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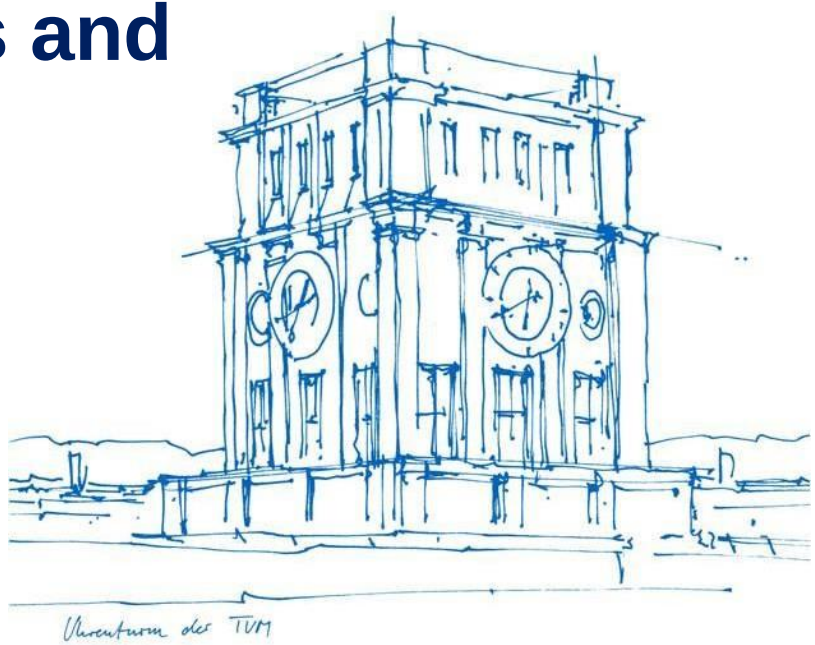
Introduction to Business Ethics:

(Economic) Foundations and tools of Business Ethics

11./17. January 2023



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Focus of today

Introduction

Chapter 1: Business Ethics in the Age of Globalization

Chapter 2: Basic Concepts

Chapter 3: Historical-economic Background: Premodernity and Modernity

Chapter 4: Foundations and Tools of Business Ethics

- **Economic and socio-scientific foundations and tools**

Chapter 5: Problem Areas of Business Ethics

Chapter 6: Corporate Ethics

Rationality

Derived from Latin "ratio"
Translated: "calculation", "reason"
Max Weber: Two distinctions

Purposive rationality
- Relationship between a goal and the means

vs.

Value rationality
- Reasonableness of a certain goal

Individual rationality

vs.

Assessment of social conditions

Max Weber 1864 - 1920

Instrumental Rationality and Value Rationality

Instrumental Rationality

Goal-Means-Relationship:
- Goal is exogenous
- Hypothetical Imperative: „If objective A is to be achieved, then means B fulfills this purpose.“

Efficiency:
- "things are done right"
- In relation to a certain predetermined goal

Value Rationality

Reasonableness of a certain goal:
- Goals have to be justified
- Correctness of the goal dependent on e.g. moral, religious or aesthetic beliefs

Effectiveness:
- "right things are done"
- Correctness dependent on criteria

But: Interdependency Between Goals and Means

Homann 1980: no consideration in isolation possible!

Permanent feasibility study:
Feedback between goals and means is consequently necessary
„Ought implies can“
Focus only on instrumental rationality not enough for economics

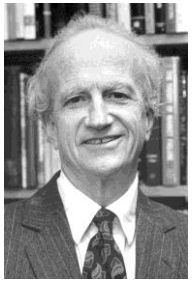
❯ No strict separation between instrumental rationality and value rationality

Source: Karl Homann 1980: *Die Interpendenz von Zielen und Mitteln*. Mohr Siebeck, Tübingen.

Open Concept of Advantage in Economics

Stigler/Becker 1977: „matters of taste cannot be disputed“

Question: What should be the subject of scientific research?



Gary Becker (1930-2014), Nobel Prize 1992

George Stigler (1911-1991), Nobel Prize1982

Preferences

- Actions can be explained by changing preferences
- Lack of theory on development of preferences

➡ Methodologically sufficient to consider preferences as exogenous and stable

Situative Restrictions

- Objectively observable across individuals
- Allow an interpretation of corresponding behavioral conditions

➡ Methodologically meaningful subject of investigation

Source: George Stigler/Gary Becker 1977: *De gestibus non est disputandum*. In: The American Economic Review, 67 (2), 76-90.

Methodological Individualism

Question in background: How can social phenomena be explained?

> Every analysis of a society begings with the individuum.

What it is NOT: A statement about true nature of man/concrete form of human behavior
(= ontological individualism)

⟩ Methodological individualism makes statement about how to develop good theory about social phenomena

Methodological Collectivism/Holism

Contrary to methodological individualism

> Starting point of holism: Every individual behavior is based on social circumstances.

Macro phenomena can not be explained by individual behavior.

➡ Example: System Theory (Luhmann) – systems as a whole have certain peculiarities and a certain internal law that does not merely result from the aggregation of entities.

