Ethical Economy. Studies in Economic Ethics and Philosophy

Christoph Luetge
Johanna Jauernig *Editors*

# Business Ethics and Risk Management

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# Introduction: Business Ethics and Risk Management

After the outbreak of the economic crisis, the immediately following search for culprits quickly resulted in pillorying a specific professional group: the risk managers of the financial industry. As was (and still is) commonly believed, risk managers have been juggling unscrupulously with figures and numbers until even most hazardous financial risks looked like safe and sound investments. This description may be superficial and polemic to a great extent, but it highlights the fact that risk calculation is not only a question of financial benefit, but an ethical question too. Consequently, the responsible businessman should not only calculate financial or technical ventures, but also ethical risks.

Issues of moral risks in general have become more and more important over the last decades. First, growing awareness among citizens of social or ecological problems such as the green movement, the antinuclear movement, or various antiwar movements has given more weight to ethical concerns in business. Second (and closely related), different corporate scandals proved that ethical risks can turn into economic risks in an instant.

Scandals ranging from the Ford Pinto Case in the 1970s to the Madoff investment fraud or the Fukushima nuclear disaster can serve as examples of how closely intertwined ethical and economic issues can be. It is not only the outright breach of law followed by sanctions that a thoughtful businessman must seek to avoid, but also the heavy reputation losses that can occur even if the company's conduct lies within the legal framework (e.g., weapon supply to autocratic states). So it is in the companies' very own interest to consider ethical risks. Especially under conditions of globalization, these matters are greatly aggravated: In the global regulatory framework, gaps emerge in many places. These spaces need to be filled with a responsible, risk-considering entrepreneurial conduct.

But there is more to the risk management of a responsible businessman than avoiding harmful externalities. Especially in our modern economy, in a world where positive-sum games are played, it positively becomes a moral obligation for a businessman to take entrepreneurial risks. Making business essentially consists of risk taking. Without it, no company can flourish or even survive in the long run. Reflecting on the work of Adam Smith, one could argue that it is precisely the

entrepreneurial risk taking that we expect our dinner from. Thus, within a (well-functioning) order-framework, making profit, which is not possible without risk taking, becomes a moral obligation.

This line of thought is explored further in the first section by Christoph Luetge's chapter "Risk Taking and the Ethics of Entrepreneurship."

The second section of the volume deals with risk management in the context of financial markets. Elena Esposito argues that under conditions of risk, a complex ethical attitude is needed which abandons the idea of principles of behavior that allow to univocally distinguish a good position from a bad one. However, types of behavior should be signaled that reduce the variety of future possibilities. In his chapter on the Madoff investment fraud case, Boudewijn de Bruin argues that financial due diligence complemented by epistemic virtues can be an effective shield against financial crime.

Risk management in organizations is the subject of the third section. Jacob Dahl Rendtorff analyzes how Hannah Arendt's concept of moral blindness can be applied to spot administrative evil in organizations and corporations in relation to a kind of risk management that is blind to the moral consequences of management decisions. Cristina Besio also examines risk management in organizations. She examines, from a sociological point of view, the functional role of moral communication in dealing with risks that arise in uncertain situations characterized by conflicts and divergent opinions about specific technical issues. In his contribution, Matthias Gronemeyer holds the assumption that uncertainty and risk are irreducible. The risk of economic failure, he argues, cannot only be kept at bay by a framework of rules and laws. What is needed in addition is the "economically mature citizen" who is capable of combining several moral principles in order to yield the desired limitation of risk in business.

In the next section, philosophical issues of risk management are explored. Thomas Beschorner appeals to the individual as a moral actor. In order to foster good business practices rather than only avoid harm, he argues that the moral agent has to be brought back into play, and institutional measures need to be reflected to promote Corporate Social Responsibility. Nikil Mukerji takes one step back and analyzes what underlies many business relations and contracts – the reliability of promises. In his chapter, he analyzes the consequentialist and deontological views on the matter.

In the last section, risk management is examined on the basis of case studies. Risk in an area where failure may lead to hazardous events is the topic of Julie Jebeile's chapter. Using the example of the Fukushima nuclear disaster, she shows how imperfect epistemic control on nuclear power plants and group inertia in decision making and action led to the catastrophe. Nguyen Hoang Anh applies the problem of risk to a specific example. She depicts how the global international crisis has affected the economy of Hanoi where international trade plays a key role.

Christoph Luetge
Johanna Jauernig

# Part I
# Risk Management and Risk Taking

# Risk Taking and the Ethics of Entrepreneurship

**Christoph Luetge**

## Introduction

In his famous article published in 1905, "the Protestant ethics and the spirit of capitalism", Max Weber (1905/2005, 29) described the situation of the continental European textile industry until around 1850: "The number of business hours was very moderate, perhaps five to six a day, sometimes considerably less; in the rush season, where there was one, more. Earnings were moderate; enough to lead a respectable life and in good times to put away a little. On the whole, relations among competitors were relatively good, with a large degree of agreement on the fundamentals of business. A long daily visit to the tavern, with often plenty to drink, and a congenial circle of friends, made life comfortable and leisurely."

This was, according to Weber, capitalist economy only according to its form, but not according to its spirit. Its spirit was still that of a traditionalist economy, with its lifestyle, the traditional modest profit that was mutually accepted, and the traditional daily measure of work.

However, this comfort zone was suddenly disturbed, when a new entrepreneur appeared who paid much more attention to the customers, and tailored products to their needs and wishes. It was then that the spirit of modern capitalism entered the arena. However, this entrance was not an easy one, as the entrepreneur found himself opposed by a wave of suspicion, even hatred, and moral outrage.

Weber believed that only a certain character of entrepreneurs could prevent them from failure in business, a strong character that included clarity of vision, energy and, maybe most important, certain ethical qualities. Among them, Weber counted a kind of sober modesty: the new type of entrepreneur was supposed to be averse

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to unnecessary effort; he could rather be seen as an ascetic, not living in luxury. According to Weber, it was primarily this specific ethos that led to the rise of the Occident, indeed to the rise of the entire capitalist economy. To pre-capitalist man, this ethos was completely incomprehensible: for him it was totally baffling, even despicable, how anyone could regard it as the only aim of his life to "to sink into the grave weighed down with a great material load of money and goods" (Weber 2005, 33). Pre-capitalists could only explain this as the "product of a perverse instinct, the *auri sacra fames*" (Weber 2005, 33).

So it was Weber's thesis that a certain ethos was driving capitalism. As historical evidence, however, has shown, this thesis can no longer be maintained (cf. e.g. Luetge 2012a). There are a lot of other situational conditions and constraints to be taken into account, too. A specific ethos, even coupled with a certain (Protestant, Calvinist) religion, cannot any longer be seen as the main factor, for empirical and theoretical reasons.

However, it can still be asked how ethics can be connected, in a forward-looking and innovation-promoting way, to entrepreneurship. Usually, ethics is seen as a means of slowing down, of deceleration – to put it bluntly: as a brake. It asks for moderate profits, for satisficing instead of maximising, for avoiding risks altogether, for putting limits and boundaries to the otherwise unleashed economy. Yet, as I will argue, an ethics for dynamic societies should also *encourage* risk-taking.

This ambivalent nature of ethics with regard to entrepreneurship is somehow expressed in the words from Thomas Mann's "Buddenbrooks", written in (Mann 1901/1998), where the old Lübeck merchant gives as advice to his son and future owner:

> "My son, enjoy doing business during the day, but only the kind of business that allows us to sleep peacefully at night." ("Mein Sohn, sey mit Lust bey den Geschäften am Tage, aber mache nur solche, daß wir bey Nacht ruhig schlafen können.")

This quote is not a simple call for conducting one's business in a moderate way (sleeping peacefully at night), but also for *enjoying* doing business at day. This implies taking risks in order to expand one's company, and not just aiming for moderate profits. It is what the merchants of the Hanseatic League, in Lübeck and elsewhere, had been doing for centuries, but which got lost or at least reduced in some companies, as the story of the "Buddenbrooks" tells.

Ethics should promote risk taking and the entrepreneurial spirit, not only in the economy, but in all parts of society. To argue in favour of this, I will proceed as follows: section "Definitions of Entrepreneurship" will give an overview of some definitions of entrepreneurship. Sections "Risk Taking and Entrepreneurial Spirit" and "Competition and Entrepreneurial Spirit" will discuss the link of risk-taking and competition, respectively, to the entrepreneurial spirit. Section "Risk in Experimental Economics: A Cross-Cultural Perspective" relates the ethics of risk-taking to experimental findings, and section "Consequences for Ethics" draws some consequences of the present deliberations for ethics in general, leading to a short epilogue.

## Definitions of Entrepreneurship

Economists have defined the concept of entrepreneurship in different ways. The concept originated in France, already during the late Middle Ages. In the eighteenth century, the early Irish economist Richard Cantillon defined it as "self-employment of any sort. Entrepreneurs buy at certain prices in the present and sell at uncertain prices in the future. *The entrepreneur is a bearer of uncertainty*." (Cantillon 1755/1931, written around 1730).

In 1816, Jean-Baptiste Say called the entrepreneur "the agent" who unites all means of production and who finds in the value of the products which result from them, the reestablishment of the entire capital he employs, and the value of the wages, the interest, and rent which he pays, as well as profits belonging to himself."(Say 1816, 28 f.)

One of the most famous characterisations has been provided by Joseph Schumpeter (2008, 83), who wrote that there is "a process of industrial mutation – if I may use that biological term – that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. *This process of Creative Destruction is the essential fact about capitalism* . . . ". The metaphor of creative destruction has since then been used to characterize not only the activities of the entrepreneur themselves, but the entire process of the market economy.

Ludwig von Mises (1996, 585), in his treatise first published in German as "Nationalökonomie, Theorie des Handelns und Wirtschaftens" (Genf 1940), places particular emphasis on the difference between entrepreneurs and other people:

> What distinguishes the successful entrepreneur and promoter from other people is precisely the fact that he does not let himself be guided by what was and is, but arranges his affairs on the ground of his opinion about the future. *He sees the past and the present as other people do; but he judges the future in a different way*.

Mises' tradition has been continued within the Austrian School of Economics. One of their main contemporary proponents, American economist Israel Kirzner (1997, 72/69), connects entrepreneurship and discovery:

> An entrepreneurial attitude is one which is always ready to be surprised, always ready to take the steps needed to profit by such surprises. The *notion of discovery*, midway between that of the deliberately produced information in standard search theory, and that of sheer windfall gain generated by pure chance, is central to the Austrian approach.
>
> The entrepreneurial role: In standard neoclassical equilibrium theory there is, by its very character, no role for the entrepreneur. In equilibrium there is no scope for pure profit: there is simply nothing for the entrepreneur to do.

And in a similar spirit, Jeffry Timmons (1994, 7) linked entrepreneurship to creativity and vision in an even more general sense:

> Fundamentally, *entrepreneurship is a human creative act*. It involves finding personal energy by initiating and building an enterprise or organization, rather than by just watching,

> analyzing, or describing one. Entrepreneurship usually requires a vision and the passion, commitment, and motivation to transmit this vision to other stakeholders, such as partners, customers, suppliers, employees and financial backers.

Entrepreneurship is, therefore, not only for a special group or class of people. This is what M. Yunus (2006) is convinced of: "All people are entrepreneurs, but many don't have the opportunity to find that out."

Creativity and discovery, thus, are two main elements of entrepreneurship. However, risk-taking must be added to them. The point that entrepreneurship crucially implies taking risks has been particularly stressed by Frank Knight (1921/1971) and Peter Drucker (1985). It is present in most of the definitions above in that they highlight that creative role of the entrepreneur.

In recent years, risk management has become an important task for corporations and entrepreneurs. It is pivotal, first, for the economic aspect: Enterprises should be successful not only in the short, but also in the long run. This idea is highlighted today by the many approaches to sustainability, which encompass nowadays not only the classical issues of sustainability in production, resources or in the supply chain, but also sustainable innovation, sustainability marketing (Belz, Peattie 2012), and others.

But risk management is also a key factor for the ethical aspect of the corporation: especially large corporations must reckon with the possibility of ethical risks. Such ethical risks may arise in problems like corruption, discrimination, working conditions or employee management. And sooner or later, such ethical risks can easily become economic ones, mostly via one of the following ways: either certain actions by the corporation cause damages to its reputation, which in turn leads to reduced sales. Prominent examples of this are Arthur Andersen, which had to go out of business after its reputation was severely damaged during the Enron scandal in 2001, or the major reputational losses Toyota and Goldman Sachs suffered in 2010.

The second way involves corporations being heavily fined for violating certain laws and standards. In recent years, fines have become significant even for large corporations not only in the US, but in Europe and countries like Germany, too. For example, after its corruption scandal, Siemens had to pay about one billion Euros in fines. ThyssenKrupp, in 2007, was obliged to pay a fine of almost half a billion Euros by the European Commission, for illegal price fixing. And even seemingly smaller and more 'innocent' industrial sectors like vitamins have given cause to fines as large as 790 million Euros in 2001, again by the European commission. It thus becomes clear that even for large multinationals, legal fines due to ethically inacceptable behaviour are a serious economic risk.

## Risk Taking and Entrepreneurial Spirit

Ethical risks make risk management necessary. But what is often overlooked, is the fact that not taking risks can be an ethical risk, too. True, in terms of classical risks, most are aware of the thumb rule according to which any action is better than

no action. But in the field of ethics, most approaches and thinkers call mainly for reducing risks, limiting them – and not seeking new ones. A rare counter-example is philosopher Christoph Hubig (2007, 102), who pointed to the fact that not taking alternatives into account can be a risk factor, too, and that new chances should always be seen in relation to risks. He calls for understanding risk management as the flip side, or even as just one aspect of *opportunity management*. For ethics, this would imply quite a radical turn.

However, the idea is not totally new. There is a famous story in the Bible, the Parable of the Talents (Mt 25, 14–30 and Lk 19, 12–27), which tells the following story (here according to Luke):

A master is preparing to leave his house to go on a long journey. He calls his servants and entrusts them each with the same amount of money, telling them to do business with it until he comes back. After his return, the master demands an accounting of his servants. The first of them has managed to generate the tenfold, and he is greatly rewarded by the master. The second servant has generated the fivefold and is also rewarded, in relation to his achievement. The last one however hands the master his money back, telling him that he just hid it because he was afraid of losing it and being punished. Far from being satisfied, the master now is particularly angry. In the version of Matthew, he says:

> You wicked and slothful servant. You knew that I reap where I didn't sow, and gather where I didn't scatter. You ought therefore to have deposited my money with the bankers, and at my coming I should have received back my own with interest. Take away therefore the talent from him, and give it to him who has the ten talents. For to everyone who has will be given, and he will have abundance, but from him who doesn't have, even that which he has will be taken away. Throw out the unprofitable servant into the outer darkness, where there will be weeping and gnashing of teeth. (Mt 25, 26–30)

Many theologians have tried to interpret this parable as something else than a case for entrepreneurial spirit and profit maximisation. It has been said the parable is meant in a metaphoric sense rather than in an economic one, implying that one should not hide one's talents. Certainly, the story does have this aspect, too. But it can hardly be denied that the parable is against moderation, against being content with moderate success, against merely satisficing rather than maximising one's utility. It is a clear call for investing, in entrepreneurial qualities, which we in principle all have, as the parable seems to imply.

Moreover, the means for generating this investment are also mentioned, as a competitive process is put to work between the servants. And in the end, some clearly end up with having more than others, an outcome that is regarded as neither unjust nor inevitable, but as the result of entrepreneurial action, as the return on an investment. And those who turn out not to be sufficiently productive, end up with losing all they got. Therefore, the Parable of the Talents can be understood as a call for controlled risk-taking.

