

On Pushing Back the Boundaries of Economics: The Case of Business Ethics

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Abstract: This paper attempts to go beyond the traditional boundaries of economics to examine an important area too long neglected in modern economics — ethics. In this paper, orthodox economic methodology is turned on its head; that is, instead of employing a *ceteris paribus* environment, the analysis proposes a model in which the environment is a key variable of interest. Particular attention is given to environmental dynamics — how changes in the environment can cause a change in the level of business ethics employed by the business firm.

The image of causation used in the proposed model relies heavily upon important concepts from disciplines outside economics, primarily sociology and psychology. Particularly prominent is the use of Maslow's hierarchy of needs to help explain possible linkages between ethical behavior by the business firm and benefits derived from such behavior, as well as the costs of exploitative behavior to the firm.

The model is intended to help us better understand the conditions under which business firms are likely to behave ethically and when not. Also, the model yields insights into effectiveness of public policy aimed at increasing business ethics when firms fail to meet society's expectations.

Finally, an assessment of the model is made — strengths, shortcomings, and future research needs are indicated.

THE AUTHOR APPROACHES THE SUBJECT of business ethics as a formally trained economist who believes that contemporary orthodox economic models are too restrictive in both scope and methodology. The spirit, scope and method of this study go well beyond the confines of traditional economic theory. It is more in keeping with the current (non-mainstream) work of social economists and institutional economists, who are committed to expanding the boundaries of the discipline to make economic analysis more meaningful.

Unfortunately, modern orthodox economics has nothing to say about the topic of this paper — business ethics. Orthodoxy has defined the boundaries of economics to include only phenomena amenable to positive science investigation. Positive economics attempts to deal exclusively with “what is,” ignoring normative issues involving “what ought to be.” For economics to become a positive science (it didn't start that way), all ethical and moral issues had to be expunged from the discipline. Modern orthodoxy accomplished this, for example in Friedman's (1966) classic statement of the nature of positive economic methodology, by treating all institutions, ethical behavior included, as a “given,” lying outside economic models.

This narrowing of the discipline was done to obtain the status of “hard” science. However, critics maintain that the costs are too high — that economics, with its “elegant,” mechanically determinate models, is a “discipline of tools without relevance” (Whalen, 1987, pp. 259-260).

Economics is (should be treated as) a social science and, thus, should deal with socio-economic behavior. However, orthodox economics deals mainly with “things” (machines, acres of land, “widgets” etc.), rather than with people and human behavior. Indeed, orthodoxy has defined away human behavior via the assumption of *homo economicus* (economic man).

In contrast, this paper treats socio-economic behavior as a key ingredient of the analysis. The focus is business ethical behavior.

Methodologically, the analysis is “outer-disciplinary” in nature, if you will. That is, it attempts to push out the walls of orthodox economics to study business ethics. To do this, orthodox economic investigation (*ceteris paribus* methodology) is turned upside down — business ethics is treated as the primary variable of interest, rather than as a “given” (*ceteris paribus*) environmental parameter.

“Outer-disciplinary” work is often a useful, and sometimes necessary, first step toward interdisciplinary analysis. The attempt to push out the boundaries of a discipline naturally raises the question “Out where?” Given the near nonexistence of empty “disciplinary space,” the answer will most likely encompass part of the domain of another discipline or disciplines. In the analysis presented here, we enter the fertile disciplinary territory of sociology and psychology. The model is enriched by important contributions from these disciplines. However, the analysis is not interdisciplinary — at least not in the sense given, for example, by Klein (1989) or Miller (1982) — so much as it is essentially mono-disciplinary/economic in nature, albeit in the spirit of what economics once was as political economy.

By attempting to break down the narrow confines of modern orthodoxy, our approach hopefully will help pave the way to

true interdisciplinary analysis of socio-economic phenomena.

The Issue

There is much debate over whether business firms are able (and, if able, should be expected) to behave in an ethical manner. Taking the position that they cannot, Raymond Majerus (1982, p. 412) argue “[suppose] a firm discovers that the way that it produces a certain product exposes its workers to a hazardous substance. Taking the ethical approach, the firm . . . redesigns the production process to remove the exposure danger Since the market for the product is competitive, the firm in question now has higher unit costs than its less ethical competitors. It may go bankrupt quickly, or its reduced profits may make it unable to attract the capital with which to maintain its market share. ...” Majerus, thus, reasons that the competitive firm is not able to behave ethically due to competitive market pressures forcing it to produce at minimum costs (also see Phillips, 1987; Knight, 1935). In contrast, Richard E. Hattwick et al. (1984, p. 184) claim that “... business success and a high standard of ethics can be compatible. . . . Good business ethics and social responsibility enjoy the happy circumstance of also being good business practice.” Here is the belief that business ethics makes sense financially — that it is good business.

Who is right? Can business ethics be left to the market?