Subjective Concept of Advantage (1/2)

Subjective concept of advantage :

Value of a good depends on individual advantage it brings to the respective consumer

+

Gossen's First Law:

The marginal benefit of a good decreases with increasing consumption

Subjective Concept of Advantage (2/2)

Anticipation of the marginal principle in John Law, 1705 :

> „Goods have a Value from the Uses they are apply'd to; And their Value is Greater or Lesser, not so much from their more or less valuable, or necessary Uses: As from the greater or lesser Quantity of them in proportion to the Demand for them. Example. Water is of great use, yet of little Value; Because the Quantity of Water is much greater than the Demand for it. Diamonds are of little use, yet of great Value, because the Demand for Diamonds is much greater, than the Quantity of them.“

Quelle: John Law 1705/1750: *Money and Trade Considered: With a Proposal for Suppluying the Nation with Money.* R.&A. Foulis, Glasgow.

Classical Paradox of Value (1/2)

Why is a diamond more expensive than water?

	Exchange Value	vs.	**Value of Utility**
Water	low		very high
Diamond	very high		low

Already Adam Smith saw no direct connection of both value concepts.

Classical Paradox of Value (2/2)

Why is a diamond more expensive than water?

Labor theory of value

- Objective value theory
- The value of a good can be explained by amount of working time spent on it

⬇

Unable to solve the classical value paradox

Marginalism

- Subjective value theory
- Individual use of a good is directly dependent on its available quantity

⬇

Solves the paradox

❯ Exchange value of water in desert high, in a city rather low

Theory of Revealed Preferences

Using this theory (Revealed Preference Theory), utility functions can be constructed from the actor's observed choices.

Example: Decision maker has choice between good A and good B or good B and good C

One observes, following preferences:
A is chosen over B
B is chosen over C

Revealed Preferences:
Good A is preferred to good B
Good B is preferred to good C

Criterion of Transitivity

Derivation of complete order of preferences

Two revealed preferences (A > B and B > C)

+

Assumption of transitivity : if A > B and B > C
➡ A > C

Result: Decision maker prefers good A to good C. Order of preference: A > B > C
IMPORTANT: Last preference itself was not observed!
It is an *indirectly* revealed preference
Assumption of transitivity must be fulfilled

Instrumental Use of Utility Functions

Wrong interpretation: one decision maker prefers one good over another because it maximizes his utility

A utility function is merely a formulation of consistent individual choices
Certain consistence requirements must be imposed on the choices, since idiosyncratic behavior cannot be modeled
➡ Empirical studies that violate axioms pose a challenge to neoclassical theory

⟩ Descriptions of behavior through utility functions are just an "as if".
Success depends on success of the prediction

Ordinal Utility Function

What must be present in order to specify an ordinal utility function?

1. Transitivity
2. **Completeness**

> Any pair of goods X and Y can be compared

This means: either a good is preferred or one is indifferent between the two goods

⟩ Result:
Ordinal order of goods, this means the alternatives can be ranked from best to worst

Concept of Indifference

Meaning:

A good X is liked as much as a good Y

Delineation from **indecisiveness:**

Indecisiveness	Indifference
• Period of reflection time is needed to weigh the respective benefits of the two goods	• There is no period for reflection needed, someone knows that both alternatives have the same value

Rationality of Decision Maker

Sufficient criteria for an ordinal utility function:

Transitivity + Completeness

Additional axioms that can be posed on decision makers as a requirement for rationality, for example:

Irrelevance of third alternatives
From a set of alternatives of goods X and Y, preference is given to X.
➡ Preference relation must not change if a good Z is added

Homo Economicus

A picture of man ascribing a selfish motive to man?

➡ NO!: only a postulate of consistency for decision making

Open concept of advantage on the example of Mother Teresa:

Puts welfare of children above her own
Compatible with homo economicus model if behavior is consistent
Egoistic action in the narrow sense is due to logic of situation (for example in anonymous markets)

❯ What constitutes a benefit to the individual is up to him!

Economics as Situation Theory

Falsification of homo economicus by psychology/behavioral sciences?
Economic method is still successful
Reason: its special scope
No behavioral theory, but *situation theory*

- Reality and world view of the people are hidden
- True motivation of actors irrelevant

➡ Actors do not act as homo economici per se, but by situationally accounting for actions of others in their decision

⟩ Modeling of interaction processes that forces individual actors to adapt behavior based on situational incentive structure

Economics and Economic Policy

1. Step:

Economics asks for ...

- Actions of individual actors under given framework conditions
- Type, quantity and mode of production of goods to be produced
- Distribution of goods among members of society

2. Step:

Economic policy asks for ...

- Institutions to implement the answers
- Regulatory policy/economic framework
- Process policy to influence process of economic activity

Which social condition is desirable? ➡ **Open concept of utility**

❯ How can social common good be operationalized?

Hayek 1967: Distributive and Procedural Justice (1/2)

Respectively: consequentialist vs. procedural theories of justice

1. Distributive Justice:

Theories:

E.g. Utilitarianism

- Social interpretation of happiness
- Fair state means: greatest happiness of the greatest number

Exhibited in the context of specific welfare functions

vs.

Pareto-Criterion

- Result-oriented minimum consensus

Source: Friedrich August von Hayek: *Rechtsordnung und Handelsordnung*. In: E. Streißler (Hrsg.), Zur Einheit der Rechts und Staatswissenschften. CF. Müller, Heidelberg, 3-20.