## Competition and Entrepreneurial Spirit

In a famous article, "Competition as a Discovery Procedure", Friedrich August von Hayek (1978) lists the main advantages of competition. Hayek puts forward not an unconditional, but a functional argument in favour of competition: He insists that competition creates broadly distributed wealth, because

(a) it sets incentives for creativity and fosters innovation by pioneers,
(b) it disciplines the competitors and
(c) it enables the quick spreading of new ideas and problem solutions.[1]

In this way, competition, however, mainly creates *pressure*, not freedom. The idea of the market as primarily an expression of freedom (Friedman 1962) is misleading.

Another point that has been added mainly by German economists Walter Eucken (1949) and Franz Böhm of the Freiburg School is that competition is an efficient tool for destroying and eroding temporary positions of power.

Hayek himself, however, also points to the disadvantages of competition[2]: The market aims only at efficiency, not at "social justice". Even if Hayek regards social justice as an empty concept, a mirage, he is still in favour of correcting some results of the market, for example, doing something for the poor, like establishing minimum standards of living. Other disadvantages are the (seemingly wasteful) simultaneous developments of several competitors and the problem of 'losers': who are the 'losers' of competition, are there short-term as well as long-term 'losers' (and how can those be compensated)? Finally, luck plays a significant role in competition, too, not just merit and 'needs'. If it should be 'needs' alone that count (whatever these needs are), then ethics and competition cannot go together.

A general solution to the ethical problem of competition could be the classical Smithian idea that morality can be found in the rules of competition: Morality gets implemented on the level of rules, while competition takes place on the level of individual actions. So first, we have to distinguish between rules and actions.

When all competitors are subject to the same rules, no one can gain an advantage by failing to adhere to standards at all or by sticking to 'lower' standards than his competitors. All sorts of examples can be found for this, from tax laws to ecological protection.[3]

A possible counter argument could ask whether too much competition can be a bad thing too. Certainly, *unrestricted* competition can negate the advantages – but this is not a simple question of too much or too little competition. Certain parameters of competition must be restricted, like fraud or blackmail; if we allow for

[1]This is Hayek's well-known argument against the possibility of a central planning authority, which, he argues, could never amass nor manage the amount of information necessary to produce and distribute the goods.

[2]In the same vein, Schumpeter's (1942) use of the (originally Marxist) term "creative destruction" is equally ambivalent.

[3]Cf. the examples given by Pies, Winning, Sardison, Girlich (2009).

these, competition leads to undesired results. However, after these parameters have been set, then competition should be strict and might lead eventually to the ruin of (less productive) competitors. This is the consequence of the market economy as an economic system.

According to Harvard historian Niall Ferguson (2010), competition is also one of the killer applications that "the West" developed but other cultures (originally) lacked. Globalisation, then, is a process of others appropriating these killer applications gradually. However, from an intercultural perspective, competition has always been present in non-European cultures, albeit in different forms: For example, while ancient China has traditionally been regarded as anti-competitive and stuck in traditions (Jones 1981), some findings contradict this:

For example, China was conducting highly competitive exams for civil servants. Starting in the seventh century, these exams required the knowledge of canonical Confucian texts. The candidates had to know central books of Confucianism, like the "Analects", the books of Mencius and five others like the "Book of Songs", the "Book of History" and so on. While in the beginning, some elements of these exams still favoured certain groups, especially the aristocracy, these were eventually abolished completely, leaving only a purely knowledge-based exam. This was a highly competitive system, which in Europe at that time can be compared only to (some) religious orders. It was however not a case of classical economic competition on 'ordinary' markets.

The upshot of this is: Competition is not an exclusively economic concept. Of course, economists define it and try to develop conditions for good and bad competition. But we find forms of competition quite different from the ones usually discussed in economics, forms that might be more acceptable to critics of capitalism: in sports, in chivalry, in auctions, in other cultures like ancient China, and even in 'socialist competition':

For example, Lenin was not against competition: There is a 1917 speech in which he goes as far as saying that capitalism *destroys* competition and that socialism is in favour of competition by breaking up monopolies:

> ( . . . ) capitalism long ago replaced small, independent commodity production, under which competition could develop enterprise, energy and bold initiative to any considerable extent, by large- and very large-scale factory production, joint stock companies, syndicates and other monopolies. ( . . . ) competition is replaced by financial fraud, nepotism, servility on the upper rungs of the social ladder. (Lenin 1917)

Socialism, according to Lenin, does *not* aim at doing away with competition:

> Far from extinguishing competition, socialism, on the contrary, for the first time creates the opportunity for employing it on a really *wide* and on a really *mass* scale, for actually drawing the majority of working people into a field of labour in which they can display their abilities, develop the capacities, and reveal those talents, so abundant among the people whom capitalism crushed, suppressed and strangled in thousands and millions. (Lenin 1917)

The task of a socialist government is to organise competition: "Now that a socialist government is in power our task is to organise competition" – and the elimination of monopolies "is the opportunity created for the truly mass display of enterprise, *competition* and bold initiative"(my italics).

It is true that Lenin wanted competition mainly to take place within the organisation and administration, but he still advocates competition of some sort:

> (. . . ) we must organise the accounting and control of the amount of work done and of production and distribution by the entire people, by millions and millions of workers and peasants. (. . . ) And in order to organise this accounting and control, which is *fully within the ability* of every honest, intelligent and efficient worker and peasant, we must rouse their organising talent, the talent that is to be found in their midst; we must rouse among them – and organise on a national scale – *competition* in the sphere of organisational achievement . . . Competition must be arranged between practical organisers from among the workers and peasants. Every attempt to establish stereotyped forms and to impose uniformity from above, as intellectuals are so inclined to do, must be combated.

One of the most important theorists of Marxism is in favour of competition – and this is very much reminiscent of a quote from British Business Secretary Vince Cable: "Capitalism takes no prisoners and kills competition where it can." (Cable on 22nd Sept 2010) This is a criticism of capitalism that even an advocate of the market economy could subscribe to: It is immoral for a company to actively fight competition. It is not immoral to fight competitors within the boundaries allowed by the rules of competition, but from the ethical point of view outlined here, turning against the system of competition itself should be seen as unethical.

For example, a former monopolist that envisages competition in the future should not actively engage in preventing competition, lobbying against it or taking steps to discourage potential competitors from taking part in it. It would be ethical, however, to prepare one's company for the future market and taking steps to increase the efficiency of production processes and so on.

## Risk in Experimental Economics: A Cross-Cultural Perspective

In recent years, the field of experimental economics has become a very fruitful resource for business ethics. Ethicists should not overlook experimental findings, concerning, e.g., moral attitudes, moral perceptions or conceptions of justice. Certainly, values cannot be derived directly from facts, but this does not mean that facts have no bearing or no implications for values. In particular, there are "bridge principles" between descriptive and normative aspects, like "Ought Implies Can".[4] The facts do not stand for themselves in ethics but are in need of interpretation – yet certainly they gain relevance for normative questions.

On the topic of risks which is central to the relation of ethics and entrepreneurship, a number of authors in experimental economics and psychology have conducted studies on comparing risk attitudes between different countries, some of which will be listed here:

[4]Cf. Luetge, Vollmer (2004). See also, for its consequences to business ethics, Luetge 2005 and 2006.

1. Four studies relied on questionnaires: In 1994, Rohrmann conducted a study using population samples from Australia, Germany and New Zealand. He found that differences for risk ratings are greater between different groups in society than between different nationalities. In 1999, the same author conducted another study comparing student samples in China and Australia. The results showed that Chinese were less prepared to take risks than the Australians. In particular, the risk attitudes differed in 'morally questionable' areas like gambling, illegal drugs or unsafe sex. See also (Rohrmann 2006).

   Third, Weber and Hsee (1998) used student samples to compare risk perceptions in financial settings between the US, Germany, Poland and China. The perceptions differed considerably, but in all countries less risky options were generally preferred.

   Fourth, the study of Kloeb et al. (2009) analysed the attitudes of more than 900 people from ages 14 to 20 in Turkey and Wales. While their risk-taking behaviours differed, the motives for risk-taking were very much the same.
2. In a meta-analysis, Boholm (1998) compiled studies from different countries. Her findings showed that US, France, Poland, Hong Kong and Japan do not significantly differ in risk magnitude. However, Russians were found to have much lower risk magnitude ratings than US citizens.
3. Three other studies relied on survey data (primarily from the GSOEP) for looking at issues of risk-taking among immigrants: Bonin et al. (2006) found that, in Germany, immigrants of the first generation are more risk averse than Germans. However, this difference disappears in the second generation. Constant and Zimmermann (2006) showed that immigrants are more willing to take risks in that they are more likely to be self-employed. In Jaeger et al. (2010)'s study, people with lower risk aversion were found to be more likely to migrate, at least within a country (Germany, in this case).
4. Finally, a study on 35 firms by Griffin et al. (2009), using data from 1997 to 2006, found that cultural variables, in particular, culture-specific avoidances of uncertainty, have both direct and indirect influence on attitudes towards risk on the company level and should not be underestimated.

These findings cast substantial light on the issues of risk taking and ethics.

## Consequences for Ethics

The arguments I have brought forward here have consequences for ethics in a number of ways. First, ethics should cooperate more intensely with other disciplines, and not merely regard itself as a theoretical enterprise mainly concerned with language philosophy, linguistics or deontic logic. As K. Appiah (2010) recently stressed, many great philosophers of the past have ventured into the empirical realm as well – without ceasing to be great philosophers. Some paradigms of ethics, especially at least some strands of Analytic Ethics would benefit from an enriched perspective on social and economic phenomena.

Second, major ethical categories might be reinterpreted with the perspective in mind that I have developed here. *Duty* can be reinterpreted not as being categorically opposed to self-interest, but as an encouragement for (long-term) investments in one's (long-term) interest. Duties to act in a specific way might be taken as a heuristic tool for long-term commitments to specific practices, standards or values – and these are not meant in a financial sense only.

The old philosophical (Aristotelian) concept of *phronesis* might be interpreted as wise economic *and* ethical balancing, as economic calculation in a wider, but not necessarily altruistic perspective, as a way of doing well by doing good. More examples could be given.[5]

## Epilogue

Just as the idea of the honest business man is embodied in the "Buddenbrooks" as mentioned above, the general idea of ethics and economics as partners can be found in Thomas Mann's writings as well. In the final part of the tetralogy "Joseph and His Brothers", "Joseph the Provider" (Joseph der Ernährer), the biblical Joseph is presented as the honest economic politician, who administrates Egypt for the Pharaoh in a wise way, "with a system that combined exploitation of the economic situation with benevolence" (in Original: "ein zusammengesetztes System von Ausnutzung der Geschäftslage und Mildtätigkeit", Mann 1943/2004, 308).

He gives seeds to the poor who cannot afford them, but sells seeds to the rich, "stipulating that they bring their irrigation systems up-to-date and refusing to allow them to continue to bungle along in feudal backwardness . . . " (in Original: "nicht ohne ihnen zur Auflage und Bedingung zu machen, daß sie ihr Bewässerungssystem auf die Höhe der Zeit brächten und es nicht länger in feudaler Rückständigkeit dahinschlampen ließen", Mann 1943/2004, 310) And Joseph is finally – in a manner almost reminiscent of Adam Smith – called "no divine hero, no messenger of spiritual salvation, but merely a man of business . . . " (in Original: "kein Gottesheld und kein Bote geistlichen Heils, sondern [ . . . ] nur ein Volkswirt" (Mann 1943/2004, 410).

That would be an ideal to achieve.

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[5]Cf. Luetge (2012b, 2013) as well as Homann (2002).

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# Part II
# Risk Management on Financial Markets

# The Present Use of the Future: Management and Production of Risk on Financial Markets

**Elena Esposito**

## Reference to Ethics and Intransparency of the Markets

The debate on ethics, both in the academy and in public opinion, in recent times increasingly refers to financial markets. And these markets present at the same time evident problems of control and management, which tend to extend to the economy as a whole and apparently don't find a solution. In front of the crisis in recent years, and especially in front of the attempts to react to it, the awareness spreads that we don't have the proper tools not only to effectively govern finance and its movements, but not even to understand the ongoing phenomena. Never as in recent decades there was a multiplication of models that promise to control financial risk, which should therefore be prepared to face the movements of the markets, but never as in this period crisis are difficult to manage and to interpret.

Call for ethics and disorientation in the markets seem to proceed in parallel. This is hardly just a coincidence. Nobody really understands what's going on, which dynamics are developing nor how they can be controlled. In this situation the call for ethics (or the recrimination for the lack of ethics) is one of the few claims that seem to find consensus. The need for ethical reflection looks convincing, and the appeals are proliferating. This happens mostly in two dimensions.

First, and this is the most immediate aspect with nearly unanimous consensus: the accusation of the immoderate greed of operators (of speculators, traders or the CEOs of big corporations), who abandoned any measure of fairness and proportion in their quest for profit, being culpably guided only by a huge lust for profit.

Second, the call for ethics should curb the increasingly evident detachment of finance from the "real" fundamentals of the economy, from production and

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from the availability of goods. According to the accusation, in the increasingly abstract and esoteric traffic of derivatives and of the other complex instruments of structured finance any link has been lost between Wall Street and Main Street, and consequently the movements of finance proceed without control and no longer aim at the regulation and the efficiency of the real economy. Computerized and formalized finance works autarchic and self-referential – hence apparently without any constraint (partly because it doesn't want them, and partly because regulators do not have the necessary tools and do not even really understand what's going on).

The result is a widespread demonization of finance (and often even of financial operators): a sphere of society seen as tendencially parasitic, following selfishly its own purposes completely separated from the concrete living conditions and from the needs of citizens, and also from general principles of equity and solidarity. Often it is assumed that there are more or less illicit hidden interests or a lack of scruples that urgently require an external regulative intervention.

There is no doubt that a more efficient and updated regulation is needed (especially of increasingly complex and mysterious financial instruments like derivatives, and of unmanageable markets like over-the-counter trades). The point, however, is to understand which guidelines should lead a competent and effective intervention, and also to understand if in this framework the call to ethics is really advisable.

## The Goodness of Morality

From a sociological point of view many doubts immediately arise. We know since long that ethics, if we look at it in a detached (morally neutral) way, shows many difficulties, both conceptual and practical.

First one should ask if ethics really helps to take decisions, i.e. if the reference to ethics allows to decide in an ethically correct way. In sociological terms, this is expressed in the distinction between values and programs (Luhmann 1993a, 197; 1984, 432 ff): ethics formulates a series of good values (fairness, solidarity, moderation), but when one must decide it is difficult to translate them into concrete indications (into programs), i.e. to know concretely what to do. What does it mean for example that we should not be greedy? If it is simply meant that profit should not be interesting, it does not make much sense to operate in the economic area, where one must in any case circulate money. If it is meant rather that the search for profit should have limits, it is not clear where the threshold is between a correct greed and a "bad" greed, considering also that many successful operators are actively involved in philanthropic activities (think for example at George Soros or Warren Buffett). To earn much money with speculation and then to use it in charitable activities is good or bad? We must ask if the problem is speculation itself or the use of money as such (which does not concern only speculation). And above all: it is useful or harmful to moderate the search for profit when one works in finance? An ethical fund should engage actively to get profits or should restrain the search for financial success? Would it be morally better to earn less, even when the earnings are used

for good purposes? This apparent moderation would also endanger the very function of finance, which traditionally has been identified in the (positive) task to monitor the efficiency of markets and to report imbalances and malfunctions (and possibly to contribute to remove them, exploiting them in order to make profits). Without the guidance of "greed", which levels motivations and purposes, this function would require a number of additional decisions, and would become much more cumbersome and intransparent. Of course this alleged function of finance can be disputed, but this would be a different point. In this as in many other cases the principles of ethics do not give concrete indications for action.

