will.² As Putnam (2003, p. 405) has argued, it requires more than moral rules, since there are other ways values are expressed besides rules telling us what people must do.

A further limitation is that deontological ethics has no criterion for dealing with conflicting rules. There is no higher-level rule that enables a unique rank-ordering of moral rules according to their relative importance; nor does the theory allow for exceptions (Crisp & Slote, 1997). If killing is wrong and we find ourselves in a situation in which killing one person would help to save the lives of a hundred others, would we not, perhaps, reconsider the rule and look at its consequences in this particular context? What about a situation in which one needs to choose between two evils, for example lying in court and betraying a friend? Deontology is a powerful universalist ethical approach, but it encounters problems when applied to concrete and complex real-life situations.

This points to the need for an ethical theory that escapes the normative rigidity of universal moral rules.

3. Virtue Ethics

3.1 *The Ethical Theory of Virtues*

The founding father of virtue ethics is Aristotle. His approach focuses on the good person, with virtues understood as characteristics of the good person. Although a personal ethics, virtue ethics is not individualist, because it regards people as social beings who can function only in relation to others. Hence, virtue ethics is expressed in relationships; morality is concerned with concrete social life instead of abstract moral rules.³ Virtue is acquired in daily interactions with others, in communities, and through a process of trial and error (MacIntyre, 1987). Whereas

²This is a widely known failure of deontological ethics – it is one thing to know what is best to do, but quite another to act accordingly. Of course, an authority may enforce a moral rule, but without a majority vote in favour of the rule, the rule will not be followed. The frustration of many well-wishing individuals about the lack of a political will to enforce moral duties was eloquently voiced by U-2 singer Bono: ‘We have the cash, we have the drugs, we have the science, but do we have the will to make poverty history?’ (Interview with the Seattle Post-Intelligencer on http://seattlepi.nwsource.com/opinion/221105_bono22.html).

³There are several influential ethical theories that are related to virtue ethics, in particular.

deontology is a universal ethic, concerned with universalisable rules, virtue ethics is contextual and concerned with responsibility in specific instances. It is not grounded in reason or in desire, but seeks to find a balance between reason and emotion (called intuition) that transcends the dichotomy of head and heart. In her book on morality and emotions, the Aristotelian-inspired ethicist Martha Nussbaum (2001) has demonstrated how emotions are part of ethical reasoning, as they involve judgements that acknowledge our vulnerability. By recognising human neediness and the incompleteness of human strivings, emotions are evaluative in themselves, and not just a by-product of ethical reasoning, let alone something that inhibits moral deliberation as Kant held (Nussbaum, 2001, p. 19).

Virtue ethics focuses on the good, or 'self-sufficient' virtues, as Aristotle (1980, p. 12) formulated it in his *Nicomachean Ethics*. Humans seek to follow the good for itself, committed to certain ends and not seeking them instrumentally for some other goal (Aristotle, 1980, pp. 1–2). This good includes the use of good means and a good process. This makes virtue ethics an intermediate position – somewhere between the exclusive focus on ends in utilitarianism and other consequentialist ethics, and the exclusive concern with imperatives of deontological and other principled ethics. Hence, the good in virtue ethics involves having both good motivations and good reasons. Together they produce moral goods, like justice, generosity, liberality, or kindness, which derive meaning from their application in particular contexts. The combination of motivation and reason in specific contexts distinguishes virtue ethics from utilitarianism and deontology (Braithwaite, 1971; Stocker, 1997). Both motives and reasons matter; it is the process connecting the two that matters most according to Aristotle.

This nuanced ethical position transcends the dichotomy between self-interest and altruism, as motivation derives from shared and contested values in a particular community, shaped by institutions that will partially enable good behaviour and partially constrain bad behaviour. Acknowledging fundamental uncertainty, vulnerability, human fallibility, and human interdependence, self-interest simply does not provide the best guide for behaviour. Altruism, the other extreme, requires the moral strength of Gods, not the weak will of humans. So, like self-interest, it is not a feasible strategy. Therefore, both self-interest and altruism are two extremes or ideal-types of motivation that are weakened by the contingent contextual factors on which virtue ethics is founded.