Hayek 1967: Distributive and Procedural Justice (2/2)

Respectively: consequentialist vs. procedural theories of justice

2. Procedural Justice:
Equality ideal of formal civil liberties
Issues of procedural justice, rather than result orientation

Theories:
Entitlement Theory (Robert Nozick)
Friedrich A. Hayek: The market as place of spontaneous order

Source: Friedrich August von Hayek: *Rechtsordnung und Handelsordnung*. In: E. Streißler (Hrsg.), Zur Einheit der Rechts und Staatswissenschaften. CF. Müller, Heidelberg, 3-20.

Distributive Justice

How can different social conditions be compared?

1. Value judgments must be traced back to judgments of individuals
2. Individual value judgments can be described as revealed preferences about utility functions
3. In order for utility levels to be intersubjectively comparable, a cardinal scale level is necessary
4. Through welfare functions different benefit levels can be compared. Depending on choice of welfare function, different results emerge

Economics and Value Judgments

Normative individualism:
Value judgments are attributed to wishes and needs of individuals

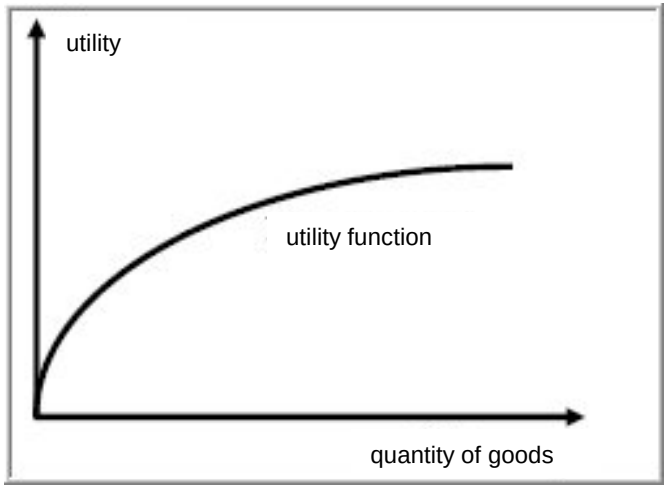
Individual sovereignty:
Every member of society can judge its own situation

Methodological individualism:
There is no superordinate social value that can not be attributed to value judgments of individual members of society

Utility Function

Concept of **utility function**:
Individual objectives can be indirectly derived from choice actions
Revealed preferences can be described by utility functions (assumption: certain consistency requirements).

Only **functional role**:
Keep metaphysics out of decision theory
Individuals "have" no utility function.
Individuals behave *as if* they maximize function.



Cardinal Utility Scale

Intention is to individualistically substantiate social goals
➡ Question: How can individual benefits be aggregated/compared?

Necessary: **cardinal scale level**
Distances between the utility values can be meaningfully interpreted
Intersubjective comparability of benefits is ensured.
Examples:

- Temperature in degrees Celsius
- Time

➡ Temperature difference between 10° C and 20° C is the same as between 5° C and 15° C

Utilitarian Welfare Function

Formula:

$$W^U = \sum_{i=1}^{n} \alpha_i \, u_i(x)$$

W^U : Utilitarian welfare function

u_i : utility for individuum i

α_i : weighting factor for individual i. Special case: $\alpha_1 = \ldots = \alpha_n = 1$

x : state of society

❯ Social welfare as the weighted sum of the individual utilities of individuals

Nash Welfare Function

Formula:

$$W^N = \prod_{i=1}^{n} [u_i(x)]^{\alpha_i}$$

W^N : Nash welfare function

u_i : utility for individuum i

α_i : weighting factor for individual i

x : state of society

❯ Sensitive to variations of individual utility (example.: $u_{384} = 0 \rightarrow W^N = 0$)

Rawlsian Welfare Function

Formula:

$$W^M = min[u_1(x), \dots, u_m(x)]$$

W^M : Rawlsian welfare function based on John Rawls's "Theory of Justice"

u_i : utility for individuum i

x : state of society

⟩ Operationalization of maximin criterion: W^M at maximum when individual of society who is worst off, realizes the maximum benefit

Problem of Previous Welfare Functions

Assumption: interpersonal comparability of utilities

Example: Utility of a beer = 100 vs. Utility of tomato juice = 10
➡ But: Beer is ten times as attractive as beer is not a meaningful statement

Contemporary utility interpretation: only *ordinal* statements like e.g. "better"/"worse", distances between utility values are not interpreted

❯ Cardinal utility concept is rejected today by most economists

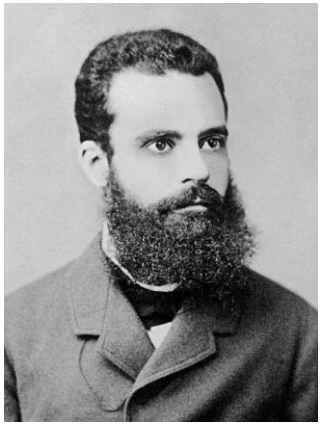
Pareto Criterion (1/3)

Assumption: Social conditions can only be judged from individual point of view

⬇

Definition **Pareto-efficiency**:

State A is Pareto-superior compared to State B, if at least one individual is better off in State A and no other individual is worse off.