But this is not the only problem. The fundamental dilemma of morals is well known since centuries: good intentions can have bad consequences, while morally correct intentions can lead to bad results (Mandeville). Not only greed and lack of scruples can be useful for the collective good, but in the exasperated reflexivity of finance this condition is enormously strengthened: every action and every expectation tends to produce results opposite to those desired. Observers observe first of all the other observers and derive the main information from their behavior, not from the observation of the world (Stiglitz 1985, 2003; Grossman 1981, 1989). This produces the well known paradoxes of asymmetric information[1] and especially a widespread condition of moral hazard (which not by chance refers to moral): not only does one risk more if one knows to be protected, but one exploits all regulatory measures in order to obtain additional opportunities of profit. Therefore, for example, is so difficult to design measures to protect banks in order to reassure the markets: they interpret them immediately as a signal that there is reason to worry, and tend then to use the protection to risk more (because they expect the State to intervene, but also because others do the same, and one is practically forced to raise the stakes). The (good) intention to moderate risks leads to the (bad) result to increase them in an even more uncontrolled, because even more circular way. And again: how can we recognize a good behavior, when sometimes it is apparently more effective to be bad (but presumably not when one does it with good intentions)? It is not enough to suggest to refer to consequences rather than to intentions, because consequences become unpredictable when intentions are observed: financial markets are an immense production of self-defeating prophecies (Merton 1936).

The fundamental paradox of ethics, however, is an other and even more radical one, because it calls into question a higher level of moral reflexivity (Luhmann 1997, 1039ff., 1989). The ones who urge to resort to moral do it admittedly with good intentions, i.e. assuming that morals itself is a good thing (though perhaps in a complex world it can lead to bad results) – and putting themselves on the side of the good. Further reflection, however, casts doubts on this assumption: the moralization of communication as such is good or bad? It is good or bad to orient to the distinction between good and bad? Before introducing moral distinctions a behavior is simply what it is: one makes transactions, proposes rules. When this behavior is moralized

[1] Cf. typically Akerlof (1970).

the distinction between good and bad is introduced, and this has consequences: for example, it requires everyone to locate on one side of the distinction, with the claim to despise morally the ones on the bad side. Morals forces to take position: you cannot declare something as bad without accusing it, and without putting yourself more or less explicitly on the other side. Moralizing divides the world into goods and bads. And nobody likes to be sealed as bad: the one who is accused tends to react. Moralizing tends to fix and often to oppose positions which could be much more fluid, with the inevitable production of conflicts. Moralizing, i.e., has an immediate polemogenous effect, and produces a paradox if one reflects on it: the unanswerable question if the distinction good/bad as such is good or bad.

The issue, at this point, concerns not only the effects of moral actions, but moralizing as such: ethics should consider that its intervention inevitably produces conflicts and should ask whether this effect is positive (good) or negative (bad). In some cases the conflict is wanted, with the aim of identifying bad intentions and wrong behaviors. We should however be aware that this has consequences: the conflict tends to absorb the whole of communication conveying it in a single direction and in a clear opposition of fronts (Luhmann 1984, 488ff.) – with high costs and losing many shades and much information. In the recent debate on financial markets we can ask if looking for the guilty person is really the most convenient strategy, particularly in conditions where decisions are so widespread that it is difficult to identify a real responsible, and the constraints are so strong that the intentions of the decision-maker often have little effect on the result. Moralizing polarises the fronts and neglects several other factors.

## Morals and Uncertainty

But why, given the many and well known problems of moralizing, does the call for ethics still find so much consensus – also in a technical sphere as finance? Although as we have seen morals in itself does not help to take decisions, moralizing helps when one doesn't know how to decide. In very uncertain situations there are inevitably many different opinions, because the available information does not lead univocally in a single direction; the more these decisions are considered important, though, the less one is willing to observe and to accept that others draw different conclusions (Luhmann 1993b, 368). Then one tends to attribute bad intentions or hidden interests to those who think otherwise, and this neutralizes and partly explains the different perspective. The situation is artificially simplified and the first observer is reassured, giving him a univocal reference.

This typically happens in situations of risk, in which it cannot be excluded that a formally rational decision leads to future damage, and therefore makes one repent the choice made: things can go wrong, we already fear it today, and we know that in that case we will blame the present decision. Since the possible damage is in the future, and the future is still not there, no one can know with certainty how things will be, and the decision is always uncertain. Avoiding risks produces other risks and

every choice is the (risky) selection of a risk with respect to another, not of risk with respect to security (Luhmann 1991b, 28ff.). If the decision is taken by someone else, moreover, the willingness to accept risks is even smaller: in situations of risk a well-known phenomenon of double standard has been observed, which means that one is much less tolerant of the possible harmful consequences of the decision of others then of the consequences of one's own decision – of passive smoking compared to one's own choice to smoke, for example.

Then we often tend to moralize – especially when the feared consequences are catastrophic and the perspective of the decision-maker is intransparent. The case of financial markets is exemplary: anonymous and often mysterious people take every day uncertain decisions which may have heavy consequences. Moralizing the greed of the decision-makers or the conflict of interest helps to have a reference in this highly insecure situation, and also allows to neglect "in good conscience" the multitude of other factors involved.[2] One finds an easy and widespread consensus, but theoretically weak and empirically inadequate, especially considering the complexity of current financial markets, which developed in such a way as to make elusive even the attribution of guilt and of correct behavior.

## The Morality of Debt in Risk-Neutral Markets

The financial markets of the last decades are very mysterious. One of the great mysteries is what actually is bought and sold in the hectic traffic of their transactions. In front of markets which move a mass of capital that exceeds by 20 times the entire world GDP, it is clear that trade does not refer to specific goods and services: even if they were all available, they still would not be sufficient to repay the circulating breathtaking figures. But then what is at stake: which kind of "wealth" is created or even burned in the frantic trade of finance?

Since the renunciation of the Bretton Woods agreements, financial uncertainty has greatly increased – with good and evil consequences: on the one side the lack of the more or less symbolic constraints that until the early 1970s ruled (and partly assured) the traffic of capital, but on the other side the rise of new opportunities to exploit and commercialize this uncertainty. Not by chance in the following decades have been elaborated the complex techniques of structured finance and new ways to work with instruments such as derivatives, which deeply changed the processes but also the object of financial transactions. As many observers say (Arnoldi 2004; LiPuma and Lee 2005; Pryke and Allen 2000.), the "new finance" of recent decades is new first of all because it has become evident that it is directly risk that is sold and resold on the markets – an abstract and formalized risk, objectified and

[2]Sinclair (2010) argues that in the case of rating agencies the conflict of interest is a much less plausible explanation than commonly thought: the reasons of the unreliability of the assessments are deeper and more complex.

"commodified" (Bryan and Rafferty 2007, 136) with the use of refined techniques such as the models to compute and manage volatility.[3] The markets sell volatility; volatility, which is a measure of the turbulence and unpredictability of the markets, stands for risk; the esoteric markets of structured finance, then, actually sell risk.

Also the relationship with risk, however, has changed: portfolio management models are models of risk management, that promise to neutralize it with complex techniques of prediction, differentiation, compensation and hedging of risks. The result is the curious idea of "risk-neutral markets" which does not pretend to remove risk (it would be naive: the future is open and one can't know how it will come about), but to "neutralize it" for the prudent trader equipped with models. The models consider a multiplicity of possible scenarios; they even promise to consider *all* possible future courses of markets. Even if the operator doesn't know what will happen, then, he can expect to always get profits, because all future courses have been considered and processed by the model. The future, however uncertain, should not be risky.

Today we know that things didn't go that way. The course of the crisis showed us the limits of this approach, which instead of reducing financial risks multiplied them uncontrollably. Here, however, I'm not interested in the criticism of financial models and of their assumptions (Esposito 2011), but rather in the implications for our issue of ethics. The financial euphoria of recent decades was not simply an irrational enthusiasm but also relied on the new way of considering risk and its management. An often unaware consequence is of this attitude is the change in the moral sense of debt. Traditionally indebtedness (in German *Verschuldung*) had implicitly a component of guilt (*Schuld*), also because it was opposed to the established idea of prudence. For centuries one thought that prudence meant avoiding risks, and the one who chose to risk should bear the responsibility for it, also in a moral sense – he choose to deviate from safety in the hope of a profit, which however could also not occur: in this case he could not count on the solidarity of the others and even somehow of himself. It was his own fault. In a supposed risk-neutral market, however, the perspective changes radically: if the uncertainty of the future is no longer a threat for the wise operator and he will always fall on his feet however things go, it is much more prudent and commendable to risk rather than to keep one's own wealth. Indeed: who does not risk is ungenerous to himself and to the others, because the activity on the market increases the availability of wealth for everyone and is therefore the morally correct behavior. To be blamed are rather the ones who are not indebted – prudence becomes highly risky and morally suspect (what can be the motives?), because it means giving up almost certain future earnings.

In this situation, all the assumptions of ethical assessments change. Not only the results of actions are good or bad regardless of the intentions, but the intentions

[3]Especially the curious implied volatility, adventurously measured with the help of the Black-Scholes formula to price options (MacKenzie 2006, Chap. 5) – a way to calculate the unpredictability of the future starting from the (now known) unpredictability of the past.

themselves are no longer morally univocal. The accusation of greed could be paired with a symmetrical accusation of lack of greed, understanding greed as a sort of generous readiness to work for the common good. Which is the morally correct behavior, being greedy or not greedy? In the period of euphoria preceding the crisis this kind of sentiment was quite widespread: now we have almost forgotten it, but in Italy for example the low propensity of households and enterprises to make debts was blamed, because it was seen as a curb on the development of the country.

In conditions of risk, i.e. almost everywhere in the current "risk society" and evidently in finance, a much more complex ethical attitude is needed, which abandons the assumption that there are principles of behavior that allow to univocally discriminate a good position from a bad position, and to put oneself on the good side. Good behavior always risks to be bad in its consequences or even in its intentions, and the very search for an ethical orientation becomes ethically dubious. According to Luhmann (for instance Luhmann 1991a, 1993b), in many cases the task of ethics should be to signalize the risks of ethics and moralization, or even to advise to refrain from ethics as such – but this is also obviously a paradox.

More generally, in a complex society that still tends to look for univocal guidelines and presumed securities, the task of ethics could be to try to produce insecurity, in the form of irritation that insinuates into too compact descriptions of problems and makes them more open and flexible. This insecurity, however, should not be devoid of structure – it is not just noise, but should be based on precise concepts and on a reconstruction of the problems underlining their complexity. This is basically an elaboration of the fundamental paradox of ethics (ethics is good or bad?), which translates it into operational guidelines: to avoid to start from principles or from unities and to look rather at problems or differences – at the difference good/bad rather than at good as such, at the implementation and consequences of ethics rather than at principles and standards. If one still wants to have an ethical principle, it should take the form of the ethical imperative reformulated by Heinz von Foerster: "always act so as to increase the number of choices" (von Foerster 1973, 227) – also and precisely when these choice may contradict your current orientation.

## Second-Order Ethics

How can we interpret these very abstract observations in the concrete case of business ethics? How does the ethics of finance change, if still there is one?

The current problem of financial markets is in first place the management of the crisis, and the call to ethics serves primarily to identify the responsibles (or even the guilty persons). If we investigate more in depth, however, we can see that the responsibility is not so much greed or bad intentions, that undoubtedly were there, but rather a unilateral use of financial models – in the sense of our definition of ethics: a use too much oriented to unity and little attentive to differences, which produced serious consequences.

As we saw above, the formalized models of portfolio management promised to operate in a risk-neutral world – an idea that is morally far from neutral. To control risk, in fact, means to control the future, even if it is unknown: thanks to the formalization and to an enormous computing capacity, one thinks to be able to consider all possible future courses and to prepare strategies for each of them, even if one doesn't know which one will actually come about. Then one can (and according to a certain idea of morality one should) use in the present these "neutralized" futures, because they do not present risks and allow to increase future wealth. This is for example what securitizations and many operations with derivatives do.

This is basically the mechanism of credit, which the economy has been using without many difficulties for some centuries: a future wealth is anticipated in the present, and is used to produce further wealth that will allow to repay the sum received. The problem is that the financial techniques of recent decades have exasperated this mechanism, removing the awareness of risk that led to be cautious and to gather information – because one knew that the future is unknown and can come about other then expected (credit was not given to everybody). For the ones working recently in the alleged risk-neutral markets, this openness of the future has been cancelled and the future has been "defuturized" (Luhmann 1976): not only did one use in the present the future deemed probable, but one used all possible future courses, binding them with present decisions. When the future then actually became present no possibilities were available any more, because they had all been used in the past: one was left apparently without a future, as the "indignados" in the latest protests are complaining.

In the sense of von Foerster, this protest has indeed a moral dimension, although it is not easy to say who are the good ones and who are the bad ones: finance is ethically to "blame" because it reduced the available possibilities with a unilateral use of models, which did not consider the openness of the future and actually limited it – without even being aware of it. So the future was paralyzed, as it happened in the crisis when none was willing any more to act in the present to produce future possibilities. Phenomena such as lack of liquidity or credit crunch are the financial correlates of the unwillingness to use the future. And one really has less future available, because the future results also from what we do and plan in order to increase its possibilities – and is reduced if we do nothing. It is however an ethical fault without a real culprit, except perhaps ethics itself, that should have signalized the one-sidedness and the short circuits.

In this sense, the task of ethics would be to watch over defuturizations and to signal the behaviors that reduce the openness and variety of future possibilities. But the problem is that one of these "techniques of defuturization", and perhaps the main one, is moralizing itself: the search for culprits and the criminalization of risk-taking, which tend to paralyze markets and to curb the production of the future. If one searches security, one does not control the production of risks, which come about nevertheless. But this defuturization is essential for the current use of ethics, and one of the reasons of its success. The more complex approach of a "second-order ethics" would not be able to perform the short-term effect of moralizing: to provide

a guidance in situations of uncertainty, allowing the observer to escape insecurity and to appear consequent to himself and to the others. Emblematic in this regard is the attitude "without ifs and buts" increasingly widespread in risk situations – a kind of blockade of self-reference which rejects programmatically the complexity of the situation and stylizes this refusal in a moral sense, refusing even to take the responsibility of it. This kind of appeals usually get much consensus, shown also by the recent undifferentiated protests against finance. The issue however remains open: in the current conditions of financial markets, in front of the possible catastrophic consequences of the crisis, can we afford this kind of attitude? In open situations of risk, can our society afford moralization?

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# Epistemically Virtuous Risk Management: Financial Due Diligence and Uncovering the Madoff Fraud

**Boudewijn de Bruin**

## 1

The greatest fraud in the history of the US, the biggest Ponzi scheme ever, a stunning $65 billion lost to some 5,000 clients, a maximum prison sentence of 150 years – the perpetrator, Bernard Madoff, has found a secure place in the history of finance. In 1960 he founded Bernard L. Madoff Investment Securities, LLC with $5,000 he had saved while working as a sprinkler installer, plus a loan from his father-in-law (Independent 2009). The firm soon became a frontrunner in the computer technology that would considerably help establishing NASDAQ, the world's first electronic stock market. Madoff went on to gain a reputation on Wall Street as one of the biggest market makers. He was one of the first to use computer technology for automated trading. He was to become Chairman of the National Association of Securities Dealers, donate generously to various charities and political campaigns, and enjoy great respect among the Jewish community in New York City – the community that he was so ruthlessly to defraud (Berkowitz 2012). He also gained a name within the financial world and had close connections to the overseeing authorities. In an interview with Inspector General H. David Kotz and Deputy Inspector General Noelle Frangipane on 17 June 2009, he described Securities and Exchange Commission (SEC) Commissioner Elisse Walter as a 'terrific lady' whom he knew 'pretty well', and SEC Chairman Mary Shapiro as a 'dear friend' who 'probably thinks "I wish I never knew this guy"' (Kotz and Frangipane 2009).

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The discovery of the fraud is a story of epistemic virtue. Many people on Wall Street may have had their suspicions about Madoff, and at least some of the funds feeding money to Madoff will have performed some kind of financial due diligence on him. But it was Harry Markopolos, a 'quant' working for Rampart Investment Management, LLC, who ultimately uncovered the Ponzi scheme. In this chapter, I look at the Markopolos case through the lens of epistemic virtues. Epistemic virtues are virtues that are concerned with the way we deal with information and investigation. They contribute to our adoption of true and justified beliefs and lead us to acquire genuine knowledge. They make us critical and careful, patient and persevering. It is the possession of these virtues, I argue, that distinguishes Markopolos from others who performed financial due diligence on Madoff.

