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### **Redefining Economic Reason\***

Despite Martin Heidegger's warning, it's not modern technology but modern economizing that destroys the Being. With its exclusive focus on profit-making modern economizing endangers the integrity and diversity of natural ecosystems, autonomy, and culture of local communities, and the chances of future generations for a decent life.

This paper gives a critique of the profit principle and redefines economic rationality in a more holistic, substantive and, humanistic form.

#### **1 Criticizing the Profit Principle**

The devastating effects of profit-centered corporate business organizations are accurately described by American social critique David Korten. In his influential book *When Corporations Rule the World* he argues that today's global economy has become like a malignant cancer, advancing the colonization of the planet's living spaces for the benefit of powerful corporations and financial institutions. It has turned these once useful institutions into instruments of a market tyranny that is destroying livelihoods, displacing people, and feeding on life in an insatiable quest for money. It forces us all to act in ways destructive to ourselves, our families, our communities, and nature. (Korten 1995)

The economic and financial crisis started in 2008–2009 deepened our understanding of the problems of mainstream businesses which base their activities on unlimited greed and the “enrich yourself” mentality.

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There are two distinct but interrelated problems with the profit principle. One is how profit is the sole measure of rightness of economic activities and the other how profit is the main motivation of economic activities. We will see that profit is neither a necessary nor a sufficient criterion of economic reason.

### *1.1 Problems with Profit as the Measure*

Profit is inadequate as the sole measure of the rightness of economic activities. Profit provides an incomplete and biased evaluation of economic activities. It reflects the values of the strongest stakeholders, favours preferences here and now, and presupposes the reducibility of all kind of values to monetary values.

The market as an evaluation mechanism has its inherent deficiencies. First of all, there are stakeholders that are simply not represented in determining market values. Natural beings and future generations do not have any opportunity to vote on the marketplace. Secondly, the preferences of human individuals count for rather less, that is, in proportion to their purchasing power; the interests of the poor and disadvantaged people are necessarily underrepresented in free market settings. Thirdly, the actual preferences of the market players are rather self-centered and myopic; that is, economic agents make their own decisions regarding short-term consequences only.

To use profit as the sole criterion of judging economic activities implies strong commensurability which means that there exists a common measure of the different values based on a cardinal scale of measurement. Mainstream economics suggests that values external to the market mechanism should be calculated by using shadow prices and other market-based evaluation techniques. In this way externalities can be “internalized” and full cost pricing of activities can be developed.

Ecological economists demonstrated that the strong comparability of values is not held in economics. The value of natural assets cannot adequately be expressed in monetary terms. (McDaniel and Gowdy 2000) Similar arguments can be developed for important human and social values such as health and safety, ethics and aesthetics.

Profit can be used as an indicator of the financial viability of economic projects but not as an exclusive criterion of the rightness of economic activities. To judge the overall values of economic activities we should use a number of non-financial value-criteria in addition to profit.

The following scheme is an illustration of such a multidimensional and holistic evaluation procedure.

The underlying idea of project evaluation is that a project is worthy of being undertaken if and only if the state of affairs with the project is better than the state of affairs without the project.

Let  $P$  be a project whose total monetary cost is  $p^*$ . Let  $Q$  be the original state of affairs, that is, the state of affairs without the project. Let  $Q^*$  be the new state of affairs, that is, the state of affairs with the project.

There are two alternative uses of the amount of money  $p^*$ . One alternative is to undertake project  $P$  by financing it with money  $p^*$ . The other alternative is not to undertake project  $P$  and use money  $p^*$  for financing other projects, e.g. investing in treasury bonds.

Let  $d(P)$  be the discounted cash flow that project  $P$  can produce for a given period of time. Let  $d(p^*)$  be the discounted total earnings of the amount of money  $p^*$  for the same period of time. So  $d(P)$  and  $d(p^*)$  represent two alternative uses of the same amount of money.

Let  $E(\cdot)$  be a value function by which the state of affairs can be evaluated on ordinal scale from the ecological point of view.

$$(I) \quad E(Q) = \begin{cases} 1 & \text{if the state of affairs } Q \text{ is beneficial for the nature;} \\ 0 & \text{if the state of affairs } Q \text{ is neutral for the nature;} \\ -2 & \text{if the state of affairs } Q \text{ is harmful for the nature.} \end{cases}$$

Let  $S(\cdot)$  be value functions by which the state of affairs can be evaluated on ordinal scale from the social point of view.  $S(\cdot)$  is also a Tversky-Kahneman type value function.