Vilfredo Pareto (1848-1923)

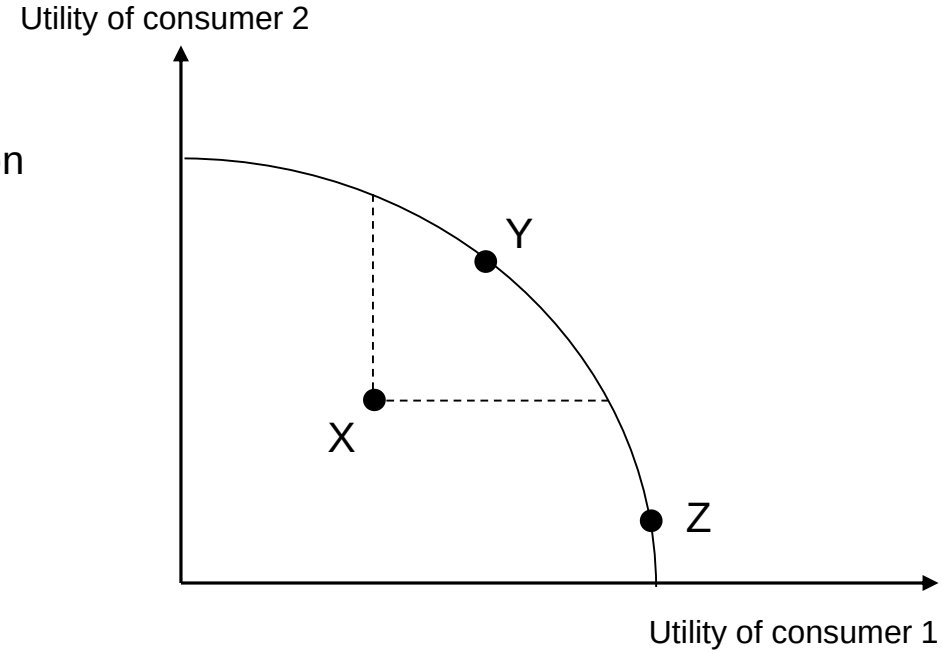
❯ Social conditions can be classified with this criterion

Pareto Criterion (2/3)

State X:
Certain utility level for 1 and 2
Under utility-possibility frontier
➡ not Pareto efficient, because better position is possible

State Y:
1 and 2 are better off than in State X
➡ State Y is Pareto-superior in relation to State X

This applies to all points located northeast of State X

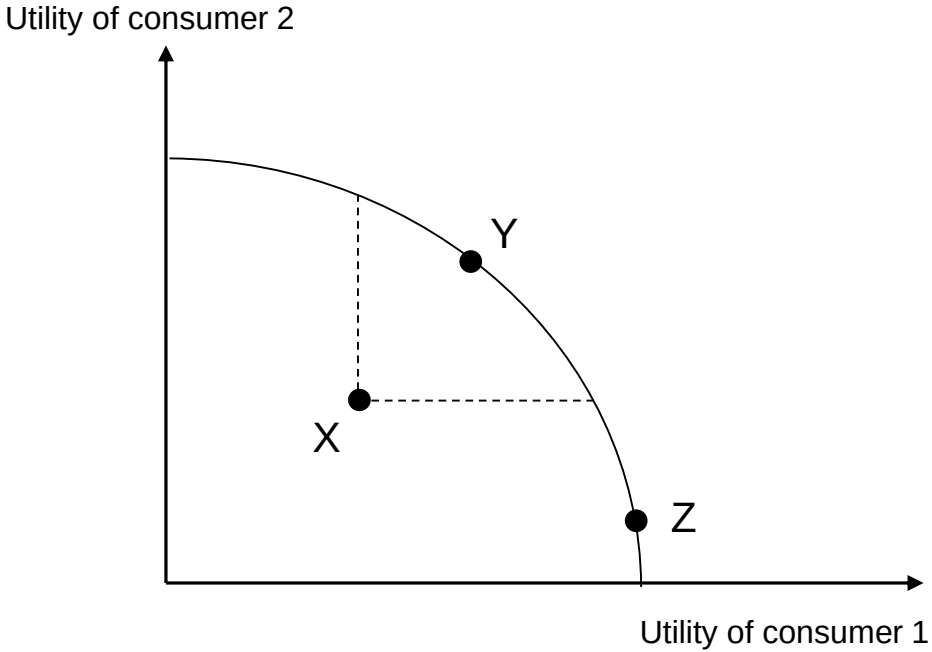


Pareto Criterion (3/3)

Z:
On utility-possibility frontier
No other condition is achievable without discrimination of an individual

➡ From X to Z: from Pareto-inefficient state to Pareto optimum

➡ However: no Pareto improvement
Consumer 1 is improving, but consumer 2's consumption is declining



Pareto Criterion: Results

Pareto efficiency and Pareto optimum:
Movement from Pareto inefficient state to Pareto optimum does not necessarily mean a Pareto enhancement (movement from X to Z)
A Pareto enhancement does not yet imply a pareto-efficient state (movement of X to a point Northeast of it, but below the pareto-efficient curve)

Pareto improvements as a minimum consensus:
Who would object to one side being better off if the other side does not suffer?
Most likely no one. Assumption: no envy!

❯ Compared to welfare functions: Pareto criterion is normatively more appealing

Strong vs. Weak Pareto Criterion

When is one social State A preferred over another State B?