Virtue ethics acknowledges that the good has no universal standard, and that moral behaviour is imperfect and continuously adapting to changing social circumstances. It is guided by the values that are shared and contested in communities, supporting these values through a trial-and-error process, but recognising that values are fallible and that we can never reach perfect virtue. This continuous trial-and-error process is all the more complex because the good is plural, consisting of a variety of values. So, not only is every single virtue a means between two extremes (e.g. courage is a means between cowardice and rashness), every virtue is a balance between excess and deficiency, and all the virtues together form a balance because they are interdependent. For this reason it is not easy to be virtuous, even if one tries to further the dominant values of one's community, as they may conflict in specific situations. Virtue ethics recognises that people often fail to find a balance between excess and deficiency of values due to 'weakness of the

will, indecisiveness, guilt, shame, self-deception, rationalisation, and annoyance with oneself' (Stocker, 1997, p. 66). Recognising human fallibility, virtue ethics rejects the assumption in deontological ethics that the will automatically follows reason. In virtue ethics, the good is a delicate balancing act of finding the mean between extremes through a social process of trial and error that may not always succeed. As such, virtue ethics may be regarded as transcending the dichotomy between utilitarianism and deontology because it acknowledges that in the real world, agents are concerned with both consequences and duties, but subject to social relations and context.

Nonetheless, virtue ethics has its own shortcomings. Its concern with the good person makes it difficult to evaluate situations, structures, and institutions. The theory was developed for individuals, not for organisations or society. The theory might be adapted to address moral questions beyond persons, but this is a complex endeavour. Aristotle developed his theory for 'the good man', excluding the non-citizens of Athens, such as foreigners, slaves, and women. His community was relatively small and consisted of relatively well-off persons. But what about virtuous behaviour towards the disadvantaged? And what institutions would be necessary to guide virtue in such a far more complex situation? Moreover, how can we assume that everyone will act out of good motives towards the deprived in other countries, whose position is so distanced? Finally, why would good motives lead to good results? The way to hell is paved with good intentions, as a saying goes. These critiques deserve serious attention. Unfortunately, the space here is too limited to address them fully, so I will deal with the two main criticisms by comparing the answers of virtue ethics with those of deontology. I will do so first for the assumption that good motivation leads to good results and second for the problem of the limited community for which virtue ethics was initially developed.

Good intentions alone do not make for good results. This is precisely the attraction of utilitarianism and other consequentialist ethical positions – it is the outcomes that matter, not how they come about. But such an exclusive focus on results allows for individual behaviour, institutions and policies, that disadvantage a minority, ignore the needs of some, and achieve improved results for the majority at the cost of a few. Kant's insistence on equal respect for all prevents such an extreme focus on aggregate results at the expense of some people. But the Categorical Imperative seems to rely too much on people's moral reasoning to ensure equal respect for all. It assumes that good intentions, universally shared, will not only result in good rules, but will also result in universal obedience to these rules as moral duties. In deontology, good intentions are supplemented with the enforcement of rules by an authority, if a majority creates such a universal rule in the first place. This is not the case in virtue ethics, which puts more weight on individual motivation to behave well.

But virtue ethics is not exclusively an ethics of good intentions; Aristotle was among the first to acknowledge the weakness of the human will. So, like deontological ethics, virtue ethics includes a supplement to good intentions. It is not an external force, exercised by an authority and requiring agreement on a formal rule; rather it takes place via the social process through which virtues develop and are sustained over time – socialisation and education combined with learning from

the consequences of our behaviour on others. These social processes, of course, are not free from power, and may therefore be distorted and manipulated by everyday power relations, as Foucault (1977) has argued.

Acknowledging this complication to Aristotle's view of a social reality without power, the internalisation of morality draws attention to the consequences of one's behaviour through feedbacks – the trial-and-error process of virtuous behaviour, which may include power relations. Aristotle (1980, p. 30) views the trial-and-error process thus: 'First, then, let us consider this, that it is the nature of such things to be destroyed by defect and excess, as we see in the case of strength and of health ... exercise either excessive or defective destroys the strength, and similarly drink or food which is above or below a certain amount destroys the health, while that which is proportionate both produces and increases and preserves it.' The example of a firm's environmental decisions may illustrate how this process of seeking the virtuous mean versus following a moral rule may work in practice.

In 1995, Shell decided to discard an old oil platform, the Brent Spar. After carefully studying the costs and environmental effects, and with the agreement of the British government, it decided to sink the Brent Spar in the North Atlantic. When the decision became public, Greenpeace protested. It also occupied the platform and began organising a consumer boycott. The environmental activists claimed that the storage still contained a large quantity of oil and other substances, and that sinking it would cause much environmental harm. Instead they proposed recycling, which required a risky transport of the old, and partly damaged, platform to the coast. Shell was forced to commission an independent study to the environmental effects of both options. The results of this study confirmed Shell's position: sinking the Brent Spar in deep sea would have less negative environmental effects than transporting and recycling it. Also, Greenpeace's estimations of the contents of crude oil were proven wrong, and the organisation apologised to Shell.