In an attempt to help resolve the debate, a socio-economic model of business ethics is proposed which distinguishes the conditions under which business ethics is profitable for the business firm, and, when profitable, the conditions under which the firm is likely to be strongly committed to ethical principles. The analysis draws upon Hattwick’s (1985) basic conceptual approach to the study of business ethics which has been quite useful in this regard, despite disagreement with much of his analysis. An important (controversial) implication of the model is that, under certain conditions, ethical considerations may play a stronger role in competitive markets than in less competitive markets. This directly challenges the notion advanced by Majerus that competitive business firms are least able to behave ethically because of competitive pressures to be efficient.

The Meaning of Business Ethics

At the broadest level of human behavior, ethics deals with right or good versus wrong or bad behavior (Kanne, 1988). Ethical behavior is aimed toward achieving certain moral ideals, such as “serving the public interest” or “treating others as you would want them to treat you” (Purcell, 1982). Unfortunately, such a global (abstract) view of ethics is difficult to carry out, since there is much disagreement over what actually is ideal behavior (McKee, 1979 and 1987).

For practical purposes — so that we don’t get mired in a debate over what is truly ideal ethical behavior (which is beyond the scope of this paper) — we will take a pragmatic view of ethics and define it as a code of conduct. As a subset of this, business ethics involves a business code of conduct. For example, a business code of conduct might specify that it is wrong to deceive customers about product characteristics or that it is wrong to discriminate against workers (Orr, 1979). Perhaps one of the best examples of an organization attempting to introduce practical ethics into actual decision making by individuals is the Rotary Club’s “four-way test of the things we think, do or say” (Hattwick, 1985): (1) Is it the truth?, (2) Is it fair to all concerned?, (3) Will it build good will and better friendships?, and (4) Will it be beneficial to all concerned?

The distinction between ethics and business ethics is largely for heuristic reasons. It is a contrived distinction, for in reality “ethics is ethics.” As Theodore V. Purcell (1982, p. 360) points out, “There is really only one basic ethics. But it is useful to apply that ethics to the special problems of business” For example, while dishonesty in general touches upon a wide range of behavior in our society, dishonest behavior in the business sector relates to such special problem areas as product performance, employee work hazards, and financial reporting to stockholders (Dugger, 1989).

Thus, we will treat business ethics as pertaining to good or right behavior as defined by a code of business conduct. This code may embody such moral concepts as fairness, justice, honesty, loyalty, compassion, concern, courtesy, friendliness, thoughtfulness, and kindness, as they apply to the conduct of business. Admittedly, this lacks precise operationalism. However, our purpose in this study is not to offer a scheme of what is right or wrong, but rather to provide a conceptual framework for better understanding the conditions under which business firms are motivated to behave ethically. Whether their particular behavior is truly ethical is not the issue. We will leave that to the ongoing debate among moral philosophers and theologians over what is right or wrong.

Ethics As Investment Behavior

Does a code of business conduct “pay” financially? Is it good business? If so, under what conditions? In an attempt to answer these important questions let us begin with the benefits the firm may obtain from behaving ethically. To do this we will explore the potential of business ethics as investment behavior.

Potentially, business firms may benefit financially from behaving ethically. For example, consumers might prefer doing business with a particular firm because of the fair treatment they receive. The firm may be able to translate this into a less elastic

(less price sensitive) demand for its product as well as an increase in product demand. On the employee side, a business firm might experience an increase in employee morale, productivity, and retention due to “enlightened” personnel policies (O'Donnell, 1982).

Such possible payoffs to ethical behavior have considerable intuitive appeal; however, it is important that we understand the conditions under which they are likely to materialize. We need to explain the causal linkages between ethical behavior and the end payoff of such behavior. Our model requires an analytical explanation of ethical business practices as investment behavior. We need to know, for example, what the causal linkages are between “enlightened” management and employee productivity.

Ethical behavior can be linked to a payoff via integrative (as opposed to distributive and coercive) transactions between the firm and its customers, employees, suppliers, investors, competitors, and the public. In integrative transactions, “I win, you win” (e.g., employee profit-sharing), as opposed to the “I win, you lose,” zero-sum nature of distributive transactions (e.g., Poker card game) and the “I win, you lose,” negative-sum nature of coercive transactions (e.g., armed robbery) (Thurow, 1981, pp. 120-121).

Integrative payoffs may be achieved by linking a transaction with the fulfillment of the psychological needs of the parties involved. The work of Abraham Maslow (1970) on human needs is relevant to this type of transaction. Maslow points to the “higher order” needs of esteem and self actualization arising after “lower order” needs (such as safety and security) are met. Ethical behavior that, for example, meets workers’ needs of esteem and self actualization may (in addition to making the worker better off) benefit the employer by increasing worker morale and productivity. Both parties benefit: employees feel more self-fulfilled as workers, and management has workers who are more loyal and productive. This might also meet the “higher order” psychological needs of the employer, such as the desire to be a “humane and good” employer. (As explained below, the payoff need not be monetary in nature.)

However, such a mutuality of benefits between the employer and his/her workers does not guarantee that an investment in ethical behavior (e.g., enlightened personnel management) will be made by the employer. When ethical behavior is an investment decision, the cost side also must be considered. We will examine the cost side below, after exploring some other ways that ethical behavior may confer benefits to the employer.