Strong Pareto Criterion:
In A, *at least* one individual is better off without another being disadvantaged

Weak Pareto Criterion:
In A, *all* individuals are better off

Counter-intuitive?
➡ Mnemonic: the weak Pareto principle is empirically more difficult to realize

Buchanan's Critique of Distributive Justice Approaches

Problem with Robinson Crusoe example:

- Cardinal economic problem of scarcity must not be described solely in individual case
- Danger thereby: inferrences from individual to society are often problematic
- Leap from individual utility maximization to maximizing utility of society is wrong
- Essential interactions between individuals must not be hidden

James M. Buchanan (1919-2013), Nobel Prize 1986

❯ Economics is essentially interaction economics

Source: Geoffrey Brennan und James M. Buchanan 1985: *The Reason of Rules. Constitutional Political Economy*. CUP, Cambridge/New York

Buchanan's Critique of Welfare Economics (1/2)

1. Welfare economics tends towards intervention science

Criteria of outcome justice requires orientation toward theoretical ideal (e.g. Pareto Optimum)
If the ideal is not achieved, there is a tendency for state interventions

2. Efficiency criterion is unrealistic

Efficiency criterion: Any equilibrium that occurs in the complete market is a Pareto optimum
Complete market is a theoretical ideal ➡ Efficiency criterion is unrealistic
Abstract scale, instead of criterion of justice
Economics has lost its orientation function in society
Economics should be re-connected and upgraded in the public discourse

Buchanan's Critique of Welfare Economics (2/2)

3. Efficiency ideal regardless of wishes of individuals

Pareto Optimum is determined independently of market process ➡ independent of desires of individuals

Market as "Calculation Machine" (Samuelson 1954, 388)

Deviation of status quo from Pareto optimum = market failure (market prevented from doing calculative work)

Correction: indifference between democratic process and benevolent dictator

➡ Welfare economics raises efficiency to a normative requirement, which is to be achieved by state control

❯ Welfare Economics does not take the actual desires of those affected into account

Source: Paul Samuelson 1954: *The Pure Theory of Public Expenditure*. In: The Review of Economics and Statistics, 387-389.

Buchanan’s Criterion of Consensus (1/3)

Buchanan's demand: an **internal and not ideal** criterion, rather than a theoretical ideal for comparing different social conditions

➡ Criterion of agreement/consent: Consistent orientation based on status quo

Can a situation be established from here and now that everyone agrees to?

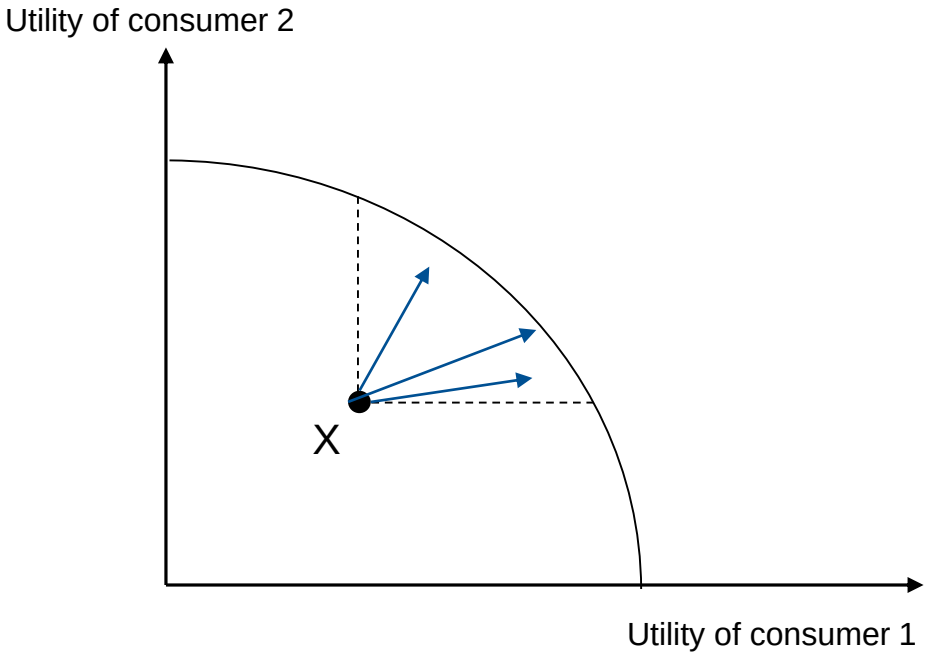
Buchanan's Criterion of Consensus (2/3)

State X as a starting point (status quo)

Focus on all states that reach a consensus between players starting from State X

➡ successive movement in northeastern direction

❭ Reference point: status quo and not external Pareto criterion of complete competition



Buchanan's Criterion of Consensus (3/3)

Three key findings/interpretations:

1. A **heuristic** that changes from external perspective of efficiency to internal perspective of political processes (mutual consent!)