Epistemic virtues are very novel in applied ethics (Marcum 2009; De Bruin 2013). So far, they have almost exclusively surfaced in foundational debates in the philosophical theory of knowledge. In defending the claim that epistemic virtues have to complement financial due diligence practices, the present study attempts to show that epistemic virtues have a serious contribution to make to business ethics. This chapter presents what can be considered as a case study in epistemic ethics. A case study is an investigation of one single case with the explicit aim to obtain a deeper understanding of a larger class of similar cases (Gerring 2007; Ruzzene 2012) as well as to develop new theories or further explore – or 'test' – existing theories (Brigley 1995). The Madoff fraud has attracted quite a lot of attention in the academic literature (Eenkhoorn and Graafland 2011; Freeman et al. 2009; Nielsen forthcoming), but, to my knowledge, the role of Markopolos in uncovering the fraud has not been examined in detail. While the primary purpose of the case study is to shed light on financial due diligence, simultaneously it will put to the test the theory of epistemic virtues in as yet unexplored terrain. In sum, the present case study further explores and 'tests' a novel theory in applied ethics (epistemic virtues) in a novel context (financial due diligence) which is also interesting in its own right (Markopolos and Madoff).

The chapter is structured as follows. Section 2 introduces the strategy Madoff claimed to be following and provides some further relevant background information. Section 3 introduces the theory of epistemic virtues. Section 4 traces epistemic virtues in Markopolos' investigative and financial due diligence research, defending the claim that it was epistemic virtues that led him to continue investigations where others stopped. Section 5 concludes.

## 2

What Madoff claimed to be offering his clients involved a *split strike conversion* approach (Bernard and Boyle 2009; Schneeweis and Szado 2010), which is based on buying shares in S&P100 companies and simultaneously selling and buying particular options on the S&P100 index. A *call option* on XYZ shares is the option to buy, at or before a particular moment in time (the expiration date), a specified number of XYZ shares at a predetermined price (the exercise or strike price). A *put*

*option* is similarly an option to sell particular shares. Suppose you have an XYZ call option to buy 100 XYZ shares for $20 at or before January 2013. Suppose, moreover, that today XYZ shares are trading at $10. If you wanted to purchase XYZ shares it would be senseless to exercise the right that the option grants you. The call option, in the jargon, is *out of the money*. Similarly, a put option is out of the money if the strike price is lower than the market price of the underlying shares.

A split strike conversion approach much like the one that Madoff used can now be illustrated by means of the following example. You buy 100 shares at $10 per share. To person A, you sell a call with a strike price of $20, and from person B you buy a put with a strike price of $5. Now there are three scenarios. If the price of the shares rises above the strike price of the call, then A will want to exercise their right to buy them from you at $20, and since you bought them at $10 you will earn $10 per share for a total of $1000 minus the fees, the price of the option, and other expenses. If the price of the shares sinks below the strike price of the put option, then B will want to exercise their right to sell them at $5, and you will lose $5 per share for a total loss of $500 plus fees and so on. And if the share price remains between the strike price of the call and put options, neither A nor B will want to deal with you. You will neither lose nor gain.

This example clearly shows a relevant characteristic of a split strike: you will never gain more than $1000 and never lose more than $500. By choosing the strike prices differently you can of course determine any other interval within which gains and losses will remain. As a result, a split strike is unlikely to lead to spectacular results.

What Madoff claimed to be engaged in was a variant of this. He claimed to hold a basket of 30–35 securities from the S&P100 index. He would sell an out-of-the-money call option on the S&P100 index and buy an out-of-the-money put option, and if the option prices were too high, he would switch to holding a portfolio of 100 % treasury bills, the alleged epitome of riskless assets. Moreover, Madoff claimed, he would only trade once a month.

As one would expect from a split strike strategy, Madoff's returns were not particularly spectacular – if each month were considered in isolation. But very much unlike a split strike approach, Madoff's strategy was claimed to reach returns of more than 10 % per annum consistently over almost 20 years, and to arrive at a volatility of only 3 % on average (Culp and Heaton 2010). This is exceedingly improbable for split strikes.

Madoff's returns did not come from split strike conversion. They were fake. They were the result of a Ponzi scheme. Named after the Italian Charles Ponzi, a Ponzi scheme is a very simple mechanism by means of which the money that investors pay into the scheme is not invested but rather used to pay returns to the investors in the scheme. I offer you and other investors 20 % per annum on your investments with me. Instead of investing the money that you and others bring in, however, I use the money to pay out the 20 %. Of course, the risk is that the money dries up, which makes it imperative for me to attract new investors, who also have to be paid 20 %, which spirals into an increasingly pressing demand to raise new capital. Ponzi schemes are highly unsustainable (Artzrouni 2009).

Madoff's fundraising capacities were unequalled, though. Somewhere in the 1990s – some believe even much longer ago – Madoff had stopped investing the money from his clients. He would use his respectability, status and apparent trustworthiness to attract enormous sums of money for his Ponzi scheme. Part of his strategy was precisely to offer rather unspectacular returns, to keep silent about his investment tactics, to require absolute confidentiality from his investors, and to give a decidedly exclusive feel to his investments to make people feel privileged to be accepted in his fund. Many succumbed to his charms (Sarna 2010).

Harry Markopolos is generally credited with having discovered the fraud (Arvidlund 2009; Henriques 2011; Sarna 2010). While it is true that many people in the finance industry had suspicions about Madoff's operations, their usual response was that he was probably engaged in illegal activities on the verge of insider trading and frontrunning, and that as long as Madoff paid you when you wanted, clients should not care. Working for Rampart Investment Management Company, LLC, an options trader, Markopolos was asked by his employer to investigate Madoff's investment strategies in order that Rampart could emulate them. Rampart had heard from a partner, Access International Advisors, LLC, that they were dealing with a hedge fund that claimed returns of 2 % a month on the basis of split strike conversion strategies and that this fund was managed by Madoff. Markopolos analysed information about the fund's revenues obtained from Access CEO René Thierry Magon de la Villehuchet, and this started a lengthy investigation which ultimately led Markopolos to the conclusion that Madoff was indeed running a large Ponzi scheme. Warnings that Markopolos and a few people working with him on the investigation started to issue from 1999 onward to Access and other funds working with Madoff, to journalists, and to the SEC were ignored. Madoff's fund did not start to wind up until the end of 2008.

How did Markopolos find out? Markopolos used models from mathematical finance, which are part of the usual financial due diligence which Access and other clients of Madoff ought to have carried out. The mere use of these models cannot explain why Markopolos succeeded, however, because it is highly unlikely that he was the only person ever to have done the maths on Madoff. Rather, I argue, Markopolos succeeded where others failed because his use of financial due diligence methods was complemented by epistemic virtues. One way to put the difference would be to say that Markopolos just did his job where others did not. But when some do their jobs and others do not, many factors may explain the difference including such things as lack of knowledge and skills, dysfunctional management, desire to frustrate one's superiors, and so on. The claim the present chapter seeks to defend is that the difference between Markopolos and other financial analysts – due diligence analysts among them – is a lack of epistemic virtue.

To obtain a deeper understanding of epistemic virtues, I shall devote some attention to virtues in general before turning to Markopolos' investigations. I explore the thesis that his success was due to a combination of financial due diligence and epistemic virtues.

## 3

A traditional Aristotelian and Thomistic conception of virtues underlies the present chapter (Pouivet 2010). This conception views virtues as motivators and/or enablers of action. A virtue motivates you to perform certain actions by influencing your preferences and desires. A virtue enables you to do certain things by removing internal obstacles that lie in the way of performing virtuous actions. Moreover, most virtues actually do both: they enable and they motivate (Driver 2000).

The virtue of courage illustrates how virtues motivate. Imagine that at $t_0$ individual $S$ has not yet acquired the virtue of courage. $S$ is a coward at $t_0$. He sees a child drowning in a raging river. He has his mobile phone ready, so he can ring the emergency number 999 (let us call this action $A$), and were it not for his cowardice, he could have jumped in the water and attempted to rescue the child (action $B$), or he could have called one of the tourists nearby and asked them to help (action $C$). But being the coward that he is, he neither jumps nor calls but only rings 999. The coastguard arrives only barely in time. Shocked by the sight of the guards' resuscitation attempts and the child's suffering, $S$ decides to work on his lack of courage, and he succeeds. At $t_1$ he has acquired the virtue, and as if to put him to a test, he again sees a child drowning. He waits no longer, searches for a place where he can safely jump into the water, swims out and rescues the child.

Courage has enabled $S$ to rescue the child and to perform other actions requiring courage by removing what one could call 'internal obstacles' to the performance of such actions. In the treatment of epistemic virtues below, we shall see that these internal obstacles often involve so-called *behavioural biases*, which lead us to behave suboptimally with respect to investigative activities and other forms of belief formation (Barberis and Thaler 2002). For the purpose of illustration, however, I focus on a non-epistemic instance of courage. $S$ at $t_0$ was blocked by his cowardice to perform actions $B$ and $C$. His choice situation was a singleton set containing action $A$ only. Acquiring courage, then, led to the removal of these internal obstacles, as a result of which his choice set at $t_1$ contained the actions $B$ and $C$ besides to $A$.

If courage illustrates how virtues enable, the Aristotelian virtue of liberality provides an example of how a virtue may motivate. $S$ at $t_0$ is a Scrooge spending nothing on anyone – 'Bah, humbug!'. Haunted by the three Ghosts of Christmas, he decides it is time for a change and acquires the virtue of liberality. It works. At $t_1$ we see him treating his relatives, neighbours and his clerk's family with generosity and concern. Liberality has not so much removed obstacles to performing generous actions; it would be wrong, for instance, to describe $S$ at $t_0$ as incapable of giving. Rather, at $t_0$ he had no preference whatsoever for giving; he was miserly in wanting to keep his money. What the three ghosts did was make him change his preferences so as to become motivated to be generous.

Two things have to be said about this very succinct virtue theory. I must say something about the theory of the mean (virtues lay in the middle of two extremes) and also about the idea that most virtues both involve motivation and enabling. First,

the examples discussed so far only involve one vice, that is, one extreme of the virtue. I considered a move from cowardice to courage, not a move to courage from recklessness, nor did I consider a move from prodigality to liberality. These moves can be described in exactly the same way, though; interestingly, showing this will also cover the second point about motivation and enabling.

To start with recklessness: a reckless person is one who is, one could say, 'too courageous'. A reckless *S* seeing a drowning child dives into the river without thinking but injures himself because the water is too shallow. One might think that for a reckless person to learn how to steer the middle course between cowardice and recklessness requires a form of 'disenabling'. On that count, *S* would have to acquire internal obstacles to the performance of reckless acts. A reckless *S* might, however, just as well learn to change his preferences and acquire a motivation for more careful and considerate, but still courageous, behaviour. Courage, then, is a virtue that both enables and motivates.

This is not generally true, though. To move from the extreme of prodigality to the mean of liberality only involves a preference change: roughly, a change to give less and keep more. When a person who is 'too generous' learns to acquire the right attitude to getting and giving, this does not involve disenabling certain prodigal actions but only demoting these actions in their preference ordering.

While virtue ethics has a long tradition in twentieth century philosophy (Anscombe 1958; Jankélévitch 1949; MacIntyre 1981; Pieper 1934; Solomon 1992), the theory of epistemic virtues is a very new development. Two streams were developed simultaneously. A *reliabilist* version of virtue epistemology was pioneered by Sosa (1980) and focused on such cognitive faculties as perception and memory. A *responsibilist* version was advanced by such authors as Code (1984), studying not so much innate human faculties but acquired character traits conducive to the acquisition of epistemic goods (knowledge, understanding, wisdom, enlightenment). It is the responsibilist version of virtue epistemology that I use in this chapter, but before reviewing the most important *epistemic* virtues it is important to distinguish them from what Aristotle called *intellectual* virtues. In the *Nicomachean Ethics* and other works, Aristotle famously discussed moral virtues (*ethikes arêtes*) which describe such acquired character traits as courage and temperance, distinguishing them from the five intellectual virtues (*dianoetikes arêtes*) of art, science, prudence, wisdom and imagination. Responsibilist virtue epistemology sees epistemic virtues as instances of moral not intellectual virtues. They are character traits fostering the good life of *eudaimonia* and leading their possessor to steer the middle course between two extreme vices. As a result, just as its non-epistemic version, epistemic courage leads a person to pursue inquiry and investigation, even if this means they will face certain risks, but without them performing their inquiry recklessly as that would turn to the other extreme.

What are the most important epistemic virtues? I list them briefly here and discuss each virtue in more detail when I turn to Markopolos' financial due diligence. The current presentation owes much to Baehr (2011), Montmarquet (1993), Roberts and Wood (2007) and Zagzebski (1996). The prime epistemic motivator is *love of knowledge*, which can be traced at least as far back as

Augustine's *studiositas* (Trottmann 2003). Love of knowledge is complemented by epistemic *courage*. An intellectually courageous person is eager to subject their beliefs to thorough scrutiny and to continue their inquiry irrespective of potential resistance or disdain from others until they have reached a conclusion. They keep trying to answer the questions they ask and they are not deterred by the fact that this may graphically reveal their ignorance. Epistemically *temperate* or sober-minded individuals, in turn, are disposed to avoid adopting beliefs overly enthusiastically without any good evidence, but they also shun an inert disinterestedness which might lead them to be unwilling to adopt any beliefs at all. Temperate persons are sceptical enough to take with a grain of salt what salespeople tell them, for instance, but they are not so sceptical as never to believe anyone. Epistemic *justice* is a form of open-mindedness, a readiness, that is, to confront one's ideas with those of others, and it includes an active awareness of one's epistemic shortcomings and fallibility. Epistemically just people will want to hear both sides of the story, and not draw any firm conclusions as long as they have only partial evidence. Epistemic *generosity* and *humility*, finally, are dispositions to share one's knowledge freely with others (but not in a way that would unjustifiably harm one's own interests) and to avoid being overly confident and arrogant concerning one's knowledge, intelligence or wisdom.

To anticipate a possible objection, does this mean that one cannot perform one's job without epistemic virtues? It may be that particular jobs require little in the way of gaining knowledge, and performing such jobs may be possible without the possession of epistemic virtue. But it is hardly likely. Even the most routine sort of work requires that one gets acquainted with the routines, and this requires at least a rudimentary level of epistemic virtue. More importantly, however, we are here engaged with a highly knowledge-intensive industry where doing one's job well – or 'excellently', as some virtue theorists might want to say – does require epistemic virtue. To the extent that the failure of many financial due diligence analysts to detect the Madoff Ponzi scheme was a failure to do their jobs, the difference between these analysts and Markopolos is one of epistemic virtue.

## 4

When Markopolos' employer, Rampart Investment Management Company, LLC, first heard about Madoff's fund, he was told by his boss to imitate – and emulate – Madoff's split strike conversion strategy. He responded to the challenge with vigour. Describing himself as a 'research geek', Markopolos saw it as a question purely of mathematical finance that it was 'only logical' to see 'as an academic exercise, and not as the largest fraud in Wall Street history'. Writing about himself and a few colleagues, he said that 'we weren't looking for crime; we simply wanted to see how [Madoff] made his numbers dance' (Markopolos 2010, 20).

While strictly speaking Markopolos' work started as a form of reverse engineering rather than financial due diligence, the methods that he applied were exactly

the methods that financial due diligence analysts use, and as soon as the maths suggested that it was fraud instead of financial genius that made the number 'dance', Markopolos indeed turned to financial due diligence and abandoned the ambition to emulate Madoff.

Financial due diligence is the process by which one ascertains the risks and returns of prospective investment decisions. I give a brief sketch of what financial due diligence agents do, which is based on a recent overview article by Culp and Heaton (2010). This, incidentally, contains a treatment of the Madoff case that is very similar to the work that Markopolos carried out.