Business ethical behavior may yield a payoff by reducing the “cost of doing business” with other parties (Hattwick, 1985). For example, union-management bargaining tends to become more time efficient and less costly (in terms of lost production) as the parties develop trust and confidence in each other. Adherence to an appropriate code of bargaining conduct (such as “when you give your word, you stand by it”) is one way to achieve this trust and confidence, and any resulting benefits.

Closely related to this, ethical behavior can be used to establish helpful “payback” transactions. Suppose one party considers making a sacrifice with the expectation that the other party will do likewise in the future. For this transaction to occur (in the absence of binding contractual obligations or coercion) there must be a commitment to a code of conduct that honors payback obligations, such as commitment to exchange reciprocity. A labor union, for example, might agree to wage “givebacks” when the business firm is in financial trouble if it believes that the firm will reciprocate with appropriate wage enhancements when profits improve (which may not happen until after the labor contract expires, preventing the union from using the contract to protect its investment). Payback transactions can become an important part of long-term relationships. It gives the parties a way to share the risks (and benefits) of a dynamic environment. However, without a commitment to a supportive code of conduct by both parties, payback transactions are not likely to occur.

Naturally, there are no guarantees that the payback expectation will be honored. More will be said below about the circumstances under which ethical behavior may not yield a payoff (Miller, 1984; Waterman, 1988). For now, we simply note that investments in ethical behavior are not risk free. (Of course, an altruist can be expected to behave ethically even in the known absence of any payoff [Kennett, 1980a and 1980b; McKee, 1987].)

In sum, it has been argued that ethical behavior may yield a monetary or psychological payoff via the avenues it provides for developing integrative transactions (multi-lateral benefit structures among the parties), for lowering the cost of transacting business, and for establishing “payback” transactions (reciprocal systems of benefits) between the parties. These causal linkages point to the potential of ethical behavior as investment behavior — behavior aimed at foregoing present benefits in order to reap greater benefits in the future. Naturally, whether such behavior is profitable depends not only upon the benefits/revenues realized, but also upon any costs incurred.

Costs and Revenues

In this section we examine the costs and revenues of ethical behavior in the long run. In the long run there is sufficient time for the business firm to vary all inputs of ethically relevant activities (e.g., redesign and expand a worker grievance system).

It will be helpful to graph the long-run cost and revenue relationships. In Figure 1 we measure the discounted present values of the revenues and costs of ethical behavior on the vertical axis (Wilkinson, 1966), and the level of such behavior on the horizontal axis. Costs and revenues may be combined on the vertical axis since they are both dollar measures. Note that ethical behavior is the independent variable and total revenue and total costs are the dependent variables (economists do not follow the

standard tradition of placing the independent variable on the “Y” axis). The monetary values on the vertical axis may be explicit values (e.g., when ethical behavior lowers the cost of doing business), or they may be imputed, implicit values that occur when ethical behavior yields a benefit or cost of a psychic nature. For example, when the employer acts ethically because of the personal satisfaction he/she receives, we can impute a monetary value to that satisfaction (in much the same way that we estimate psychic labor income [Rosen, 1979]). On the horizontal axis of Figure 1 we measure increasing levels of ethical behavior as we move along the axis from left to right. The further to the right the firm is on the horizontal axis, the more ethical the firm is considered to be. In this sense we will make ordinal (as opposed to cardinal) comparisons among firms and, thus, do not need to quantify ethical behavior.

The total cost curve in Figure 1 is labeled TC. While the exact nature of the cost schedule is not known, we will propose a plausible (logical) cost configuration. For this we draw upon standard engineering relationships between scale (size) and output (ethics) (Thompson, 1989, pp. 239-240). Regarding ethical behavior, scale will refer to the system used to carry out a code of business conduct (and thus is not directly reflected in Figure 1: rather it pertains to the means for implementing a particular level of ethical behavior). For example, a grievance system may be used to protect workers' rights. An increase in scale here would imply an expansion of the grievance machinery (e.g., mere steps).

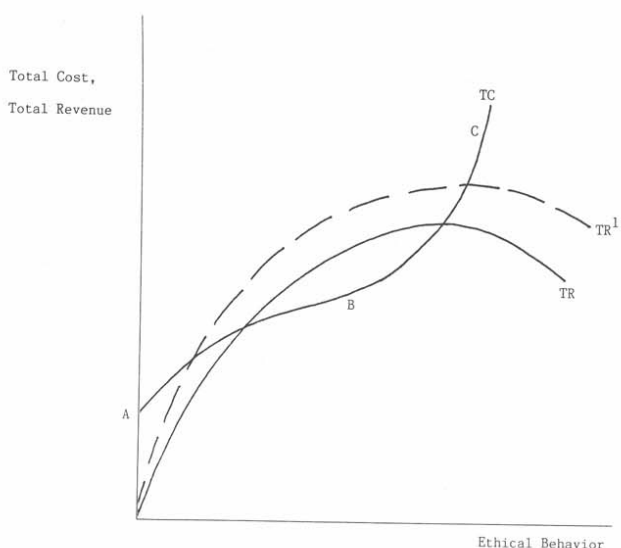


FIGURE 1: The Total Revenue and Total Cost of Ethical Behavior for a Typical Business Firm.