2. Market as an **interaction process** for reciprocal improvement through exchange acts, rather than an algorithm whose performance has to be measured against the efficiency ideal

3. Move away from Pareto optimum as distribution criterion and return to Pareto improvement as process criterion → should refer to rules, not individual actions

Example of a Consensual Rule

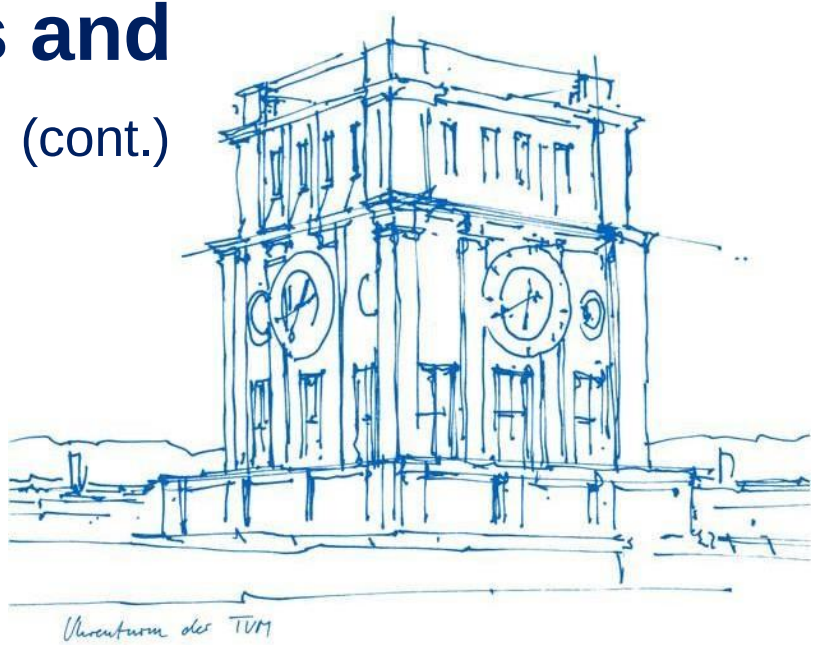
Criteria:
Rule must be derived from metarules/rules of higher order
These metarules must sometimes be sufficiently general to be unanimously approved

Example:
Establishment of a state with a monopoly on the use of force
End of Hobbes' war of all against all
Generate universal peace dividend

Introduction to Business Ethics:

(Economic) Foundations and tools of Business Ethics (cont.)

17. January 2023



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Winterterm 2022/23

(Dilemma Structures vs.) Pure Coordination Games

Pure coordination games:
There are basically no divergent interests between individuals
However, it requires a well-known rule for coordination with each other

Example: left or right-hand drive

Assumptions:
No driver has a preference for driving on the left/right side
All have preference for everyone driving on same side

Coordination:
If achieved, no individual incentive to deviate from rules
Equilibrium is self-enforcing
Rule violations do not have to be sanctioned

Pure Coordination Games: Example

$Assumption\colon\ a > b$

		Player 2: drive left	Player 2: drive right
Player 1: drive left		I: a, a	II: b, b
Player 1: drive right		III: b, b	IV: a, a

Dilemma Structures

Basic assumption:
Theoretically possible and mutually desired gains from cooperation can not be realized

Behavioral interdependencies as main reasons:
No interaction partner can control outcome alone
Anyone who acts with respect to common interests risks being exploited

- **Pareto-inferior equilibrium**: best possible result is not achieved

Prisoner's Dilemma (1/2)

Description of the situation: Two prisoners are suspected of joint crime

They are isolated and interrogated in separate rooms

Maximum sentence for the crime: three years imprisonment

Both are silent (= cooperation): due to minor offenses only one year imprisonment

Both confess (= defection): two years imprisonment

One is silent (= cooperation) and the other confesses (= defection): leniency and thus no imprisonment for the latter, maximum penalty of three years for the former

Prisoner's Dilemma (2/2)

High relevance in theory:

Patterns of interaction:
Two persons interact with each other

Interdependence of behavior:
No person can determine result of the interaction alone

Mirror-inverted situation:
Both persons each have two strategies: cooperate and defect

No behavioral commitment:
Crucial: In advance, there was no effective commitment of people to a strategy

Prisoner's Dilemma: Normal Form

		Player 2: cooperate	Player 2: defect
Player 1	cooperate	I 2, 2	II 0, 3
	defect	III 3, 0	IV 1, 1

Prisoner's Dilemma: Evaluation (1/2)

Situation Player 1 (analogously for Player 2):

Depending on the decision of Player 2:

- Player 2 cooperates: Defection maximizes payoff (3 > 2)
- Player 2 defective: Defection maximizes payoffs (1 > 0)

➡ Defection is the dominant strategy

Both players defect ➡ Quadrant IV (payout: 1, 1)

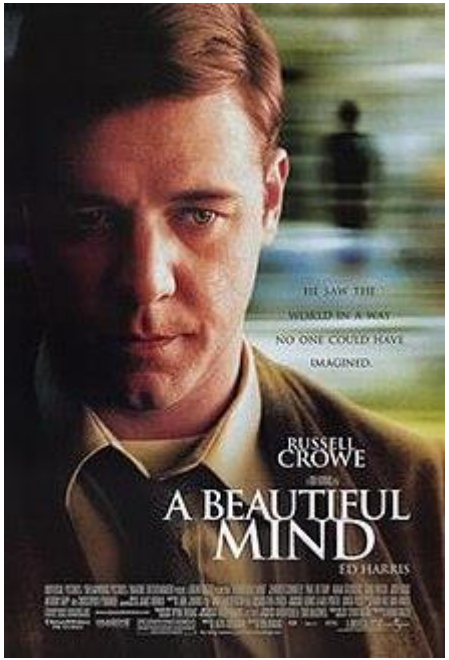
⟩ No player has an unilateral incentive to change strategy: **Nash equilibrium**