Financial due diligence uses both qualitative and quantitative methods. Qualitative methods involve scrutinising the reputation of the fund manager, the quality of internal control in the investment firm, the adequacy of their reporting, and their regulatory compliance. Quantitative methods are primarily drawn from mathematical finance and are more specifically used to gauge risks and returns.

The first thing that Markopolos was interested in was Madoff's returns. The concept of *return* is the analogue of interest received on a deposit account. If you earn 5 % interest per year, your return is 5 % per year. Return on equity (company shares) is similar, but because shares pay out dividend and shares change in value, calculations are unlike compounding interest. If shares of, say, $100 pay a dividend of 5 % after the first year and have appreciated to $120, your return is 25 %.

Even if the concept of return on equity is simply a generalisation of interest on deposits, investing in equities is very unlike saving money in a deposit account. The difference is an epistemic one: one knows one's interest rate, but one does not know the returns on equity in advance. This is why financial due diligence analysts desire to develop methods to estimate one's returns.

The premise on which methods from mathematical finance are built is that the riskier the investment the higher the expected return investors will demand on their investments. But what is risk in finance? Especially in the context of several other contributions to this volume, it should be noted that the conception of risk used in finance is rather different from rational choice theoretic understandings of risk. In rational choice theory, one faces a choice situation with risk if one has attached subjective or objective probabilities to all possible outcomes of all actions one can perform. Roughly speaking, risk is probability. In finance, by contrast, risk is not captured by probability but by the concept of *volatility* and its cognates. To illustrate this concept, suppose you consider buying shares in one company. To get some idea of what the return might be, you first calculate the empirical mean of the returns based on historical data from, say, the past 10 years. This gives you some idea of what to expect, but it does not tell you how risky the investment is. To that end, the standard deviation is used.

Yet it would be misleading to claim that volatility is the only concept financial due diligence analysts have in order to ascertain the risks of an investment. To understand why, another idea from finance should be discussed: *diversification*. If your investment portfolio only contains shares in one company, you bear risks which you may partly eliminate by buying shares in other companies as well. It is better, so to speak, to buy shares in five different food companies than in one, and it is

even better to buy shares in companies in five different industries than in one. The risk eliminated from one particular asset when one holds that asset in a diversified portfolio is called *unsystematic* risk, but some risk still remains attached to that asset: its *systematic* risk.

Why would we be particularly interested in this sort of risk? The assumption that underlies the finance theory of risk is that if markets are functioning efficiently, one may expect that the unsystematic risks of an asset, which can be eliminated by diversification, will *not* be reflected in the price of the asset. If I were to demand a reduction in the price of one asset because of its unsystematic risk, a competing buyer would accept a lower price because they would see that they could remove that risk by diversification. Risk that cannot be removed by diversification will be reflected in the price, however.

It is an asset's systematic risk that financial due diligence analysts are concerned with. Several measures of systematic risk exist, but I shall focus here on the measures that are most frequently used in financial due diligence. They involve the well-known *alpha* and *beta*. Roughly, an asset's beta captures the systematic risk of that particular asset in that it measures the extent to which its volatility is correlated with the volatility of the market. An asset's alpha, on the other hand, describes whether the investment offers investors enough to compensate for the risks they run. One of the models to estimate alpha and beta is the Capital Asset Pricing Model (CAPM) developed by Sharpe (1964) and others. This is too elegant not to discuss here in a little detail, but readers who know the material or who are less interested in the mathematical details may skip the next paragraph.

Suppose you invest a proportion $X$ of your assets in a market portfolio (that is, invest it in shares reflecting the market such as the S&P100 index), and you invest a proportion $1 - X$ in risk-free securities (Madoff opted for treasury bills). The market proportion of your portfolio is by definition perfectly correlated with the market and therefore has a beta of 1. The risk-free proportion, moreover, has a beta of 0 because it has by definition no correlation with the market at all. Since betas are linear, the beta of your portfolio is $\beta_p = X \cdot 1 + (1-X) \cdot 0 = X$. Let us denote the return we can expect from the entire portfolio as $E(R_p)$. The expected return can be analysed entirely in terms of the expected returns of its two parts: the market share (which following the same notation is $E(R_m)$), and the risk-free share (of which, since it has no risk, $E(R_f) = R_f$). This yields $E(R_p) = (1-X) \cdot R_f + X \cdot E(R_m)$. Now substituting $\beta_p$ for $X$ we easily derive from this equation the CAPM formula: $E(R_p) - R_f = \beta_p(E(R_m) - R_f)$.

Back to Markopolos. Seeing the challenge to mimic Madoff's success as a purely 'academic exercise' at first, he needed to study historical time-series of Madoff's returns on investment. As a proxy Markopolos used return streams he had obtained from his company's trading partner, Access International Advisors, LLC, from which earlier information on Madoff had been forthcoming. Access had dealt extensively with Madoff. Closely scrutinising the data, Markopolos soon ventured the hypothesis that the returns were fake. 'There's no way this is real. This is bogus' (Markopolos 2010, 30).

**Fig. 1** Estimates of alpha and beta

| | *Culp and Heaton* | *Markopolos* | |
|---|---|---|---|
| *Fund* | Unknown | Fairfield Limited | Sentry |
| *Period* | 1989–2001 | 1990–2005 | |
| *Alpha* | 0.007 | 0.009 | |
| *Beta* | 0.05 | 0.06 | |

In order to confirm his suspicions, Markopolos developed a model to estimate alpha and beta. The model attempted to copy Madoff's alleged split strike conversion approach. If Madoff were indeed applying this approach to baskets of 30–35 securities from the S&P100 index, a rather strong correlation with the S&P100 index (a high beta) should be expected, because if a basket picks around a third of a market, it is going to covary with the market quite significantly. Because Madoff claimed to be trading only once a month, this is largely true even if for whatever reason – insider dealing or telepathy – he would always select the best 30 or 35 from among the 100 shares available.

Markopolos does not provide information on how he estimated the risks on the basis of the data available to him around 1999, when he started his investigations. He does give details of a study involving years 1990–2005, though (Markopolos 2005). For those years, he estimated alpha and beta by applying such models as CAPM to data from Fairfield Sentry Ltd. This was a so-called *feeder fund* doing little more indeed than feeding its clients' money to Madoff's scheme. Culp and Heaton (2010) provide a similar analysis on the basis of an unnamed feeder fund for the period 1989–2001. Since this is closer to the time period when Markopolos had access to data when he started his research in 1999, these data are included here too. The differences from the later Markopolos study are minimal. See Fig. 1 for the results.

Anyone familiar with CAPM would be perplexed. The feeder funds show a beta of 5 % or 6 %. This means that for practical purposes they are entirely risk free. (Recall that risk-free assets have a beta of 0 %.) Markopolos writes that he expected the beta

> to be around 50 per cent, but it could have been anywhere between 30 and 80 per cent. Instead Madoff was coming in at about 6 per cent. Six per cent! That was impossible. That number was much too low. It meant there was almost no relationship between those stocks and the entire [S&P100] index. I was so startled that the legendary Bernie Madoff was running a hedge fund that supposedly produced these crazy numbers that I didn't trust my math. *Maybe I'm missing something*. (35)

Markopolos cannot have been the only one doing the maths. There is evidence that numerous people on Wall Street had their suspicions about Madoff, some based on quantitative financial due diligence (Arvidlund 2009). Moreover, even though Markopolos himself describes his modelling strategy as 'complex' because it had 'a lot of moving parts' (34), there is, from a mathematical point of view, nothing difficult about the model. Dan diBartolomeo (2010), a mathematician who taught Markopolos and whom Markopolos later approached to check his maths, described the methods as 'textbook simple quant methods of due diligence', which could yield

conclusions 'in a few hours'. The mathematics of asset pricing appears in many undergraduate economics curricula; it is therefore hard to believe that no one else had done the same financial due diligence and run the same regressions at the time.

Take Fairfield Greenwich Group (FGG), the investment firm offering feeder funds such as Fairfield Sentry Ltd. The firm had a detailed description of its financial due diligence practices on its website – which was, incidentally, removed during the Madoff windup – which stated that

> [a] core area for further analysis is to attempt to dissect and further understand investment performance, how a manager generates alpha, and what risks are taken in doing so. As portfolio management and risk management incorporate elements of both art and science, FGG applies both qualitative and quantitative measures.

Fairfield Greenwich even went so far as to claim that 'the nature of FGG's manager transparency model employs a significantly higher level of due diligence work than typically performed by most fund of funds and consulting firms' (quoted by Blodget 2009). This is of course very doubtful; it is rather likely that due diligence was carried out at a very low level. This is not to say, however, that if Fairfield Greenwich had indeed run the regressions and estimated alpha and beta – as their financial due diligence statement claims they did – they would have come to the conclusions Markopolos had arrived at. Like many others, Fairfield Greenwich financial due diligence analysts might have blamed the maths rather than a person with a long-standing and unrivalled reputation – Bernard Madoff.

Indeed, other feeders simply admitted they had not gone beyond investigating Madoff's reputation, which at the time, of course, was spotless. De la Villehuchet, CEO of Access Internation Advisors, LLC, and another Madoff feeder, told Markopolos that he was 'totally committed' to Madoff and that he had done his 'own form of due diligence'. He told Markopolos that 'I'm comfortable with it. He comes with an impeccable reputation. I mean, my God, he's one of the biggest market makers in the U.S.' (Markopolos 2010, 91).

In the end, then, Fairfield Greenwich financial due diligence analysts may have found a beta of 5 %. But if, as Access CEO de la Villehuchet held, you are estimating the beta of a man with an 'impeccable reputation' who had held important positions in the financial services industry, highly respected in society, with close connections in politics and elsewhere – and praised for investor ingenuity and technological innovation – then you might indeed have doubted the maths and the beta rather than the man and his fund.

Markopolos, however, using similar methods of financial due diligence, went much further; and that he went further is to be explained, I argue, because epistemic virtues motivated and enabled him to go further. The most important epistemic virtue is *love of knowledge*. Following a view that goes back at least as far as Augustine, a person who loves knowledge is a person who does not just desire to obtain *true* beliefs; more than that, the person wishes to acquire relevant beliefs which can be *justified* on the basis of available evidence. Beliefs based on rumours or gossip are excluded, as are mere speculation and other beliefs formed on the basis of unjustified evidence (Roberts and Wood 2007).

Markopolos persistently displays this important epistemic virtue. Several people with whom he would talk about Madoff would admit that Madoff's returns were 'unreal'. But they would not care to investigate how to explain the lack of realism, only speculating about the possibilities of illegal insider trading, frontrunning and so on. Markopolos, on the other hand, employed a great diversity of methods to confirm his hypothesis. A report entitled 'The World's Largest Hedge Fund Is a Fraud', which he sent to the Securities and Exchange Commission on 22 December 2005, contained no fewer than 30 red flags uncovered by a large diversity of qualitative and quantitative methods (Markopolos 2005).

Epistemic *humility* is another virtue that characterises Markopolos' work. This virtue contrasts with two vices that may usefully be spelled out (Weiss and Knight 1980). One vice is that of *vanity*. A vain person is continuously demonstrating their knowledge and status, and when sharing information they are typically more interested in what the recipients of the information will think about them as a person than whether they will actually learn something from it. Epistemic humility also contrasts with *arrogance*. An epistemically arrogant person unjustifiably defends knowledge claims by reference to their superiority or authority. This is not to say that superiority and authority cannot deliver such justificatory grounds. If one's superiority entails a better access to data, one's justification is probably going to be better. A manager who claims to know, however, simply because he is the manager, is epistemically arrogant. Epistemic humility, in other words, leads a person to acknowledge their lack of knowledge and to allow for the possibility that the other person may be right. It makes you aware of your own fallibility, but without being self-effacing and without being tempted to engage in what psychologists call *groupthink,* merely following the crowd due to an unjustified lack of confidence in your own reasoning capacities.

Markopolos showed great humility when he had his mathematical models checked by various others inside and outside his firm and by invoking the assistance of many other individuals. Michael Ocrant, for instance, was a journalist who had uncovered various Ponzi schemes during his career. After Markopolos explained his suspicions to him, Ocrant simply decided to ring Madoff. He was invited over to Madoff's office the same day. Madoff made a tremendous impression on Ocrant, showing him around the office, allowing him to ask any question he might fancy, and answering them in seemingly consistent and plausible ways (Ocrant 2001). Ocrant concluded that if Madoff were indeed running a Ponzi scheme, 'he's either the best actor I've ever seen or a total sociopath' (82). To Markopolos and his colleagues he reported back that

> [t]his guy was as cool as can be. I mean, I didn't see the slightest indication that anything was wrong. In fact, rather than worrying about the story I was writing, he acted like he was inviting me over for Sunday tea. He doesn't act like he's got something to hide. He spent more than two hours with me. He showed me around the whole operation. He even offered to answer any other questions. Guilty people usually don't act this way.

Markopolos replied to Ocrant that 'The numbers don't lie.' But Ocrant doubted that. 'Is it possible we're missing something?' (Markopolos 2010, 83).

Markopolos was sober-minded enough to have asked that question himself after he had done his initial mathematical modelling and had concluded that the Fairfield Sentry Ltd feeder fund had a beta of 6 %. He had gradually discarded alternative explanations for the beta, though, and accepted his mathematical knowledge as a firm basis to conclude that Madoff was operating a Ponzi scheme.

Another virtue that benefited Markopolos was epistemic *courage*. Courage lies between cowardice and recklessness, and apparent examples of courage needed in investigation are the courage of the war reporter, the volcanologist or the NASA test pilot (Baehr 2011). We also need epistemic courage, however, when we are to ask questions the posing of which may risk others to ridicule us, to speak up in public debates about minority issues, to criticise our superiors, and other epistemic activities that may lead to personal harm. Ocrant, for one, did not ask Madoff straightaway whether he was running a Ponzi scheme. With courage, however, Markopolos did voice suspicions about investments which many clients of Rampart Investment Management, LLC, firmly believed in. Thereby he risked the firm's relationship with the clients. He risked his own position in the firm when he made clear that he would not emulate Madoff's success for Rampart, and he endangered his status as a quant when he admitted that he had failed to develop mathematical models that would even consistently explain Madoff's successes. And when he started going public with his suspicions, he claims to have risked his own and his family's life because of alleged connections between the financial world and organised crime (Henriques 2009).

Arguably the most important epistemic virtues that contributed to Markopolos' success, however, are *temperance* and *justice*. Epistemic *temperance* is a disposition to choose the right amount of inquiry and investigation, to adopt one's beliefs not too quickly and not too hesitantly, and to strive for the right degree of justification for one's beliefs (Battaly 2010). To find out if a certain marketing strategy works, a manager may decide to set up an experiment and a field study with thousands of subjects, a crew of award-winning researchers, and adopt a time frame of one year. That would be too thorough, too careful – 'too temperate'. The manager could also ask three friends what they think about the new strategy. That would be too quick. An epistemically temperate manager knows how to strike the balance. Epistemic *justice*, in turn, refers to the disposition to consider the views of different parties impartially and open-mindedly and to listen to both sides when opinions or bits of evidence conflict. Epistemically just agents will carefully sort out and weigh the evidence provided by both sides before adopting a belief, and they will not set aside particular sources of information on irrelevant grounds such as race and ethnicity (Fricker 2007). Epistemic justice is a particularly difficult virtue, as witnessed by evidence from behavioural economics on *confirmation bias* and the phenomenon of *belief perseverance* (Barberis and Thaler 2002). Tax professionals, for instance, who are supposed to estimate the legal risks of particular ways of reporting company taxes, tend to spend more time searching for cases that confirm their client's position than cases that would go against it, and this lack of epistemic justice has the undesirable effect that their clients report their taxes in overly aggressive ways, leading to their being fined by the tax authorities (Cloyd and Spilker 1999).