- 1 if the state of affairs Q is good for the society;
- (II)  $S(Q) = 0$  if the state of affairs Q is neutral for the society;
- 2 if the state of affairs Q is bad for the society.

Let  $M(\cdot)$  be a monetary value function as follows:

- 1 if the discounted cash flow  $d(P)$  is positive;
- (III)  $M(P) = 0$  if the discounted cash flow  $d(P)$  is zero;
- 2 if the discounted cash flow  $d(P)$  is negative.

The following vector provides an overall evaluation of the original state of affairs:

$$(IV) \quad [E(Q), M(p^*), S(Q)]$$

where  $E(Q)$  and  $S(Q)$  represent the environmental evaluation and the social evaluation of the original state of affairs and  $M(p^*)$  represents the monetary evaluation of not undertaking the project.

An overall evaluation of the new state of affairs is provided by the following vector:

$$(V) \quad [E(Q^*), M(P), S(Q^*)]$$

where  $E(Q^*)$  and  $S(Q^*)$  represent the environmental evaluation and social evaluation of the new state of affairs and  $M(P)$  represents the monetary evaluation of the project itself.

The necessary and sufficient condition for undertaking the project is that the following preference relation is held:

$$(VI) \quad [E(Q^*), M(P), S(Q^*)] \leftarrow [E(Q), M(p^*), S(Q^*)]$$

It means that the state of affairs with the project is better than the state of affairs without the project considering environmental, monetary, and social values simultaneously.

Social choice theory may help us to make decisions in situations like (VI) where different components of the vectors are not necessarily comparable.

The multidimensional project evaluation outlined above can demonstrate that economic projects can be evaluated without accepting the strong commensurability assumption of mainstream economics. The crux of the matter is that we should extend the informational basis of analyses and broaden the evaluative space beyond monetary values to include ecological and social values that cannot adequately be translated into monetary terms.

### *1.2 Problems with Profit as Motivation*

Profit is dangerous as the main motivation for economic activities. It decreases intrinsic motivation of economic actors, which leads to decreasing quality. Also, it cultivates self-centered value orientation which results in socially insensitive and ethically irresponsible behavior.

Bruno Frey's "crowding out" theory shows why profit motivation may be counterproductive. A monetary reward offered or expected tends to crowd out an agent's willingness to perform the task for its own sake (i.e. based on intrinsic motivation) if the agent's sense of recognition, fairness, or self-determination are thereby negatively affected. The crowding-out effect of pricing may also spill over into sectors where no pricing is applied (spillover effect) if the persons affected find it costly to distinguish their motivations according to sectors. Motivation crowding-out and spillover narrow the scope for successfully applying monetary rewards. (Frey 1997)

The "crowding out" mechanism has important consequences for the famous statement of Adam Smith that we can expect our bread not from the benevolence of the baker but from his self-love. Certainly, profit expectations provide strong incentives for the baker but producing truly healthy and beautiful bread requires something different: the priority of intrinsic commitment over monetary reward. The dangerous and unsustainable

practice of modern agribusiness is a revealing illustration of the case. (Zsolnai and Podmanicky 2010)

Personality psychologist Gian-Vittorio Caprara and his colleagues show empirically that cultivating greed leads to manipulation of others and oneself. They start with the observation that a division between thought and action takes place when people break the rules or get involved in illegal and unethical activities. What is most surprising in rule violation and misconduct is that people are not bothered by their conscience, do not fear any sanction, and do not feel obliged to make reparations. (Caprara and Campana 2006)

World-renowned Stanford psychologist Albert Bandura discovered the mechanisms of moral disengagement, the psychosocial maneuvers by which moral self-sanctions become disengaged, leading to a variety of misbehaviors free of any moral concern. Self-sanctions can be disengaged by reconstructing the conduct, obscuring personal causal agency, misrepresenting or disregarding the injurious consequences of one's actions, and vilifying the recipients of maltreatment by blaming and devaluating them. (Bandura 1990)

Caprara and his team developed a scale to assess civic moral disengagement (CMD). Their empirical findings suggest that the more people are concerned with self-enhancement goals, the more they are inclined to resort to mechanisms that permit them to disengage from the duties and obligations of civic life and to justify transgressions when their self-interest is at stake. (Caprara and Campana 2006)

This result has another important consequence for the naive belief of Adam Smith and his followers in the always beneficial impact of the “Invisible Hand” of the market. If economic agents become self-concerned then it is likely that—by employing moral disengagement mechanisms—their self-exonerative maneuvers will do harm to others.