The shape of the total cost (TC) curve in Figure I reflects increasing and decreasing returns to scale. Initially, efficiency increases as the scale of ethical operations is increased (range AB of the TC curve, where total costs are increasing at a decreasing rate). One important source of increasing returns to scale is specialization and division of labor. For example, efforts by the firm to expand its grievance system may make it possible to hire a personnel specialist, someone who can perform the job more efficiently than a general manager. However, as the scale of operations is further increased, decreasing returns (diseconomies) eventually result (range BC of the TC curve, where total costs increase at an increasing rate). Continuing our example, this is the point at which systems designed to promote ethical behavior meet coordination, control, cognitive (Hattwick, 1985), and information problems. In an attempt to provide a “fail-safe” system for protecting workers’ rights, grievance machinery may be expanded to the point where it becomes too bureaucratic and unwieldy — inefficient.

Note that the total cost curve in Figure 1 has a positive vertical intercept. In our model, zero ethical behavior (at the point of origin in Figure 1) corresponds to exploitative behavior (as opposed to truly neutral behavior). Naturally, there are costs associated with exploitative behavior — such as legal penalties that the firm must pay when found guilty. The vertical intercept of our cost schedule shows the magnitude of the costs of exploitation associated with zero ethical behavior. These costs are inversely related to the willingness of others to endure exploitative behavior, which, in turn, may be indirectly related to their position in Maslow’s hierarchy of needs. That is, those who have moved up Maslow’s hierarchy to meet their “higher order” psychological needs may be less willing to endure exploitative behavior and, thus, the cost to the firm of such behavior will be greater.

Maslow’s important work in motivational psychology, thus, not only helps us understand ethical behavior as investment behavior (as argued above), but also helps explain the costs of unethical (exploitative) behavior. Maslow’s work yields important insights on the human behavior element of ethics (abstracted from orthodox economics via the postulate of *homo*

economicus).

The assumption of increasing and decreasing returns to scale give us the shape of TC in Figure 1. There are, of course, plausible alternative assumptions, each yielding a different cost configuration. For example, one might assume that diseconomies of scale exist throughout the entire range of business ethics (TC would increase at an increasing rate throughout), or that only constant returns to scale exist (TC would increase at a constant rate throughout). It would be interesting to explore such alternative cost configurations; however, our model is restricted to the above cost assumption in an attempt to set forth a simple model of business ethical behavior.

Turning to the revenue (benefit) side in Figure 1, the total revenue curve (TR) at first increases at a diminishing rate until it reaches a maximum, and then decreases as the level of ethical behavior is further increased. This reflects the psychology of relative satiation — the notion that one’s satisfaction obtained from a good or service depends upon the amount previously consumed within a particular period (Alchian, 1953). The concave (from below) shape of the total revenue curve implies diminishing marginal satisfaction among the recipients of the business firm’s ethical behavior (yielding diminishing marginal derived benefits for the firm). For example, regarding product safety information supplied to customers by the business firm, an additional increment of product safety information may not increase customer satisfaction as much as did the preceding increment. The consumer’s “appetite” for product safety information diminishes as a result of previous information supplied by the business firm. So, any marginal benefits derived by the business firm from increased customer satisfaction become less and less, implying that total benefits increase at a decreasing rate. Eventually, satiation is encountered as ethical behavior continues to be increased. This reflects the notion that you “can have too much of a good thing.” At some point, additional product safety information overloads the customer’s ability and/or desire to process information and actually yields less satisfaction. For the consumer there exists some optimum (desired) level of product safety information that falls short of complete information. Information beyond this optimum results in less satisfaction to the customer and, thus, less derived benefits for the business firm. This causes the TR curve to decrease, possibly intercepting the horizontal axis and becoming zero.

As in the case of the total cost curve, a different set of assumptions would, naturally, generate a different revenue configuration. For example, we could assume that recipients of the business firm’s ethical behavior at first experience increasing marginal satisfaction (causing TR to increase initially at an increasing rate). Concerning our example, this is the case where a small amount of product safety information actually “whets the appetite” for more. However, according to the psychology of satiation, eventually diminishing satisfaction will result from additional information (within a given period of time). Further, for some types of ethical behavior, there may be no absolute satiation of satisfaction received (and TR would increase throughout). (The psychology of satiation only calls for *relative* satiation.)

While these alternative formulations hold interest, the assumptions behind the proposed model facilitate the analysis of business ethics. Hopefully, future research will build on the basic model to explore more complex cases.

Behind Costs and Revenues: Beyond Economics To Socio-Economics

In this section we look at those factors that lie behind the cost and revenue schedules — the main parameters of the model. It is here that standard revenue and cost variables affecting a business firm enter the picture, but more importantly, institutional and cultural forces (assumed, and in that sense, ignored in standard economics) are taken into account.