Markopolos had started entertaining doubts about the legality or reality of Madoff's strategy as soon as he had seen the revenue streams that Access International Advisors, LLC, had handed to him. He did not rush to a conclusion, though. He developed mathematical models which he had checked by others. He used a great range of methodologies to examine the issue. For instance, his research led him to the observation that for Madoff to really engage in the split strike conversion approach he would have had to own more than 100 % of all existing put options. He used qualitative methodologies when he worked with Michael Ocrant, the journalist who interviewed Madoff, and he relentlessly discussed his findings with colleagues. Most importantly, even though quite early on he voiced the hypothesis that Madoff was running a Ponzi scheme, he gave careful consideration to alternative explanations provided by colleagues and clients of Rampart. One alternative was that Madoff would obtain his results from insider trading, frontrunning in particular. Access CEO de la Villehuchet had explained Madoff's competitive advantage as that Madoff's decision on what shares to buy or sell is 'based upon his knowledge of the market and his order flow' (Markopolos 2010, 27), a form of insider knowledge. Markopolos' Rampart colleague Frank Casey accused Madoff of frontrunning, that is, of using knowledge obtained as a market maker about customers' upcoming trades. Then there was the third hypothesis that Madoff was actually borrowing the money at an interest rate of around 15 % from his clients for him to use in his work as a market maker. Markopolos paid attention to all these hypotheses, and many others, and refuted all of them.

## 5

In the end, the story of Markopolos' success is a story of epistemic virtue. If the mathematical models show something very strange – a beta of 6 % for a strategy that basically follows a third of the market – but the strategy originates from a person with tremendous reputation, one needs epistemic virtue in order to dare to question not only the maths (which Markopolos did) but also reputation (which he also did). This chapter could have looked into the lack of epistemic virtue on the part of the Securities and Exchange Commission, for which Markopolos gives ample evidence. As the title of his book suggests, almost no one would listen to what he had to say. SEC officials would not listen because they did not understand the maths and did not dare to admit it, because they were obsessed with internal power struggles, because they were biased toward the assumption that Madoff was to be believed and not Markopolos, because they lacked open-mindedness, epistemic courage and humility. The story of SEC's inability to deal adequately with a large fraud, however, is more a story of a failure to establish epistemic virtues at a *corporate* level. The study of corporate epistemic virtues requires a very different theoretical approach, and that is why I have not dwelt on the SEC (De Bruin 2013). That Markopolos' story is a positive story is another reason.

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# Part III
# Risk Management in Organizations

# Risk Management, Banality of Evil and Moral Blindness in Organizations and Corporations

**Jacob Dahl Rendtorff**

## Introduction

Since the publication of Hannah Arendt's *Origins of Totalitarianism* (1951) and *Eichmann in Jerusalem: A report on the banality of evil* (1964) there have been wide debates in political philosophy about the concepts of moral blindness and evil as a means of understanding the violence and domination inherent in social and political conflicts such as war and acts of terror. We have moved from totalitarianism to the problem of evil in terrorism as a burden of our times that ought to be explained (Goldhagen 1996). The focus of political philosophy has been to use the concepts of moral blindness and the banality of evil to explain the horrors of modernity, Auschwitz and the death camps, the Gulag, the terror of September 11, and Saddam Hussein's dictatorship in Iraq (Bernstein 2002, 2005; Benhabib 2010). More recently, the question has been extended to whether such notions can explain the continuous harm and violence of poverty, racism, and discrimination around the world.

Traditionally such evil has been ascribed to willed demonic human actions and the recent literature on the problem of evil is extensive. Nevertheless, our conceptualization of evil remains somewhat insufficient in the face of the radical incomprehensibility of evil actions (Arendt 1964). Rather than explaining terror and violence in terms of real evil based on direct conscious intentionality – as proposed by classical philosophy and some contemporary philosophy – the approach informed by Arendt and her followers considers the concept of moral blindness and the banality of evil based on relations between structures, systems, and human individuals in unreflective roles which has an implication for understanding risk and the moral implications of risk of human actions in organizations.

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Despite the rich discussion of evil in political theory, this work has not been adequately extended to the notion of harm and wrongdoing in institutional contexts and risk taking in relation to morality of management in business organizations (Baumeister 1997). The discussion of the banality of evil as proposed by Hannah Arendt is directly relevant to risk management, business ethics and to the ethics of organizations and corporations. Though not manifesting in the form of political violence, private organizations and corporations that take enormous risk on behalf of society and its members often commit actions with very violent consequences for human beings, societies, nature, et cetera. Moreover, many administrators and risk managers are morally blind, in that that they do not really understand their own wrongdoing or culpability in decisions that can cause very severe pain to other people when they take risk in order to promote a particular economic gain or organizational development.

Since Arendt's analysis is based on an exceptional historical event – the Holocaust – it is often argued that her work has little bearing on understanding present behavior and is irrelevant to contemporary private and public organizations (Bernstein 2010). And it is also argued that this has nothing to do with financial or economic risk management. Although the Holocaust is arguably the most outrageous and extreme form of human activity ever encountered in Europe, I do not agree with this criticism that the doctrine of the banality of evil cannot teach us anything about modern organizations and our risk-taking in business. There are in fact many cases of evil, harm, and moral blindness in organizations for which Arendt's analysis serves as an excellent illustrative metaphor or analogy (Bercowitz et al. 2010). For example, one could consider corporate decisions that continuously damage the environment, pose security problems, destroy the world financial system or fail to address preventable workplace accidents. Furthermore, one could draw attention to the problem of lack of respect for human rights by many business organizations operating in developing countries. We can refer to a variety of harmful actions by organizations that exploit different stakeholders (e.g., owners, shareholders, consumers, suppliers, investors, and the local community), which are often ignored, even though these groups have genuine moral claims. We might also mention the exploitative profit taking and dehumanization inherent in the current financial and debt crisis (Sorkin 2010). Finally, many businesspeople have a tendency to portray themselves as moral people who take economically justifiable risk in order to promote the good of their fiduciary duties to shareholders in an amoral and morally blind environment (Bird 1986, 17–18).

Drawing on the copious pre-existing literature in political theory, I will endeavor to understand some contemporary iterations of more or less explicit violence and domination in organizations by exploring the problems of the banality of evil and moral blindness in business ethics in relation to moral dimensions of risk management. Furthermore, I will ask the critical question about how the banality of evil and moral blindness can be used to explain the lack of ethical insight and sensibility as well of the lack of ethical formulation competency in organizations in relation to the understanding of the moral dimensions of risk.

The definition of risk management that is the basis for this analysis is a wide and general definition of risk management as an essential element in the management and leadership of organizations and in the strategy of organizations. Based on the review of different articles and papers in the literature of management I propose to summarize the definition with the following sentence: "The identification, analysis, assessment, control, and avoidance, minimization, or elimination of unacceptable risks. An organization may use risk assumption, risk avoidance, risk retention, risk transfer, or any other strategy (or combination of strategies) in proper management of future events." As stated, the general argument of this paper is based on an analysis of the potential evil and moral blindness that under certain circumstances may be involved in this kind of management.

The paper contains the following major parts: (1) a discussion of the concept of moral blindness as proposed in Arendt's philosophy of responsibility and judgment; (2) an examination of interpretations of moral blindness, power, and domination following from the concept of systemic action in Arendt's philosophy, principally looking at the work of Stanley Milgram (*Obedience to authority*), Zygmunt Bauman (*Modernity and the Holocaust*), Philip Zimbardo (*The Lucifer effect*); (3) a discussion of how the concept of moral blindness applies to organizations and corporations with the problems of risk management in mind; ending with (4) a section of conclusion and perspectives.

## *Arendt's Concept of Moral Blindness*

Arendt considers the problem of evil as one of the most fundamental issues of postwar Europe (Bernstein 1996a, 12; 1996b) and the Holocaust is at the center of her analysis of evil. As a reporter, Arendt covered Nazi bureaucrat Adolf Eichmann's trial in Jerusalem in the beginning of 1960s and she expected to find a monster, but she only saw a very "ordinary" and rather uninteresting "little" man whose mental state was characterized by a dozen psychiatrists as "normal" and even desirable. In *Eichmann in Jerusalem* (1964) Arendt proposes that the Holocaust is not a unique event or an abstract symbol of evil, but rather the result of wrongdoing of ordinary people. Indeed, Arendt refers to Eichmann as "terrifyingly normal" (Arendt 1994, 276). Rather than casting him as perverted or sadistic, Arendt portrays his actions as the result of his inability to think and to have moral sensibility and judgment. Arendt uses the term banality of evil to characterize Eichmann's existence: one that is devoid of moral thinking, where heinous acts are committed by an ordinary man who has no profound understanding of what he has done and who lacks the ability to feel or understand that what he has done is wrong. Eichmann was a key figure responsible for the murder of nearly six million Jews during the Holocaust. As a bureaucrat and "organization man" he said that he had only done his job as a middle manager of the Nazi organization. He was totally blind to the moral risks of his actions. By revealing Eichmann's ordinariness, Arendt reveals the "fearsome, word-and thought-defying" "banality of evil" (Arendt 1994, 252).

According to Arendt, this banal evil is a result of concrete social conditions and organizational and institutional structures. In particular, we find its origins in totalitarianism and in imperialism. In fact, Arendt's conceptions of moral blindness and the banality of evil centrally rely on understanding how administrative and bureaucratic goal rationality in organizational systems functions in combination with the technological and scientific ideology of imperialism and totalitarianism.

In *The origins of totalitarianism* (1951), Arendt states that Nazism was no different from other totalitarian systems of modernity such as Stalinism and imperialism, which also contributed to a systematic destruction of humanity and dignity by technical means. According to Arendt, it would be wrong to consider imperialism and totalitarianism only as political factors that have nothing to do with economics. In fact, we can say that imperialism was an important basis for totalitarianism in the sense that totalitarianism has its roots in the idea of unlimited growth, a key principle of business speculation that was transferred from the realm of politics. In imperialism, economic prosperity and the search for welfare for the populations in power legitimizes risk-taking. In this sense one could argue that the businessperson who aims for risk management for profit and unlimited growth without any concern for humanity or morality is actually an imperialist suffering from moral blindness.

While sadistic criminal soldiers in totalitarian and imperialist systems are definitely horrifying, their actions are rationally understandable in the sense that they are ordinary criminals. The dutiful bureaucratic behavior of SS bureaucrats and administrators like Eichmann, on the other hand, is harder to comprehend. Arendt emphasizes that the totalitarian state destroys the space for reflective judgment, resulting in actions without moral sensibility or ethical imagination. This helps to explain how well-educated bureaucrats and administrators like Eichmann are able to commit evil actions by combining obedience to the system with lack of concern for human dignity. There is a close connection between making human beings superfluous and the thoughtlessness of the banality of evil, as Arendt outlined in *The origins of totalitarianism*. Indeed, one cannot describe the banality of evil without taking into account radical evil because even though Eichmann was banal his actions were monstrous in an absolute sense. So the administrators and executors of the Holocaust represent radically evil totalitarianism in that their actions were characterized by thoughtlessness and because they were instrumental to realizing the ideological goals of Nazism.

In addition to the thoughtlessness and lack of moral sensibility of the administrators of the Nazi system Arendt points to another disturbing element of the banality of evil, namely the fact that radical evil implied a forced collaboration between victims and perpetrators. The perpetrators made victims cooperate through the threat of further harm. The Jews selected themselves as the police in the ghettoes. In Auschwitz certain prisoners were elected to help in the killing process and in some cases they acted as guards. Moreover, even though they knew a little about the concentration camps, the people of the German population remained silent. This form of collaboration legitimized the actions in the camps, which were never publicly questioned.

In some ways, the Nazi regime resembled the bureaucratic organization where duty and obedience ensure compliance. The ideological clichés of the Nazi system, including obedience to one's superiors, created the conditions for its efficiency. The moral blindness to the risk of destroying humanity was a result of this obedience to the norms and values of the system without question. Eichmann was characterized by the conscience of the obedient bureaucrat who did his duty. He was an element of an efficient bureaucratic system that worked according to objectified technical standards.

According to the doctrine of the banality of evil it is not possible to explain the Holocaust by criminalizing or pathologizing the Nazis (Finkelstein 1998, 100; Finkelstein and Bettina 1998; Finkelstein 2000). The Holocaust should rather be explained in terms of a complex interaction between technical rationality, lack of moral sensibility, and total obedience by people who can be considered as normal according to conventional psychological standards. But this is challenging to ethical reflection. Arendt emphasizes how the combination of cynical utility and technical precision in the Nazi concentration camps was completely incomprehensible (Arendt 1950, 373; Vila 1999). Yet it is this utility and precision that characterizes the radical nature of the banality of evil, which she considers as the foundation for moral blindness in administration and organizations. The central characteristics of the bureaucrats and the administrators of the Holocaust were their complete lack of moral sensibility, ethical imagination, judgment, responsibility, and sense of humanity (Kateb 1993).

It is an intriguing question whether Arendt's analysis of the banality of evil and moral blindness can also be used to understand the recent financial crisis in the Western world. Do the actions of the big financial firms with their unlimited risk management for profits during the crisis represent the same arrogance and lack of self-awareness that characterized the Nazi bureaucrats? (Sorkin 2010). We can take up this question by examining the imperialism at the root of the crisis where the development of the risk-taking in the economic system is justified by the concern for the welfare of the European master populations. This answer to this question may say something about the origins of the crisis as a "new burden of our times" equivalent to the burden of totalitarianism in Arendt's time. According to Arendt (1951), imperialism is the doctrine that economic and scientific thinking is superior to politics. We can say that the economic and financial crisis, as well as the global environmental crisis, is the result of a new kind of moral blindness where purely economic concerns have replaced ethical and political concerns in the management of risk and economic decision-making in society.

We might say that the modern age is one where world politics is characterized by a desire for limitless growth and risk-taking in order to ensure the wealth of the master populations. Following Arendt's conception, this limitless growth may be conceived as a new form of imperialism that emerged as a condition for totalitarianism. There is an erosion of the nation-state, where the economy has taken over the political realm for the purposes of exchange and exploitation (Arendt 1951). This implies the transformation to an unlimited and aimless economy where businesspeople replace politicians and states are submitted to economic

globalization. It is implicit in Arendt's conception that the focus on economic profits in the risk management in business is blind to the moral elements of business decisions in relation to stakeholders.

From the perspective of Arendt's thought the current financial crisis can be seen as an illustration of how the global financial actors with increased risk taking acted imperially by assuming the power of the nation-state. Aimless expansion of profits was the basis for the financial crisis, where the system diminished the power of human-centered values and ethics, resulting in humanity being reduced to consumers. *Homo sapiens* have, in the modern world, become equivalent with *homo economicus*. From Arendt's perspective, capitalist rationalization with economic risk-taking as a major component for the accumulation of capital implies dehumanization and the materialist values of profit and loss replace morality and spiritual values (Arendt 1958, 1965). Following this, we can argue that the role of many businesspeople in the financial crisis were also characterized by a kind of moral blindness where individual greed and self-interest replaced responsibility, moral thinking, and concern for other human beings. Accordingly, the whole idea of risk management as defined as the concern for the economic dimension of risk in order to maximize profits has forgotten the moral dimension of risk as based on concern for human beings and ethics and this is the reason for the moral blindness of economic and business systems leading to the financial crisis.

## *Interpretations of Moral Blindness After Arendt*

We can advance business ethics research in relation to the origins of the financial crisis considerably by investigating the structural and functional dimensions of the organizations and institutions currently operating in accord with Arendt's notions of moral blindness and the banality of evil that can be understood as implying a morally blind risk management. Indeed, we can begin by reviewing some of the research traditions that have emerged out of her work on the banality of evil.

It is possible to distinguish between three general post-Arendt research paradigms: (1) the functionalist approach to Holocaust studies, (2) sociological and social psychological studies of organizational behavior, and (3) studies of the political philosophy and ideology of evil in contemporary political discourse. More specifically, within the studies of administration and organizations, we can distinguish between two important research paradigms: (1) studies of administrative evil in public organizations, and (2) studies of moral blindness in business corporations.