This case illustrates two different moral positions. Greenpeace took a largely deontological position. It mobilised moral outrage on the basis of the idea that using the sea as a garbage dump is wrong and should be prevented. Instead they believed that recycling is morally superior. Shell took a different moral stance, one that included a mixture of intentions related to cost-effectiveness, as well as environmental concerns and reasons for minimising environmental damage. They followed the outcome of an internal study that had compared environmental effects as well as costs. The integrity of this internal study was later confirmed by an independent consultant's report. They also sought, and received, government approval. Nevertheless, the good intentions of Shell can be questioned, especially because of other issues involving the company (social turmoil and pollution in Ogoni-land in Nigeria, and most recently overestimating crude oil reserves to manipulate its stock price; see Klein, 2000). But whatever their intentions in the Brent Spar case, Shell was concerned about its public image and knew it could not afford a scandal. So, the reputation effect helped lead the firm to a more virtuous stance without enforcement by any authority. So, even if the intentions of Shell were not virtuous, the social process of reputation guided the multinational to the environmentally best solution. But, in virtue ethics, social pressure is a

means, whereas a commitment to the good is the end. So if Shell, through its business behaviour, reveals a lack of commitment to environmental protection, it would still risk disapproval from its stakeholders, whether they be shareholders, consumers, or environmentalists. In conclusion, whereas the good intentions of Greenpeace's deontological position seemed at first the best to follow, as it was founded upon universal moral support against dumping and in favour of recycling, it was the more nuanced virtue approach (combining good intentions and expected reputation effects with reasons based on assessing possible environmental outcomes) that led to the least damage for the environment.

The second critique of virtue ethics that I will address here concerns its design for small scale communities. As mentioned earlier, this is where Aristotle focused when he designed his theory and why communitarians support the theory today. For instance, Alasdair MacIntyre defends virtue ethics for a small-scale world, but denies that it can play a role in today's globalised economy. For him, morality develops in moral practices, which he defines as 'cooperative human activity through which goods internal to that form of activity are realised in the course of trying to achieve those standards of excellence which are appropriate to, and partially definitive of, that form of activity, with the result that human powers to achieve excellence, and human conceptions of the ends and goods involved, are systematically extended' (MacIntyre, 1987, p. 187). He praises the pre-modern economy of household-based businesses and family-based agriculture as reflecting intrinsic values, as producing goods internal to common practices rather than external goods such as profits or market power, and as preserving internal standards of excellence rather than monetary measures, such as a firm's market value. In reaction to his communitarian manifesto *After Virtue* (MacIntyre, 1987), this dichotomous view of pre-modern versus modern economies, has been criticised for assuming that virtues can only emerge and be sustained on a small scale. For example, Philip Pettit (1994) argues that the liberal values guiding much of today's economic behaviour are not necessarily instrumental, but often recognise freedom as an intrinsic value, shared in a community of economic agents. Other values may play a role as well, such as fairness or generosity. Such intrinsic values appear to hold even between relatively anonymous agents. This is illustrated in game-theoretic experiments where subjects reject unfair proposals in an ultimatum game and exhibit generosity in contributions to public good games (Gintis *et al.*, 2005). What matters is probably not only the scale of a community, but also the way certain values are shared and reinforced. For larger-scale communities, this requires social mechanisms such as responsibility, trustworthiness, and reputation. Moreover, it is not necessarily the case that deontology is the better approach to morality at the large-scale level. The problem of enforcing moral rules becomes more difficult at a larger scale – the weak implementation of UN Conventions compared to national laws is an obvious example. Without an authority to enforce rules, even when these rules come about through consensus (as in UN Conventions), they will have little impact on behaviour.

While this brief comparison of virtue ethics with deontology has tried to clarify some common misunderstandings, the next section will connect virtue ethics to economic theory.