The position of the cost and revenue curves depicted in Figure 1 depends partly on those factors (other than the level of ethical behavior) that directly affect the business firm’s operating costs and sales revenue — such as labor costs, product advertising costs, price of raw materials, number of consumers in the market, and the like. A change in these variables may shift either the cost or revenue curve in Figure 1, or both. For example, an increase in the number of consumers in the market would shift the revenue curve in Figure 1 upward (to TR) by increasing product demand, showing an increase in revenue available to the business firm for each level of ethical behavior.

Figure 1 is constructed so that the impact of a change in ethical behavior on revenue and cost is depicted by a movement along TR and TC, whereas the impact of a change in traditional revenue and cost variables is illustrated by a shift in TR and TC. This methodology enables us to analyze the profitability of ethical behavior in terms of the overall profitability of the firm. The model indicates that the level of ethical behavior is tied to those factors that determine the overall financial health of the enterprise, namely cost of resources, strength of product demand, productivity, etc.

The second (more important and more interesting) set of parameters that determine the position of the revenue and cost curves in Figure 1 consists of the values, customs, traditions, beliefs, and institutions of society. As these change over time, the cost and revenue schedules shift. For example, social-cultural changes that cause workers to value job equity more would shift the revenue curve of Figure 1 upward (TR¹) to the extent that job equity measures by the employer have a greater positive impact on worker morale, productivity, turnover, etc. (This could be the result of changes in our education curriculum: the American Assembly of Collegiate Schools of Business strongly endorses the teaching of business ethics for AACSB accredited schools.)

Thus, in the proposed model culture and institutions have an important and dynamic role to play in the analysis of business ethical behavior. This stands in sharp contrast to the orthodox approach of treating the cultural fabric of society as an unchanging “given” — assuming it into constancy rather than treating it as a live variable. Our model calls attention to the important fact that the ethical behavior of the firm, rather than being insulated from culture, reflects and is determined by it.

The proposed model encompasses the impacts of both market and socio-cultural forces on ethical behavior. To understand how these forces affect the level of ethics employed by the firm we need to add one more dimension to the analysis: market structure (rather than trying to generalize across all markets).

Business Ethics and Market Structure

For comparative purposes, let us begin with the textbook fiction of a perfectly competitive market. There are two aspects of the application of our model to the competitive case (Figure 2) that deserve special attention. First, the TR curve does not have the familiar linear configuration we expect in competitive markets. This is due to diminishing marginal benefits of ethical behavior (stated above). Though the competitive firm is a “price taker” on the output side of the market (that is, price is dictated to the firm by the market), it need not be a “price taker” regarding the benefits of ethical behavior. Second, the level of output (Q) of the good or service produced is assumed to be that which maximizes profit in the long run — Q^* (not shown in Figure 2 since it is an underlying assumption of the model, but the assumption of profit maximization can be inferred from the figure since EB^* occurs where the slope of TR, marginal revenue, equals the slope of TC, marginal cost). (The noncompetitive, “real world” case is more interesting; output may be either that which maximizes profit, or that which allows the firm to pursue goals other than profit maximization, subject to the constraint of earning a normal profit.) The profit-maximizing level of output (Q^*) is treated as a “given” in our model, since the focus of this study is on ethical behavior, and not output (see W.H. Miller, 1984). Recall that this is the converse of orthodox economic methodology where output is the key (dependent) variable of the model and the level of ethical behavior is treated as a “given,” or is simply ignored.

The key question is: Given a particular rate of output (Q^*), what does our model tell us about the ethical behavior of the competitive firm? In terms of the debate in the literature (discussed above), will it pursue some positive level of business ethics in supplying Q^* , as Hattwick (1984, 1985) claims, or will it invest in zero ethical behavior, as Majerus (1982) believes it must do?

The answer provided by our model is that the competitive firm will engage in a positive level of ethical behavior so long as the benefits of such behavior exceed costs because the competitive firm must maximize profits to survive in the long run. Accordingly, the competitive firm in Figure 2 would operate at EB^* , where marginal benefits equal marginal cost of ethical behavior (and profits are maximized).

Recall that to incorporate the profit motive in our model, a normal rate of return on investment is treated as a cost of doing business, and, thus, is included in TC. With TC being equal to TR at EB^* (in Figure 2), the business firm is just making a normal profit on its investment in ethical behavior in the long run (as is expected in the textbook competitive case).