Exkurs

Film recommendation: A beautiful mind

Biographical drama about John Nash

- Tells the story of American Nobel Prize winner Nash: His innovative work on game theory in mathematics as well as how he dealt with mental illness



Prisoner's Dilemma: Evaluation (2/2)

If both players cooperate, payoff would be higher:

payoff (Quadrant I) = 2, 2 > payoff (Quadrant IV) = 1, 1

➡ Pareto-inferior Nash-Equilibrium (mutual improvement is possible)

No improvement of the situation by their own effort

⟩ Individually rational behavior leads into rationality trap:
realization of shared interests fails because of structure of interaction situation

Dilemma structures: Its application to modern business

Example: Pricing strategy of competing firms

- Two firms sell similar products; each must decide on a pricing strategy
- They best exploit their joint market power when both charge a high price (10 million each)
- If one sets a competitive low price, it wins a lot of customers away from the rival (12 million, 7 million for the rival)
- If both set low prices, the profit of each is 9 million dollars

Source: https://www.econlib.org/library/Enc/PrisonersDilemma.html#:~:text=The%20prisoners'%20dilemma%20has%20applications,ten%20million%20dollars%20per%20mont.

Relevance of Prisoner’s Dilemma?

e.g. Ken Binmore 2011:

Prisoner's Dilemma represents a situation in which dice are as loaded against cooperation as they could possibly be

➡ Can other dilemmas describe reality better?

Here: prisoner's dilemma as a paradigmatic case that makes cooperation problems salient

Source: Ken Binmore 2011: *Natural Justice*. Oxford University Press, Oxford.

Stag Hunt

Description of situation:

Two hunters can either choose to hunt hares on their own or join forces to kill a stag together

Benefits of split stag > benefit of hare

Hare can be killed alone, stag only in cooperation

If a hunter breaks the agreement to go hunting together and instead goes hunting hares, other one goes out empty handed

Generic payoff matrix: $a > b > c$

Stag Hunt: Normal Form

$Assumption$: $a > b > c$

Hunter 1 \ Hunter 2	Stag hunt	Hare hunt
Stag hunt	I a, a	II c, b
Hare hunt	III b, c	IV b, b

Stag Hunt: Results

Two possibilities:

1) Both hunters stick to agreement and cooperate
2) One player does not trust other and goes hunting hare, because he fears to go out empty handed. Possible reasons:

If difference between a and b is low ➡ Slight doubt is enough
Maximin Strategy ➡ Maximize lowest payout

⟩ Situation more cooperation-friendly than prisoner's dilemma, but mutually beneficial cooperation may still not be achieved

Battle of the Sexes

Description of the situation:

A couple would like to spend the evening together (main concern)

Two possible meeting points: Cinema and football stadium

They forgot to agree on a meeting place

Woman prefers football stadium, man prefers cinema

Generic payoff matrix: $a > b > c$

Battle of the Sexes: Normal Form

$Assumption$: $a > b > c$

		Woman: Cinema	Woman: Stadium
Man	Cinema	I a, b	II c, c
	Stadium	III c, c	IV b, a

Battle of the Sexes: Results (1/2)

Two Nash equilibria in pure strategies:

Quadrant I	Quadrant IV
If woman goes to stadium, it is also best for man to go to stadium	If man goes to cinema, it is also best for woman to go to cinema

➡ no dominant strategy

Cooperation fails if:
Both go to their favorite place OR
Both want to do other a favor

Battle of the Sexes: Results (2/2)

Interest to coordinate is entangled with a distribution conflict
➡ No pure coordination game

Clearly diverging preferences regarding coordination solution
➡ Connection of converging and diverging interests

⟩ Incentive structure suits reality: Often we want to get together with others, but have different ideas about specifics

Overcoming Dilemma Structures (1)

Task of Business Ethics:
Identify factors that prevent or would facilitate cooperation for mutual benefit.

Constitutional Perspective: Buchanan here sees the state as a social institution that is established through a collective act of exchange

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Example: Traffic Offenders (1/2)

Analysis using Prisoner's Dilemma:

Situation A:
Player 1 (traffic offender) breaks traffic rules
Player 2 (other road users) sticks to it
➡ Quadrant III

Situation B:
Constancy of the behavior of others leads to change in behavior of Player 1
➡ Quadrant I

Player 1 \ Player 2	cooperate	defect
cooperate	I b, b	II d, a
defect	III a, d	IV c, c

$Assumption: a > b > c > d$

Example: Traffic Offenders (2/2)

Result: Consensus of behavioral change fails because

$$Utility\ (Player\ 1, Quadrant\ III) > Utility\ (Player\ 1, Quadrant\ I)$$
$$or\ a > b$$

➡ Traffic offender is better off, if he breaks the rules while everyone else sticks to them

⟩ Therefore, unilateral behavioral changes fail to pass a consensus test

Ability to Approve

Instead: constitutional consensus test asks for ability to approve of rules

> Is a general violation of rules preferred over a of general compliance of rules?

Example of the traffic offender: general rule violation = Quadrant IV

$$Utility\ (Player\ 1, Quadrant\ III) > Utility\ (Player\ 1, Quadrant\ IV)$$
$$or\ b > c$$

⟩ Crucial: comparison between general defection (**status quo minor**) and general cooperation (**Pareto-better alternative**).