In serving the common good we need agents who care about and pursue self and community interests.

### *1.3 Profit and Economic Reason*

From the above analysis it follows that profit is neither a necessary nor a sufficient criterion of economic reason. An economic activity can be reasonable without satisfying the profit requirement. And inversely, the produced profit is not a guarantee that an economic activity is reasonable in a wider ecological and social context.

Economic reason should not be associated with economic rationality as defined and propagated by mainstream economics. (Zsolnai 2008)

Today's theory of economic rationality is normatively inadequate and empirically misleading. James March rightly characterized it as the myth of rationality. (March 2006) The reasonable action is an action that is based on right motivation, executed by fair processes, and leads to desirable outcomes. Within this interpretation, rationality is intelligent by definition. (Sen 2004) We should try to redefine economic reason in accordance with the general criteria of reasonable action.

## **2 Redefining Economic Reason**

Economic activities should pass the test of ecology, future generations, and society to be qualified for economic reason. This triple criteria require that economic activities should not destroy nature, violate the interests of future generations, or pose negative impacts on society. Economic actions can be claimed "reasonable" only if they satisfy all of these criteria.

### *2.1 Ecology*

From the perspective of nature ecological integrity is a central value. The notion of ecological integrity was introduced by American environmentalist Aldo Leopold in his classic *A Sand County Almanac*. He writes: "a thing is right when it tends to preserve the integrity, stability, and beauty of the biotic community. It is wrong when it tends otherwise." (Leopold 1948)

Economic activities might be evaluated against environmental indicators that operationalize the notion of ecological integrity.

Let A be an economic activity. Let  $E_1, \dots, E_j, \dots, E_n$  be environmental indicators. ( $n > 1$ )

$E_i(\cdot)$  is an ecological value function defined as follows:

$$(1) \quad E_j(A) = \begin{cases} 1 & \text{if economic activity A is good regarding} \\ & \text{environmental indicator } E_j; \\ 0 & \text{if economic activity A is neutral regarding} \\ & \text{environmental indicator } E_j; \\ -2 & \text{if economic activity A is bad regarding} \\ & \text{environmental indicator } E_j. \end{cases}$$

$E_i(A)$  reflects the ecological value of economic activity A regarding environmental indicator  $E_j$ .

The following vector represents the ecological value of economic activity A regarding all environmental indicators  $E_1, \dots, E_j, \dots, E_n$ .

$$(2) \quad E(A) = [E_1(A), \dots, E_j(A), \dots, E_n(A)]$$

To get an aggregate picture about the ecological value of the economic activity in question we should define weights that show the importance of environmental indicators. Let  $a_1, \dots, a_j, \dots, a_n$  be such importance weights.

It is required that

$$(3) \quad \sum a_j = 1$$

The aggregate ecological value of economic activity A can be calculated as follows:

$$(4) \quad E(A) = \sum a_j E_j(A)$$

$E(A)$  shows the aggregate ecological value of economic activity A. ( $-1 \geq E(A) \geq -2$ )

An economic activity is considered ecological if and only if its aggregate ecological value is positive. That is

$$(5) \quad E(A) > 0$$



## 2.2 Future Generations

How can we evaluate economic activities from the perspective of future generations? We can never know much about the interests of future generations but freedom is a central value here.

Edith Brown Weiss argued that the freedom of future generations is insured by satisfying the following principles: (i) conservation of options; (ii) conservation of quality; and (iii) conservation of access. (Brown Weiss 1989)

Considering principles (i),(ii), and (iii) future generations indicators can be created. Let  $F_1, \dots, F_j, \dots, F_n$  be such indicators against which economic activity system can be evaluated. ( $n > 1$ )

Future generations value function  $F_j(\cdot)$  is defined as follows:

$$(6) \quad F_j(A) = \begin{cases} 1 & \text{if economic activity } A \text{ is good regarding} \\ & \text{future generation indicator } F_j; \\ 0 & \text{if economic activity } A \text{ is neutral regarding} \\ & \text{future generations indicator } F_j; \\ -2 & \text{if economic activity } A \text{ is bad regarding} \\ & \text{future generations indicator } F_j. \end{cases}$$

$F_j(A)$  reflects the future generations value of economic activity  $A$  regarding indicator  $F_j$ .