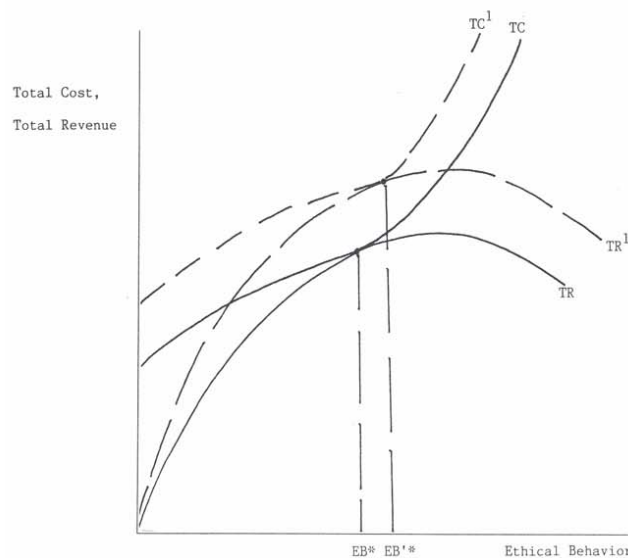


FIGURE 2: The Optimum Level of Ethical Behavior for the Competitive Business Firm in the Long Run.

Thus, the simple answer to the above question is that the competitive firm will behave ethically if it is profitable to do so. However, our model goes beyond the proposition that a positive level of ethical behavior may be good (profitable) business. It suggests that in some cases the motive to behave ethically goes beyond opportunity to necessity. This occurs when the costs of zero ethical behavior exceed the benefits, as depicted in Figure 2. Here, zero ethical behavior is actually “bad business” for the firm, and will cause long-run economic loss and failure. Thus, not only can the competitive firm be expected to behave ethically when it is profitable to do so, but, in some cases, it will not have any choice but to do so.

This stands in sharp contrast to the orthodox claim that the competitive firm can not be expected to behave ethically, since its business is to make a profit. After taking a broader perspective of firm behavior and the environmental factors that affect the firm, it becomes clear that perfect competition, profit maximization and ethical behavior are quite compatible, sometimes even necessary, partners.

Of course, the perfectly competitive case does not exist. However, from a theoretical perspective, it is useful to work through (apply our model to) this case for it provides a valuable yardstick for evaluating the implications of market imperfections.

In the real world of market imperfections (and producer market power) there is the possibility of long-run economic profits occurring to the non-competitive firm. This gives the noncompetitive firm considerable discretion over the level of ethical behavior it may wish to pursue. We see in Figure 3 that the business firm is able to earn at least a normal profit over the range of ethical behavior EB'-EB" inclusive. If the business firm is a profit maximizer, it would, of course, operate at EB*. However, if it is a profit “satisficer” instead, it may operate anywhere in the range EB'-EB" and be free to pursue other goals. For example, it might seek to maximize ethical behavior (subject to the constraint of earning a normal profit on its investment) and operate near or at EB". On the other hand, it could attempt to minimize its ethical behavior (subject to the constraint of earning a normal profit) and operate at EB'. There are, of course, various intermediate positions available to the business firm which fall in between these extreme alternatives. However, should the business firm attempt to operate outside the range EB'-EB" its costs would exceed benefits, a position not sustainable in the long run.

Thus, the model implies that when the noncompetitive firm has the discretion to pursue goals other than profit maximization (when it is able to earn more than a normal profit in the long run), the outcome is indeterminate (Gellerman, 1986). The business firm may operate anywhere in the range EB'-EB".

Let us now introduce our dynamic framework (developed above) into the analysis so we may examine the relationship between market structure and changes in society’s institutions, habits, customs, and values. Suppose, for example, consumers (as a result of a governmental safety awareness campaign) now place a higher value on producer supplied product safety information. This would shift our revenue schedule upward (to TR¹) since this information, being more valued by consumers, presumably would result in greater derived benefits to the firm (such as stronger consumer loyalty).

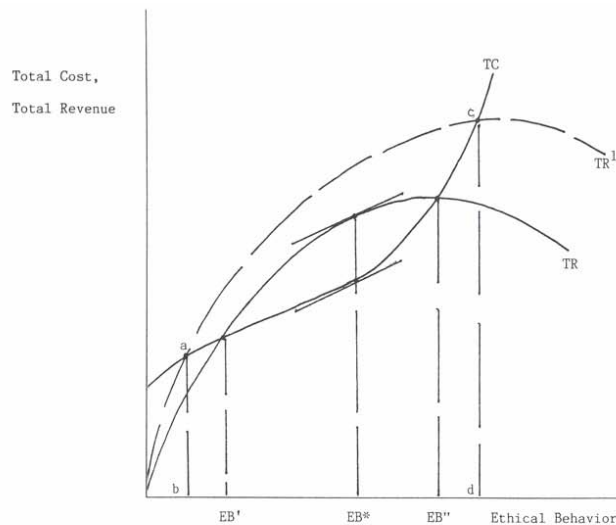


FIGURE 3: The Range of Viable Levels of Ethical Behavior Open to the Noncompetitive Firm in the Long Run.

In the textbook case of perfect competition, ethical behavior would be driven to a new unique (equilibrium) level in Figure 2, as profit is “normalized” in the long run at EB'*. (The TC curve also shifts up, to TC', on the assumption that this is an increasing-cost industry.) To the degree that the change in consumer values and attitudes moves the point of tangency between

the cost and revenue schedules to the right (outward along the horizontal axis), the ethical behavior of the firm would increase accordingly.