Among the general paradigms, Holocaust research and Holocaust studies contributed to the development of the functionalist approach, which emphasizes the role of the system and social situation rather than the individual's evil intention. Raul Hilberg (1961) described the social system of the Holocaust in his classic text *The destruction of the European Jews*, which informed Hannah Arendt's work. Lifton describes the ability of compartmentalization in *The Nazi doctors* (1986), showing

how individuals suppressed their own personal stress and doubt considering the "final solution" in favor of a scientific and organizational higher objective that had to be reached even though it was terrible for the individual (Lifton 1986).

Ordinary people like middle-class doctors were trained to see mass murder as an organizational duty and a problem to be solved. It was possible to compartmentalize their personality between the professional ideological role and the personal private role. In the camps doctors were educated to cope and deal with mass murder by, for example, constructing a specific language and rationality of goal commitment to deal with the situation. By dehumanizing the Jews and suppressing personal feelings, the extermination was constructed as a legitimate organizational goal to be implemented without questions or personal doubt.

With his work *Modernity and the Holocaust* (1989), Zygmunt Bauman describes the consequences of the Holocaust and their impacts on the sociology of modern organizations. The desire to understand individuals like Eichmann and the other Nazi criminals, who were characterized by their seemingly normal personalities, led to the famous research on obedience by the Yale social psychologist, Stanley Milgram. Milgram wanted to empirically test the propositions of Hilberg and Arendt; thus he defined experimental conditions for obedience and came to the conclusion that normal people under specific circumstances are likely to follow authorities beyond reasonable morality (Milgram 1974). His friend and colleague Philip Zimbardo furthered this research by conducting the infamous Stanford prison experiment (discussed later in detail), which had to be cancelled because some participants became brutal, violent, and sexually sadistic after a few days (Zimbardo 2007). As we shall see, Bauman, Milgram, and Zimbardo generalized the concept of moral blindness to be applicable in all kinds of organizations.

Since the Bush administration initiated the "war on terror" the debate about evil has received renewed attention in political philosophy. This has led to general discussions of evil in politics including the 2005 book by Richard Bernstein, *The abuse of evil: The corruption of politics and religion since 9/11*. In this text, Bernstein defends Arendt's concept of the banality of evil against doctrines of the absolute intentions of evil implied in the war on terror. This approach moves political philosophy from the study of intentions to the study of systems, functions, roles, and situations as conditions for evil actions, which also renders it relevant to business ethics and our understanding of a broader understanding of risk including the moral dimensions in risk management. Moreover, in relation to international law and public policy, David Luban has taken Milgram's definition of the problem of moral blindness as a starting point to critically analyze integrity as the fusion of thought and action (Luban 2003, 286).

In *Unmasking administrative evil* (2009), Guy Adams and Danny Balfour extend the discussion into research on the ethics of public administration. The authors describe administrative evil as systematic evil by large powerful institutions, for example military or political bureaucracies. They propose a technical rational analysis of public affairs and risk-taking of administrators in order to unmask the basis of systematic evil in administrations. Their argument is that the technical analytic mindset of the modern age implies a possible moral inversion where people

involved in modern organizations, like Eichmann, can be dominated by technical and instrumental organizational goals without really being aware of it. Dimensions of this creation of evil include acting at a distance, masking evil with language and technology, and compartmentalizing and socializing people into compliance with the technical analytical mindset of the organization within the social dynamics of compliance in strong hierarchical orders (Adams and Ingersol 1990).

In business ethics and organizational ethics the work of Frederick Bird in *The muted conscience: Moral silence and the practice of ethics in business* (1996) deserves mention. Here we find a detailed analysis of the moral blindness that emerges in organizations with no sense of business ethics. Recently, in *Conscience and corporate Culture* (2007) Kenneth Goodpaster has proposed an analysis of moral blindness that is loosely inspired by Arendt. Goodpaster likens moral blindness to a camera that zooms without being able to see the objective through his concepts of stimulus problem, "teleophathy," and "ambidexteriority" that creates moral blindness. Goodpaster argues that we need some kind of ethical reflection or distance to see the problem that emerges from this narrow-minded focus on management by objective. Indeed, the work of Patricia Werhane on moral imagination, which is also inspired by Arendt, may be the solution to this kind of lack of ethical awareness in business ethics, because it emphasizes how moral vision and seeing can be created and make us overcome blindness (Werhane 1998).

So we see a number of approaches dealing with the banality of moral blindness in business and organizational ethics that all attempt to contemporize Arendt's insight. None of these approaches extend this approach to a systematic analysis of the origins of the financial crisis and the need for a moral dimension of risk management, which is the intention of this paper. In order to do this we will now look deeper into the concept of moral blindness in sociology and social psychology. Indeed, it is the work of theoretical sociology (Bauman) and social psychology (Milgram and Zimbardo) that provide us with the important basis for understanding the concept of moral blindness as it applies to contemporary business organizations and how they deal with risk in order to increase organizational sustainability and integration in their environments.

## Bauman: Organizational Rationality in the Holocaust

In *Modernity and the Holocaust* (1989), Bauman argues that the Holocaust was only possible because of modern technological organization. We can say that Bauman proposes the foundations for an institutional and sociological account of the banality of evil. Together with the SS soldiers and Nazi doctors, Eichmann and other administrators used goal-rational organization to realize the Holocaust as a strictly clinical operation where modern science, bureaucracy, and technology were unified. Bauman argues that the Holocaust shows the hidden potentialities of modernity (Bauman 1991, 12) because this monstrous event was only possible in a fully goal-oriented, organized, manipulated, and controlled world. Describing the Holocaust as an integrated part of modernity implies that it represents a meeting

between factors that were both unique and extremely ordinary (Bauman 1991, 81ff.). From this perspective, while the death camps were arguably unparalleled in human history, they simultaneously resembled modern factories with human beings as the raw material and death the final product.

According to Bauman, Hannah Arendt's philosophy was important for clarifying how the ideological underpinnings of totalitarianism construct social reality, resulting in imperialist destruction of the nation-state, the institutionalization of mass society, and the creation of new human beings. Bauman argues that Nazi leaders functioned as social engineers who used a kind of "social farming" to produce new human beings (Bauman 1991, 70ff). The totalitarian state implied a rational control of society and realization of the vision of ideology in order to create a feeling of security among individual citizens. Bureaucracy was based on well-defined calculations of aims and means. The system of the Holocaust was, therefore, extremely rational and based on strict administrative and organizational discipline and structures. The moral blindness of the system occurred in a very efficient and goal-rational organizational system.

Violence and dehumanization were authorized and accomplished through modern organizations. The Holocaust was a modern product, because it was rationally planned and effectively organized by administrators and scientific (medical) experts. Indeed, one could argue that without modern civilization there could have been no Holocaust, even though the Holocaust was not an inevitable consequence of modernist logic. Bauman agrees with Arendt that rationality in modern society can lead to terror. The totalitarian state uses lies and fiction to reduce human plurality and difference into ordinary and authoritarian personalities. In rational organizations the only criterion for success is efficient expert action. Bureaucratic objects are described in purely technical and ethically neutral terms (Bauman 1991, 102ff). There is no proximity between human beings and there is no responsibility, even though there also may be evil in proximity (Vetlesen 2005, 26).

The system was marked by strong separation of work tasks, with a long distance between those who ordered the actions and those who executed the actions. No one could be held fully responsible (Bauman 1989, 25), or, to put it differently, identified as the origin of the evil. It is thus impossible to, following Kant, state that this evil was a result of an "evil will." Rather, it came from ordinary and incomprehensible thoughtlessness where no one really cared for the consequences of the actions. The individual perpetrator was just a part of a long chain where the distance to the victims both physically and psychologically resulted in their invisibility. He or she was actually not aware of contributing to the killing of innocent victims. Bauman argues that one way to make victims invisible is to make them a logical part of the universe of bureaucratic duty (Bauman 1991, 27).

The Nazi administrator was able to execute his orders because he was at distance from his victims. Gassing was a technical form of killing where the perpetrators could do it at a distance. Of course this does not exclude that they could also kill at close range, but this requires greater blindness or explicit sadism. Differentiation and distance imply that the victim can execute death orders without being confronted with the results of the action. In Auschwitz, and in many other

concentration camps, distance was created through the total dehumanization of the victims. This has been described in the novels of the concentration camp victim Primo Levi. He has described how the Nazis considered the prisoners as animals and not as human beings. Arendt also states that human beings are changed into specimens of a species whereby they are robbed of their humanity and individuality (Arendt 1964, 1979, 458ff). It is a characteristic aspect of moral blindness that human beings are dehumanized and that they are treated as numbers, things or objects and that it is not longer necessary to have a human relationship with such dehumanized objects. Bureaucracy aims at the most efficient solution without having any concern for human costs (Bauman 1993).

The obedient bureaucrat is an individual who accomplishes well-defined tasks in the organizational system without any doubt. The administrator takes care of a system function and their personality becomes an integrated part of the institution. This was, for example, the case with Eichmann who was only thinking about his own promotion. Bureaucracy is founded on the efficiency of the means rather than the consequences of the actions; therefore, a goal-oriented organization may very well contribute to the realization of irrational goals.

Bauman agrees with Arendt that "it was rational for the victims to collaborate". Seen from the perspective of the collaborators they contributed to their survival. They could not know that they contributed to the killing and that the Nazis used them in their project of total extermination of the Jews and others. This might be understood through a paradoxical application of the "prisoner's dilemma" in rational choice theory, which posits that the best result can be obtained by collaboration. But this presupposes that the victims know the rationality of those in power. If they do not, one cannot be sure that a rational action will lead to the fulfillment of the aims of the collaboration. As a consequence of this misunderstanding, goal rationality leads to a close interaction between perpetrator and victim. In effect, the perpetrators maintained the Jews in a collaborative rationality aimed at their very destruction, though they could not foresee this because it was an irrational form of collaboration.

As a consequence, it was a terrible truth that the self-governing bodies of the ghettos would, against their own will, help the Nazis and make it easier for them to realize their aims. By only permitting negotiation with the self-governing bodies and not with individuals it was much easier to plan the deportations. The Jews became part of an organized hierarchy of command where they, as rational human beings who believed in humanity, presupposed that the Nazis would, in the end, also act rationally. But their continuous attempts to collaborate in order to lessen evil only contributed to the increased effectiveness of the Nazi genocide (Bauman 1991, 135ff.).

## Moral Blindness and Obedience: Milgram

Social psychologists like Milgram and Zimbardo have taken up the challenge of explaining how ordinary human beings contribute to incomprehensible harm and

evil. Milgram was strongly inspired by Arendt and his experiments have been called the Eichmann experiments (Milgram 1974, 178). Milgram argued that the banality of evil is closer to truth than anyone could imagine (Milgram 1974, 6).

Milgram's rather simple social psychology experiment began by advertising for voluntary participants in the local community around Yale University in New Haven. These voluntary participants had the opportunity to, without sanction, leave the experiment whenever they wanted. The research subjects were placed in a laboratory and were given the role of teacher. This role required that they give a pupil an electric shock every time the pupil gave a wrong answer to very simple questions. Every time the pupil gave the wrong answer the voltage was raised: up to 450 V. Even though the electric voltage was not real, the actor portraying the pupil would express pain or scream for each dose of voltage. The experimental subject was told that the experiment concerned the ability to test learning capacity, but was not informed that it was not the pupil but the teacher's willingness to give electric voltage that was the real focus of the experiment.

The experiment also involved a manager, who, without exercising any physical force, would demand up to four times that the teacher continue and reassure them that the pupil would not suffer permanent harm even though it was clear that the pupil was expressing strong physical pain although the participants in the experiment remained at distance from the learners because they could not see the harm inflicted on the learners. The results indicated that over half of the experimental subjects were willing to go up to the highest electrical voltage.

Milgram explained these results by postulating that ordinary human beings have a feeling of duty to an organization or hierarchical order in which they act as principal agents. Many participants continued even though they felt strongly inconvenienced by their actions. The determinant facts were a feeling of politeness, their promise to contribute to the experiment, and an ability to follow the orders of authorities (Milgram 1974, 8).

After having worked with hundreds of research subjects in his experiments Milgram tried to come up with a theoretical analysis of obedience. He thought that obedience was based on the placement of humanity is a hierarchical and disciplinarian system, which characterizes human interactions in organizations. Milgram does not deny biological and individualist psychological explanations, but primarily draws upon a cybernetic and system theoretical perspective on obedience. In other words, human beings have a potential for obedience that is created in socialization (Milgram 1974, 125). We are able to take part in organizations as automatic and self-regulating agents where we eliminate or suspend our own conception of morality and operate exclusively on the premises of the organizational system. In this sense, we can say that instrumental action in the organizational system is a condition for moral blindness.

When we become part of a system or an organization there is an intuitive pressure to act in accordance with the technical goal rationality and norms of the organizational system. The ultimate aim of a system is internal unity, where every element starts to function internally in relation to the other elements. In a hierarchical system of obedience, like the Nazi regime, everyone submits to higher

authorities, meaning that power defers up through the system of leadership all the way to the supreme commander or executive director. In Nazi Germany, Hitler was the only one who had ultimate control of the system in its totality. Everyone else, including higher-level administrators like Eichmann, could just say that they were a part of a system (Kelman and Hamilton 1989).

The analysis of obedience by Milgram shows that the placement in hierarchical structures can make people act without any concern for morality. The individual does not act with autonomy and does not show agency or responsibility, but in a kind of automatic way based on the logic of the system (Milgram 1974, 133). The different functional hierarchies in organizational systems in society regulate the actions of individuals in a way that they absorb themselves in their systemic positions. According to Milgram the desire for obedience can be found at all levels of organizational systems of society: in the family, in the schools, at the hospital, and of course in corporations. Strong obedience to instrumental rationality is based on the fact that individuals act as part of a system and feel strong faith and commitment to their particular assigned roles. Following Milgram we can say that moral blindness does not lead to a feeling of loss of morality, but rather the individual is focused on following orders and considers the loyalty to the system as more important than stopping inflicting harm (Milgram 1974, 146). In contrast to unconditional moral sensibility, one is guided by feelings of loyalty, discipline, and honor that are motivated by the desire to play an instrumental role in the community of the organizational system (Gilbert 1981).

Milgram's study, which could also be called a lesson in cynical business administration, demonstrates that ordinary people can be pushed to limitless obedience as long as the following conditions are present: (1) a pre-arranged pseudo-legal contractual obligation exists; (2) participants have meaningful "positive" roles to play in the experiment (e.g., teacher, learner, etc.); (3) basic rules are established that are arbitrarily and impersonally used, justifying mindless compliance by insisting that "rules are rules"; (4) the semantics of hurting victims becomes transmuted into a higher purpose by using positive words; (5) responsibility for negative outcomes is diffused to subordinates; (6) insignificant beginning steps eventually lead to a slippery slope towards greater harm; (7) by making small steps (e..g, only 15 V increases) no one notices the increasing harm; (8) the authority figure (in Milgram's study the scientific expert) changes from being just to becoming more and more demanding and irrational; (9) high exit costs imply that the victim with difficulties can dissent; and (10) an ideology is used as a rationale for justifying the operation as an excuse for the maintenance of power in the authority relationship (See "Ten lessons from the Milgram experiment," Zimbardo 2007, 275).

### Zimbardo: Role Playing and Dehumanization in Organizations

In his more recent book, *The Lucifer effect* (2007), Philip Zimbardo – a friend and classmate of Milgram – takes up the challenge from Arendt and Milgram and presents a comprehensive account of his Stanford prison experiment nearly 30 years after it was conducted. Among other events, the Abu Ghraib prison abuse

scandal motivated Zimbardo to write this book about how ordinary people can do evil things in dehumanizing and humiliating conditions due to a combination of moral insensibility, conducive situations, and system roles (Zimbardo et al. 2000; Zimbardo 2004).