The following vector represents the future generations value of economic activity  $A$  regarding future generations indicators  $F_1, \dots, F_j, \dots, F_n$ .

$$(7) \quad F(A) = [F_1(A), \dots, F_j(A), \dots, F_n(A)]$$

To get an aggregate picture about the future generations value of economic activity  $A$  we should introduce weights that show the importance of indicators  $F_1, \dots, F_j, \dots, F_n$ . Let  $b_1, \dots, b_j, \dots, b_n$  be such importance weights.

It is required that

$$(8) \quad \sum b_j = 1$$

The aggregate future generations value of economic activity A can be calculated as follows:

$$(9) \quad \sum b_j F_j(A)$$

$F(A)$  shows the aggregate future generations value of economic activity A.

$$(1 \geq F(A) \geq -2)$$

An economic activity can be considered future respecting if its aggregate future generations value is positive. That is

$$(10) \quad F(A) > 0$$

### 2.3 Society

Economic activities should be pro-social, that is should contribute to the development of people's capabilities.

Amartya Sen proposed to understand people's well-being in terms of capabilities. Capability is a reflection of the freedom of a person to achieve valuable functioning. Therefore capabilities can be interpreted as a substantive freedom that people enjoy. (Sen 1992)

Let  $G_1, \dots, G_j, \dots, G_n$  be capability indicators against which the economic activities can be evaluated. ( $j > 1$ )

Let  $G_j(\cdot)$  social value function be defined as follows:

$$(11) \quad G_j(A) = \begin{cases} 1 & \text{if economic activity A is good regarding} \\ & \text{capability indicator } G_j; \\ 0 & \text{if economic activity A is neutral regarding} \end{cases}$$

- capability indicator  $G_j$ ;
- 2 if economic activity  $A$  is bad regarding capability indicator  $G_j$ .

$G_j(A)$  shows the social value of economic activity  $A$  regarding capability indicator  $G_j$ .

The following vector represents the social value of economic activity system  $A$  regarding all the capability indicators  $G_1, \dots, G_j, \dots, G_n$ .

$$(12) \quad G(A) = [G_1(A), \dots, G_j(A), \dots, G_n(A)]$$

To get an aggregate picture about the social value of economic activity  $A$  we should introduce weights that show the importance of the capability indicators. Let  $c_1, \dots, c_j, \dots, c_n$  be such importance weights.

It is required that

$$(13) \quad \sum c_j = 1$$

The aggregate social value of economic activity  $A$  can be calculated as follows:

$$(14) \quad G(A) = \sum c_j G_j(A)$$

$G(A)$  shows the aggregate social value of the economic activity  $A$ . ( $1 \geq C(A) \geq -2$ )

An economic activity system is considered pro-social if its aggregate social value is positive. That is

$$(15) \quad G(A) > 0$$

#### *2.4 The Laws of Economizing*

According to economic reason economic activities should be ecological, future respecting, and pro-social. For them (5), (10), and (15) should be simultaneously hold. That is

$$(16) \quad E(A) > 0, \quad F(A) > 0, \quad G(A) > 0$$

From (16) we can derive some basic laws of economizing.

The First Law says that

( $\alpha$ ) Economic activities should not harm nature or allow others to come to harm.

The Second Law says that

( $\beta$ ) Economic activities must respect the freedom of future generations except where such respect would conflict with the First Law.

The Third Law says that

( $\gamma$ ) Economic activities must serve the well-being of society as long as such service does not conflict with the First or Second Law.

The main goal of economic activities should not be profit-making but providing right livelihood for those who are involved. Economic reason requires that this is achieved in ecological, future respecting, and pro-social ways. Intrinsically motivated economic agents who balance their attention and concerns across diverse value-dimensions are able to do this. Profit may or may not follow but the richness of Being and the quality of life can be attained. The Slow Food movement, ethical fashion, fair trade initiatives, and ethical banking show the viability of true economic reason within the present day “rationally foolish” economic world.

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