The noncompetitive case is quite different, however, since (when long-run economic profits exist), there is no single level of ethical behavior which the business firm must adopt. Here, the impact of a change in values (or other environmental parameters) on business ethical behavior is quite uncertain. In fact, a change in social values which can be expected to increase ethical behavior among competitive firms may have just the opposite impact on firms in noncompetitive markets. This is illustrated in the following policy application of our model of business ethics.

Business Ethics and Public Policy

Our model of business ethics implies that in the competitive case there is a fairly tight and predictable relationship between revenues and costs and the level of ethical behavior adopted by the business firm, Socio-cultural changes that cause the point of tangency of TC and TR to move to the right, outward along the horizontal axis, (cause marginal revenue to exceed marginal cost at the existing level of ethical behavior) will be reflected in an increase in the ethical behavior of the firm, and vice versa.

Though perfect competition, naturally, does not exist, the argument has relevance to the real world: namely, the more (less) competitive markets are, the greater (less) the opportunity for public policy makers to affect the ethical behavior of the business firm. This is due to fairly direct and predictable linkages between the cost-revenue variables and the ethical behavior of the business firm in competitive markets. When public policy makers cause TR to increase and/or TC to decrease, ethical business behavior will increase accordingly. For example, a subsidy program (or tax breaks) which increases the benefits (or decreases the costs) to the business firm of certain types of ethical behavior can be expected to increase such behavior. In competitive markets producers cannot afford to bypass revenue-enhancing (or cost-saving) opportunities — opportunities which will be taken advantage of by competitors.

However, in less competitive markets, the linkages between policy-induced changes in the cost and revenue variables and the resulting level of ethical behavior adopted by the firm are less direct and certain. In these markets, (short of such drastic measures as market restructuring or taxing away all economic profit) policy makers must find ways to cope with the discretion the business firm has in choosing its own level of ethical behavior (Waterman, 1988).

To illustrate the problem, suppose that policy makers are able to shift the firm's revenue curve upward (in Figure 3), causing the new EB' to lie to the left of the old EB' and the new EB'' to lie to the right of the old EB'' (as indicated by lines ab and cd, respectively). While firms with high ethical goals will now behave more ethically, firms seeking to minimize ethical behavior (subject to the constraint of earning a normal profit) will actually behave less ethically than before. (This conclusion has intuitive appeal — noncompetitive firms have considerable market power and this power, like all forms of power, may be used for good or bad.) In other words, public policy initiatives aimed at increasing business ethical behavior may backfire in noncompetitive markets. The less competitive the market, the greater is the chance of such unintended policy consequences. Our model of business ethics, thus, implies that a more comprehensive public policy approach is needed for business firms with substantial market power. Public policies that affect only the business firm's revenue and cost schedules may have little, if any, beneficial impact on the level of ethical behavior practiced by noncompetitive firms. In this case, short of market restructuring, policy makers must devise ways to affect directly the level of ethical behavior adopted by the firm. (Government regulation, though not without costs, is one possibility.)

Summary and Assessment

The primary purpose of this section is to provide a critical assessment of the proposed model of business ethics. To facilitate the evaluation, a brief summary of its key attributes and implications are presented below:

1. The model is non-mainstream both in its scope and methodology. The boundaries of traditional economics are pushed out in an attempt to pursue socio-economic investigation, incorporating important concepts and ideas from other disciplines. Its methodology is the converse of orthodox *ceteris paribus* model building where the state of the environment is assumed and fixed. In contrast, in the model presented in this paper the environment is given a key, explicit and dynamic role in the analysis.
2. Business ethical behavior is linked to derived benefits to the firm via a broadly defined investment framework, which takes into account both monetary and nonmonetary (mainly psychic) costs and benefits. Maslow's hierarchy of needs plays an important role in our understanding of the nonmonetary motivational aspects of business investment in ethical behavior.
3. An important implication of the model is that business firms can be expected to behave ethically (to some degree) when: (a) ethical behavior yields derived benefits to the firm in the long run, and (b) the marginal benefits of ethical behavior exceed marginal costs at a positive level of ethical behavior.

4. For competitive business firms, these conditions yield a determinate level of ethical behavior. In noncompetitive markets, where producers may have considerable discretion to pursue non-economic goals, the outcome is indeterminate.
5. The effectiveness of public policy aimed at increasing business ethical behavior varies inversely with the degree of market power. The less competitive markets are, the weaker the linkages between environmental changes and business firm behavior. Market power may be used by the business firm to insulate itself partially from environmental influences, thus weakening public policy initiatives aimed at the business firm.
6. Finally, regarding the debate in the literature posed at the beginning of this paper, the proposed model implies there is no simple answer to the question: Can business ethics be left to the market? It depends — it depends upon the nature of the ethical behavior desired (whether it is of an investment nature), degree of market competition, goals of the business firm, and the existence of favorable or unfavorable environmental forces (which reflect the values, habits, and institutions of society).

The model is in its early stages of development, and, admittedly, has several limitations and gaps. Yet, it also has some noteworthy strengths. Let us look at its strengths first.