3.2 *Virtue Ethics in Economic Theory: Virtuous Economic Behaviour*

The good life is not detached from social and economic behaviour, but embedded in daily practices. These are often characterised, at least partially, by scarcity and its accompanying contingencies for human life and well-being – uncertainty, human fallibility, and power. From a virtue ethics perspective, the idea of the good in the economy can only be developed by studying specific economic practices (MacIntyre, 1987); it cannot be defined outside the context of time, location, agents, and activity. As I have explained, virtue ethics is not a universal ethics but a contextual one, and so its application to economics needs to be contextual too. Nevertheless, there are a few general characteristics of virtue ethics that find parallels in economic theory. The starting point is MacIntyre's (1987) useful concept of practice, understood as an open system, subject to uncertainty, scarcity, human fallibility, and power.⁴ An economic practice may be defined as a set of continued economic activities that create value added among related, committed agents. In the course of these activities, sufficient external value is realised to sustain the practice over time. This understanding of economic practices requires that agents are led by motivations and reasons that belong to the particular practice and that cannot be made too instrumental for the pursuit of ends outside that practice. Instrumental behaviour may undermine the basis of a practice, and so will erode the meaning of this practice for its participants. This perspective leads to a characterisation of economic agents as reflective instead of calculative (see Davis, 2003, p. 114) and as trustworthy instead of merely credible (see Williamson, 1993, p. 484). In other words, from a virtue ethics perspective, agent rationality needs to be meaningful and not opportunistic (see van Staveren, 2001, pp. 149–152). This understanding of economic practices as concerned with meaningful interaction between agents (that is, motivated and guided by shared values), enables the economist to provide a fuller description, explanation, and to some extent also prediction, of economic behaviour than is possible in utilitarian or deontological ethics (see Sen, 1987, 1995).

The economic theory that seems most compatible with virtue ethics is the capability approach developed by Sen and others.⁵ Capability theory lends itself to a characterisation of virtues, by considering them as ethical capabilities (van Staveren, 2001). Of course, the idea of ethical capabilities is not new: Adam Smith recognised the importance of virtuous character traits for the functioning of markets in his *Theory of Moral Sentiments*. One of these he characterised as 'sympathy', about which he remarked that it is not motivated by self-interest: 'Sympathy, however, cannot, in any sense, be regarded as a selfish principle' (Smith, 1984, p. 317). Ethical capabilities may be understood as a moral guide for decision making, and as a moral intuition rather than as desire, calculation, or rules. Daniel Kahneman has shown how important the capability of intuition

⁴Uncertainty and fallibility are distinct. Whereas uncertainty refers to events (that is, the unknown future), fallibility refers to human behaviour that may fail to live up to the individual's own commitments, irrespective of uncertain events.

⁵Of course, older theories, such as institutional economics in the tradition of Veblen (1931), also acknowledge intrinsic values; but these are often closer to deontology than to virtue ethics.

is in making economic choices in an uncertain context.⁶ ‘The central characteristic of agents is not that they reason poorly but that they often act intuitively. And the behavior of these agents is not guided by what they are able to compute, but by what they happen to see at a given moment’ (Kahneman, 2003, p. 1469). This contextualised understanding of rationality not only allows for partially contingent behaviour (depending on what one happens to see), but also enables the economist to recognise behaviour patterns that are likely to have a moral basis in addition to a social and cultural one. It is this combination of factors that guides agents and gives meaning to their behaviour – for themselves by expressing their identity, and for others by recognising coherence in the social, cultural and moral patterns of the behaviour of others.

This role of meaning in economic practice enable an agent to be perceived as trustworthy by other agents, as someone to engage in economic relationships within a context of uncertainty, fallibility, and power. Hence, economic practices, like other social practices, entail checks and balances, and employ the trial-and-error mechanism of finding a mean between deficiency and excess, although power relations may limit the adaptation process towards the mean. One such social mechanism is the intrinsic motivation of agents. It is intrinsic motivation, rather than extrinsic motivation (such as wages, profits, or status) that drives agents to contribute to the value added of a practice, as Bruno Frey (1997) has suggested. When extrinsic motivation becomes dominant, feelings of responsibility will be reduced, as well as one’s commitment and teamwork. When only profit counts, firm performance may suffer from reduced productivity and less commitment to innovation and joint learning. When intrinsic motivation is crowded out in an economic practice, whether it is a firm, a trading relationship, or a public service, the practice itself will be undermined. Too much regard for extrinsic reward will constrain the value added in the practice and eventually the practice itself.

Reputation is another social mechanism providing checks and balances in economic practices. When some people reduce their commitment to a valued practice this may trigger resentment by others and reduce the commitment of others to that practice. For example, excessive monetary rewards for top-managers may frustrate workers who are denied wage increases with the argument that a pay rise would reduce the firm’s competitiveness. Such a situation will likely reduce labour productivity, increase labour turnover, and generate negative media coverage about the firm’s management.