Overcoming Dilemma Structures (2)

More potential solutions – some factors that facilitate cooperation:

- Iteration
- Communication
- Change of payoff matrix (e.g. introduce reward: reduce the cost of cooperation; introduce penalty: increase the cost of defection)
- Non-rationality, non-self-interest of individuals

For fun: How individuals communicate & decide in reality

Example from the game show *Split or Steal*

		Player 2: split	Player 2: steal
Player 1	split	I 50, 50	II 0, 100
	steal	III 100, 0	IV 0, 0

https://www.youtube.com/watch?v=7FbkwrhW_0I

Game Theory and Behavioral Evidence

- Game theory could be treated as a normative theory that tells people what they ought to do if they wish to act rational in strategic situations
- BUT there is not always one strategy that can be recommended and assures highest payoffs (for everyone)
- Has game theory indeed helped empirical researchers make new discoveries about human behavior?

Source: Stanford Encyclopedia of Philosophy

Experimental Economic Research…

…as method for Business Ethics

Actual behavior of actors can be examined within context of economic incentives

No "cheap talk" (like in hypothetical surveys), actual behavior is observed instead of mere statements of intent

Method to put implementability of desired moral actions under conditions of modern societies to test

Some results from experimental Economic Research

- Experimental economic research has drawn attention to a number of factors that traditional economics has so far neglected in its theory formation.

For example:

- **Fairness considerations** in ultimatum game (Güth et al., 1982)

→ Offers of less than one-fifth of the total amount tend to be rejected with a likelihood of approximately 50 % (Fehr & Schmidt, 2001)

Conclusion

- The concept of rationality plays a central role in economic decision theory.
- There are different result-oriented concepts of justice (i.e., different welfare functions) and process-oriented conceptions of justice.
- The Pareto principle is seen as a prominent test procedure for social conditions.
- Dilemma structures are a central aspects of modern business ethics.

Quiz time

(Questions concerning the lectures on the (philosophical, and economic) foundations and tools of Business ethics)

Question 1

What does descriptive ethics deal with?

a) It deals with the meaning of ethical terms, the nature of moral discourse and the foundations of moral principles.

b) It deals with the description and explanation of normative systems.

c) It deals with criteria of what is morally right and wrong.

d) It deals with the application of ethics to real-world problems.

Question 1 – correct answer

What does descriptive ethics deal with?

a) It deals with the meaning of ethical terms, the nature of moral discourse and the foundations of moral principles.

b) It deals with the description and explanation of normative systems. ✅

c) It deals with criteria of what is morally right and wrong.

d) It deals with the application of ethics to real-world problems.

Question 2

What is NOT correct about Consequentialist Ethics?

a) Its practical implementation is limited since, for example, it is difficult to determine the outcomes of actions.
b) It may contribute to injustice by sacrificing the happiness of an individual to maximize aggregated happiness.
c) It puts excessive demands on the individual because every single decision becomes a moral issue.
d) It emphasizes means over the end.

Question 2 – correct answer

What is NOT correct about Consequentialist Ethics?

a) Its practical implementation is limited since, for example, it is difficult to determine the outcomes of actions.
b) It may contribute to injustice by sacrificing the happiness of an individual to maximize aggregated happiness.
c) It puts excessive demands on the individual because every single decision becomes a moral issue.
d) It emphasizes means over the end. ✅

Question 3

Which statement about the veil of ignorance is WRONG?

a) It is a realistic description of how people reason.

b) It is a thought experiment.

c) It was invented by John Rawls.

d) It is a concept from contract theory.

Question 3 – correct answer

Which statement about the veil of ignorance is WRONG?

a) It is a realistic description of how people reason. ✅

b) It is a thought experiment.

c) It was invented by John Rawls.

d) It is a concept from contract theory.

Question 4

What does Gossen's First Law describe?

a) Total benefit of a good decreases with increasing consumption

b) Marginal benefit of a good decreases with increasing consumption

c) Total benefit of a good increases with increasing consumption

d) Marginal benefit of a good increases with increasing consumption

Question 4 – correct answer

What does Gossen's First Law describe?

a) Total benefit of a good decreases with increasing consumption

b) Marginal benefit of a good decreases with increasing consumption ✅

c) Total benefit of a good increases with increasing consumption

d) Marginal benefit of a good increases with increasing consumption

Clarification of why b is correct answer here:
Gossen's First Law states that the utility derived from each additional unit of product diminishes.
Why a/c is false: Yes, the total benefit of a good could decrease or increase with increasing consumption (see: https://www.google.com/search?q=gossens+first+law&rlz=1C1GCEU_deDE869DE869&sxsrf=AJOqlzVteIwNSgQI6WZMUrIlXb6dF6Gdrg:1673961121627&source=lnms&tbm=vid&sa=X&ved=2ahUKEwjpvpaQ1878AhXXgP0HHaltBCEQ_AUoBHoECAEQBg&biw=1164&bih=560&dpr=1.5#fpstate=ive&vld=cid:6f0ba7e2,vid:RBM4GA3WiDs), but this is not what Gossen's First Law is about.

Question 5

Which of the following do NOT exhibit dilemmatic structures?

a) Stag hunt

b) Battle of the sexes

c) Pure coordination game

d) Prisoners' dilemma

Question 5 – correct answer

Which of the following do NOT exhibit dilemmatic structures?

a) Stag hunt

b) Battle of the sexes

c) Pure coordination game ✅

d) Prisoners' dilemma

Thank you for your attention!