1. The model, by turning modern orthodox economic methodology on its head (making the environment a key variable of interest) and by integrating important concepts and ideas from psychology and sociology, facilitates socio-economic investigation of the important subject of business ethics, long neglected in orthodox economics. Hopefully, it will stimulate further efforts to expand the narrow and often sterile boundaries of traditional economics.
2. The model focuses on the causality of ethical business behavior and the benefits of such behavior. A causal approach sheds light on the determinants of ethical business practices and the conditions under which the business firm is motivated to act ethically or not.
3. The model's causal taxonomy (distinguishing those factors that determine the shape of the business firm's cost and revenue schedules from those that determine the position of the schedules) calls attention to the dynamics of ethical business behavior — how changes in society's values, laws, customs, etc. can (via a shift in the business firm's cost and revenue schedules) bring about a change in the level of ethical behavior employed by the firm.
4. Finally, the model, by incorporating the impact of market structure on ethical behavior, should help us better understand the market conditions under which public policy aimed at enhancing ethical behavior will be successful.

The proposed model is seen by the author as a step forward toward meaningful socio-economic analysis. Yet, at the same time, it is a step back to the time of early political economy when economists/moral philosophers were not afraid — indeed, were eager — to tackle the “big issues.” Ethics is part of that domain of “big issues.”

While the strengths of the model are essentially conceptual in nature, its shortcomings are of a more technical character. First, we should note that the proposed model of business ethics is invalid for most short-term or “one-shot” business transactions. Business ethics is treated in the model as investment behavior. With any “real” investment, present rewards are sacrificed with the expectation of obtaining greater future rewards. However, for short-term relationships, investment behavior is not rational since there are no future rewards and, thus, there is no payoff on investment (Hattwick, 1985). In this case there is no economic incentive to invest in ethical behavior. The reciprocal of this argument pertains to exploitative behavior. A potential constraint on exploitative behavior in long-term relationships is that future costs may outweigh present benefits. This constraint does not exist for short-term relationships where the business firm may reap the short-run benefits of exploitative behavior and escape future costs (e.g., false advertising by “hit-and-run” businesses).

This is not to say that all producers engaged in short-term transactions will exploit others. There is the possibility of short-term ethical behavior as altruistic behavior. Also, some types of ethical behavior may yield an immediate payoff. Courteous behavior may, for example, result in immediate benefits. However, our model does not explain how altruism and other possible behavioral determinants affect ethical behavior in the very short run. Our model is restricted to long-run behavioral relationships.

A second limitation of the model is that it treats the level of ethical behavior as an abstract bundle of good deeds. The model does not provide any insights into the composition of the firm's ethical practices. For example, it does not answer the question of why two equally ethical producers in a given environment might adopt very different types of ethical behavior. Why might one employer stress work safety while another emphasizes product safety, or customer relations? Unless we can answer such questions, policy designed to enhance ethical behavior will lack a qualitative focus. To talk intelligently about increasing ethical behavior we need to know what types of ethical practices will be encouraged by particular public policies.

Finally, the shape of the model's cost and revenue curves, though derived from accepted principles and concepts in engineering and motivational psychology and having considerable intuitive appeal, are, nonetheless, conjectural. Too little is known about the nature of the cost-revenue linkages to ethical behavior.

Linking the above two limitations, it is possible that the shape of the curves depend not only upon the level of ethical behavior employed, but also upon the particular types (mix) of ethical behavior pursued by the firm. This needs to be explored.

In light of these limitations and unknowns, the proposed model must be viewed as only a preliminary, first step toward explaining the ethical behavior of business. As a first step, it is hoped that the model will stimulate a productive dialogue on the determinants and dynamics of ethical behavior, and provide a useful base for extending our understanding of business ethics.

On a broader level, it is hoped that such efforts as the one undertaken in this paper will help open up economic investigation to the normative, ethical issues that society must grapple with. Economics has been insulated too long (via orthodox 'impersonation' of physical science methodology) from "true" social science investigation.

Finally, I would like to close on a philosophical and methodological note. Perhaps no one better captured in words the barren properties and restrictive methodology of orthodox economics than did Thorstein Veblen. His incisive, sardonic passage on the behavioral premises of orthodoxy lays bare the orthodox practice of sacrificing relevance for methodological rigor and puts in sharp perspective the importance and urgency of efforts to go beyond the confines of the traditional boundaries of the discipline:

The hedonistic conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. *He has neither antecedent nor consequent. He is an isolated, definitive human datum* [emphasis added], in stable equilibrium except for the buffets of the impinging forces that displace him in one direction or another. Self-imposed in elemental space, he spins symmetrically about his own spiritual axis until the parallelogram of forces bear down upon him. whereupon he follows the line of the resultant. When the force of the impact is spent, he comes to rest, a self-contained globule of desire as before (1889: p. 393).

The orthodox conception of *homo economicus*, though fulfilling the orthodox desire for predictability and determinacy, is not revealing of the world we live in. Only a broader perspective — one that incorporates the rich tools of related disciplines can lead the way to meaningful analysis of socio-economic phenomena.

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