Trust is a third social mechanism that helps to keep the balance in an economic practice. A joint commitment to the values in a practice creates trust among agents. This helps reduce transaction costs, increase collective action, and strengthen mutual bonds.⁷ Trust replaces the need for contracting and monitoring. This tends to be true

⁶Kahneman (2003, p. 1450) has defined intuition as ‘thoughts [that] come spontaneously to mind, without conscious search or computation, and without effort’.

⁷Of course, transaction costs are not only reduced by trust, but may be reduced, to some extent, by the exertion of power – for example, through credible threats. But this is a different point, one which will not be elaborated here.

even when agents are dispersed over large distances, such as in global value chains and other international inter-firm relationships (Gereffi, 1999; Nooteboom, 2002). In some of the social capital literature it is generalised trust between weakly connected agents that is likely to generate efficiency gains. But such trust depends on a shared belief in the values underlying the practice they are engaged in. Without a commitment to a minimum set of shared values, trust is not likely to develop (van Staveren, 2000; van Staveren & Knorrinda, forthcoming).

Economic practices thus require a delicate balance between excess and deficiency. Too much focus on external rewards will undermine the basis of the very practice itself, but too little concern with external value will drain outside resources and threaten the continuity of the practice (see McCloskey, 2006, for a study along this line on the virtue of prudence versus other virtues in the economy). This is how virtue ethics help to create a balance in economic practices, through the trial-and-error search for a virtuous mean that will let a practice continue and the agents engaged in the practice flourish. Let me illustrate this balancing act with an example from a recent study by Kees Cools (2005) on 25 cases of corporate fraud, including WorldCom, Enron, and Ahold. The study could not find any significant differences in corporate governance between the fraud firms and a control group. Apparently, no rules had been broken. The study did reveal, however, significant differences in leadership. The fraud CEOs had acquired icon status, as corporate celebrities, which led, as in a Greek tragedy, to *hubris* (pride) and unrealistically high targets, driven by the CEOs' desire to sustain their icon status through stock market success. The fraud firms had on average 18% yearly growth targets, compared to 7% for the non-fraud firms in the same sector. But the *hubris* undermined the moral practices in the fraud firms, resulting in an average loss of value of 29% on the day the frauds became public. Interestingly, the study also found that the stock market had sensed the destructive strategy of excessive external value fixation well before the fraud was discovered. An average of 40% of the market value of the firms had already been lost in the year prior to the detection of the fraud. Thus, even though stock markets do not meet MacIntyre's criterion of a moral practice,⁸ they seem quite effective as a check against vice.

Virtue ethics can help us understand and explain the moral dimensions of economic behaviour that do not arise from straightforward moral rules. A virtue perspective may shed light on economic behaviour concerned with internal values, while at the same time being affected by uncertainty, human fallibility, and power. Some connections to economic theory are already in place – motivation, reputation, transaction costs, and trust – yet much more work still needs to be done.

4. Conclusion

Paradoxically, the economic theory that has completely absorbed morality (neo-classical economics) through moral preferences in utility functions seems least

⁸In MacIntyre's (1987) view, stock markets are vehicles for generating external value only.

able to do justice to the diverse expressions of morality in economic life. Other economic theories, from new institutional economics to Post Keynesianism, have relied mainly, but not exclusively, upon deontology and virtue ethics for their understanding of the role of morality in the economy. The deontological approach helps us understand how morality can be understood as rights and norms, enabling and supporting the functioning of markets, enhancing competition, and reducing negative externalities of (perfect and imperfect) competition. But there are several weaknesses in this approach – morality is reduced to constraints, it requires external enforcement, and it easily leads to bureaucracy.

Virtue ethics understands morality as arising in economic practices through endogenous mechanisms that make morality an integral part of agent motivations, reasons, and ends. This does not require an authority to enforce moral rules that tell people what to do. Instead, morality as virtue relies upon the internal social mechanisms embedded in economic practices, such as reputation, responsibility, and trust. This, however, has its own shortcomings. It is a contextual form of morality that only develops and can be sustained in concrete practices, based on shared values and related agents, without too many power asymmetries. Further research on the relationship between ethics and economics needs to clarify how the two alternative ethical approaches to utilitarianism are related in particular economic processes, since we need both approaches to do justice to ethics in economics.

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