In contrast to Milgram's study, which focuses on obedience to authority, the core of Zimbardo's analysis is role-playing and role adaptation in organizations, in other words the "social construction of compliance" (Adams and Balfour 2009, 9). In the basement of the Stanford psychology department, Zimbardo constructed a prison simulation social psychology study involving ordinary middle-class psychology students who volunteered to assume the roles of either guards or prisoners. During the experiment, which was supposed to last 2 weeks but was stopped after 6 days due to the semi-pornographic aggression and humiliation of prisoners by the guards and the strong hysterical reactions of the prisoners, the participants in the experiment identified very well with their roles and started to act as though they were real guards and prisoners without any moral or social reservations about their roles.

As the conventional and arbitrary separation of the participants into prisoners and guardians was forgotten new rules were introduced that led the guards to become more sadistic and the prisoners to identify more closely with their roles as victims. Both parties to the game started to take their roles seriously. Accordingly, certain prisoners experienced very strong personality transformations where they changed from being independent and critical students into subordinate and stressed prisoners. The same thing happened to the guards who very soon transformed from being normal and anti-authoritarian students into brutal and authoritarian guards. These changes can be explained as an effect of role-playing and the power of social structure and reality to construct human patterns of behavior. The institution of the prison automatically structures human role-abiding behavior in terms of specific patterns of action based on what Zimbardo refers to as the "alchemy of character transformations" (Zimbardo 2007, 194).

Even Zimbardo began to like his role as superintendent of a mock prison. It was only after his girlfriend, who was a psychology research assistant, saw the conditions of the prison and objected to the treatment of the students, and after several arguments, that he began to realize he had to stop the experiment (Zimbardo 2007). Being confronted with her heroic resistance and immediate reaction as an outsider helped him realize that something was really wrong. After roughly a week he had to stop the experiment due to the aggressive and sadistic developments of the role-playing and role identification within the institutional setting of the fake prison that had become more and more a model of a real violent prison.

In his interpretation of the experiment, Zimbardo emphasizes the close relation between good and evil as two sides of the same coin in the construction of social reality. We adopt certain roles and aim at realizing these roles without looking on their general impact on human beings. When we deal with authoritarian systems and institutions we are confronted with institutional structures where it is not individual actions but their functions and roles in the system that is important. We can say that evil is produced as a part or a function of the system and institutional conditions of the role that individuals have to adopt. Moral blindness is situated and becomes institutionalized in the system.

When he heard about the abuses in Abu Ghraib in Iraq Zimbardo became aware of the striking similarities with the Stanford prison experiment: Young, normal, and ordinary people – in this case the US soldiers in the war prison – were suddenly in a situation where torture and humiliation of prisoners through sexual abuse became normalized. What occurred in Abu Ghraib was a type of compartmentalization of experience. Role identification and role-playing in the system contributed to the creation of evil and changed the personalities of the prison guards in the system. Individuals are exposed to the pressure of systems and once they have identified with their roles they therefore tend to conform even more to these roles. The organizational process implied in this "Lucifer effect," where good and evil merge, combines system and situation, obedience to authority, group-think, dehumanization, and gradual escalation from little violations to a high level of abuse (Zimbardo 2007, 355).

In his analysis of the relation between person, situation, and system, Zimbardo ends by arguing for heroism (and maybe civil disobedience) as the only way to break with the abuses from within the system as long as the leaders of the system do not change the structures and chain of command. These forms of heroism are defined as acts that are voluntary, risk integrity and health, and serve community without personal gain, for example in cases of uncompromising criticism or whistle-blowing.

## *Definition of Moral Blindness in Organizations and Corporations*

We have now analyzed the concept of the banality of evil and moral blindness beginning with Hannah Arendt and continuing with Bauman, Milgram, and Zimbardo. Bauman theoretically developed Arendt's concept by focusing on organizational bureaucracy in the modernity of totalitarianism and imperialism. Milgram provided us with an analysis of individual obedience and the loyalty of employees in the organization. Zimbardo gave us a definition of the relation between moral blindness and role-playing in organizations. Although I know that that there are many differences between Eichmann's context during the Holocaust and the university-based experimental work of Milgram and Zimbardo, I would like to point to some structural and conceptual content of the concept of modern blindness that we can deduce from the previous analysis and apply to modern business organizations and to the danger of negligence of the moral dimensions of our actions in the management of risk in business and economic decision-making based on systemic economic profit-oriented rationality (Darley 1992).

The dimensions of the concept of moral blindness that are relevant to business ethics and the morality of risk management include: (1) The implication that the manager, investor, business leader, or public administrator has no capacity for moral thinking. (2) The manager, investor, business leader, or public administrator only follows orders and justifies his or her actions by reference to the technical

goal-rationality of the organizational system. (3) The manager, investor, business leader, or public administrator is strongly influenced by the ideology, principles, or instrumental values of the organization. (4) This attachment includes an abstraction from concrete human needs and concerns in the business organization. (5) In many cases moral blindness strangely enough includes collaboration on the part of the victims of the harm. (6) The victims follow the rationality of the system and they identify with their roles, either motivated by pure obedience or by an attempt to minimize greater harm. (7) Moral blindness contains a dehumanization of the victims and other stakeholders implied in the process, rendering them as elements, things, or functions of the system. (8) Moral blindness relies on total obedience by the administrators of the system. (9) Technology and instrumental rationality is an essential element in the administration of the organization. (10) Each participant in the organization accomplishes a specific work function with a specific task but he or she has no general overview of the organizational system. (11) Top managers and leaders may behave opportunistically to follow their own interests with regard to the main goal of the instrumental system (12) Top managers, administrators, and leaders may act irrationally beyond common human understandings of morality in order to serve the instrumental rationality of the organizational system. (13) The administrative obedience to realize the organizational aim becomes the central interest of the managers, investors or administrators of the organization. (14) Obedience, role identification, and task commitment remain the central and ultimate virtues of the commitment of members of the organization to the organizational system. (15) Each member of the organizational system commits themselves to the values of the organizational goal of the system.

These elements can be said to constitute the essential structural and functional elements of the concept of moral blindness, or rather what we can also call moral silence (Alford 1990, 2001). However, we can also consider moral blindness from the point of view of a rather phenomenological or hermeneutical perspective. This is the approach that we find in Frederick Bruce Bird's (1996) book, *The muted conscience: Moral silence and the practice of ethics in business*. This book provides the most comprehensive recent attempt to define the application of the concept of moral blindness in business ethics. In fact, Bird extends the concept of moral blindness to include moral muteness and moral deafness. Moral muteness is defined as the inability of people to defend their ideas and ideals (Bird 1996, 2). Moral deafness is the inability to listen to and hear moral concerns, and moral blindness can be said to complement and include moral muteness and moral deafness (Bird 1996, 2). In his book, Bird claims that we may be able to understand the moral vacuum of business by reference to moral blindness, muteness, and deafness and this is what we can understand as an application of the idea of the banality of evil in the business organization today.

Bird seems to include, however, an important element of presupposed moral understanding in his concept of moral silence. The thesis of the book is that many people fail to voice their moral convictions due to moral silence, moral blindness, moral muteness, and deafness. This is defined as the opposite of hypocrisy where people speak about morality without doing anything. Here people have some feeling

of morality, but they remain morally blind, mute, and deaf with regard to speaking up and taking action about the morality in the organization. We can say that in this approach the banality of evil follows St. Paul's famous self-indictment: "For what I do is not the good I want to do; no, the evil I do not want to do – this I keep on doing" (Romans 7, 19). Moral silence is defined as the situation where people fail to communicate their moral concerns with reference to common moral standards. In this general context of the business organization there is no communication about morality in the organization and there is no whistle-blowing about the wrong-doing that is occurring in the organization.

Bird considers people to be morally mute when they fail to speak, (Bird 1996, 35). In particular, by failing to contribute to whistle-blowing or repressing concerns about problems they perceive in the organization. Even though there are many ways to blow the whistle, from internally creating awareness about the problem in the organization to public external statements, the morally mute may not say anything to anybody and remain silent due to fear, obedience, blindness, and so on.

According to Bird, moral muteness may include the inability of managers, investors or administrators to speak up about moral concerns. In the case of the banality of evil in organizational systems with immoral functionality this would include the failure to say anything about the internal inhumanity of the organization; however, Bird also points to another general failure of managers, namely their inability to voice moral convictions in relation to the performance of employees in organizations. Moral silence with regard to the evaluation of activities of employees who may behave immorally in their treatment of customers or other stakeholders shows a lack of moral accountability of managers and leads to system with no communication about morality.

Bird says that people who are morally deaf "do not hear or respond to moral issues that have been raised by others" (Bird 1996, 55). Moral deafness implies the inability to listen and to hear particular moral concerns. In general, moral deafness implies inattentiveness to moral messages and unwillingness or inability to listen to genuine moral convictions. Bird refers to the concern for the other as the foundation of moral hearing as proposed in the phenomenology of Emmanuel Levinas (Bird 1996, 57). The ability to be attentive, to hear and to make sense of the moral claims of the other, is essential to the person who is able to listen to moral concerns. From this perspective, to be attentive includes the ability to comprehend and to focus with sympathy on the moral issues of concern; thus, to be morally deaf is to be inattentive and unable to listen with sympathy.

Moral deafness is one element of not being able to put oneself in the place of the other and have the ability for moral concern and moral thinking. Indeed, we can say that there is an element of apathy in moral deafness (Bird 1996, 59). In particular, Bird emphasizes that morally deaf organizations ignore problems and bad news requiring moral decision-making. Famous examples he cites include the case of the Ford Pinto, the Nestlé infant formula scandal, or the 1987 boat disaster in Zeebrugge where 188 passengers died (Bird 1996, 63–65). Moral deafness implies the tendency to suppress moral concerns and to not see potential moral problems because of concern for the functional efficiency of the system.

In Bird's analysis moral blindness is a sort of umbrella notion that includes the concepts of moral muteness and moral deafness. Bird defines moral blindness in the following way: "People are morally blind when they fail to see or recognize moral concerns and expectations that bear upon their activities and involvements" (Bird 1996, 85). Moral deafness and muteness can be considered as forms of moral blindness. Bird defines moral blindness as something more than just seeing. It is a special ability to perceive, recognize, understand, and foresee. It is the ability to have moral vision and to put oneself in the place of the other and perceive, understand, and recognize the moral concerns that are relevant for the other person, group of persons, or organizations.

Different ethical theories contribute to the development of the capacity to have moral sight and moral vision. The ability to perceive moral issues is closely linked to ethical formulation competency, wherein one's understanding of ethical issues relies on knowledge of different ethical theories and arguments. Moral blindness implies a lack of moral vision and of ethical formulation competency and an exclusive focus on specific instrumental concerns of organizational efficiency. Bird combines moral blindness with moral shortsightedness, which can be considered as the inability to foresee moral factors in relation to organizational decision-making (Bird 1996, 101). It is a kind of narrow-mindedness that is not capable of seeing morality as an important dimension of organizational activities. Let's now see how this applies specifically in public administration and in private corporations.

## Moral Blindness in Public Administration

In their book, *Unmasking administrative evil* (2009), Guy Adams and Danny Balfour indicate the role of moral blindness in public administration. They take up the question at the beginning of this paper, namely whether contemporary society is subject to the repetition of history: whether the evil of the Holocaust as being integrated in contemporary society (Rubenstein 1975).

Adams and Balfour propose the concept of administrative evil as an interpretation of Arendt's concept of moral blindness. From this perspective, moral blindness may be characterized by the narrator in Kazuo Ishiguro's novel *The remains of the day* (1988). The butler Stevens is so interested in doing his job as well as possible that he forgets to question the legitimacy of what he is doing (Ishiguro 1993). He is serving his boss, Lord Darlington, who is complicit with Nazism. Stevens never questions what he is doing and he thinks that he has done everything right. Stevens is a figure very similar to Eichmann, one characterized by loyalty to his job, who further considers his professional identity as the most important thing in the world which means that they are unable to be aware of the moral dimensions of the risk decisions they take to fulfill their job functions.

Figures like Eichmann and Stevens may be said to incarnate the moral blindness in organizations and institutions. According to Adams and Balfour, moral blindness becomes worse and subtler in cases of moral inversion, where something evil is suddenly defined as good (Adams and Balfour 2009). The moral inversion emerges

because no one really knows they are doing evil since evil is presented to them as a part of their job in a technological rational system. This moral inversion is what Adams and Balfour calls the "mask of evil."

Adams and Balfour argue that the scientific analytic mindset of the technical-rational approach to social and political problems creates a new kind of administrative evil, which is masked. As a consequence, ordinary people find they are doing evil although they hadn't intended to. This combination of administrative masking in addition to our own blindness might be considered to be a form of double-blindness. Sometimes even ethical codes and other rules of conduct may be inefficient at dealing with this double-blindness because the technological analytical mindset of the administration is so powerful that the members of the administration do not see that they participate in processes that lead to greater harm.

The instrumental scientific approach to public policy problem solving may be in danger of creating more problems than it solves. Technical problem solving may contribute with solutions to social problems that forget the human dimension. This is the case when, for example, public administrators use metaphors of disease in their approach to welfare and health policy issues. The same may be the case when they deal with migration policies by applying metaphors of surplus population or racism.

Indeed, some administrators cannot see that they do evil because they think they are doing well. The concept of moral blindness in administrative evil may follow the Platonic idea that one cannot knowingly do evil or harm. Distance to the victims and moral disengagement are essential tools for creating a mask of evil. Moreover, rhetorical language modification, with special terms like the "final solution," conceal the real content of the activity and is an element of masking evil. We can also mention dehumanization and destruction of human values and dignity in the analytic mindset and technical instrumental approach to social and political problems, where sometimes human beings are considered as numbers in a system rather than individuals. Compartmentalizing knowledge and creating very narrow professional identities also contributes to the masking of evil (Adams and Balfour 2009, 30). Through ordinariness, compliance, and masking evil, technical bureaucratic organizations become capable of horrible impacts.

Adams and Balfour discuss the Challenger space shuttle disaster as a way of connecting the Holocaust and the modern world. Here the managers were pressed to ignore the dangers of destruction of the space shuttle and they took risks in order to live up to the wishes of the political system to promote the greatness of humanity of their population by sending the first civilian into space. Adams and Balfour also note that Nazi scientists, who had utilized slave labor in the production of V2 rockets, found employment in the US space program after the war. In the Nazi production facility, 20,000 of the 60,000 prisoners who worked as slave laborers died. Von Braun, who was a leading German scientist, later became a director at the NASA space shuttle program, where he was responsible for creating an authoritarian organizational culture. This culture, which was characterized by bad communication between employees, management, and politicians, led to the explosion of the Challenger space shuttle only a few minutes after departure. Indeed,

this presence of Nazism in the risk-taking of a modern administrative system in a democratic society is ironic because democracy is supposed to be a society of free and autonomous people (Adams and Balfour 2009, 81).

Even though there may not have been strong, direct evil intentions involved, Adams and Balfour argue that the organizational culture was marked by elements of moral negligence, denial, and cover-up that created an atmosphere of potential risk of evil actions. (Adams and Balfour 2009, 87). The problem was that the culture did not face the risk of a disaster when politicians pressured for the launch of the space shuttle with the first civilian on board. Von Braun's leadership was characterized by anxious, defensive control, which led to unnecessary risk taking, cover-ups, and a philosophy of ends justifying the means. In this sense, these results of his leadership directly contributed to the Challenger disaster and were the result of an evil turn in management.

## Moral Blindness in Business Administration

In business organizations, the focus on profit and greed has been considered as a kind of moral blindness. In fact, in business organizations both direct moral blindness and double-blindness are evident. Bird mentions Milton Friedman's idea that "the social responsibility of business is to increase its profits" as an example of a kind of narrow-mindedness (Bird 1996, 102) where the economic concern for profit and efficiency as the essence of risk management becomes a kind of stereotype that blocks other understandings of the moral concerns implied in the activity of the organization. Moreover, we can say that moral blindness, in its direct form in business administration, includes lacking moral vision, moral engagement, and moral imagination about the possible consequences of actions. Indeed, moral blindness includes the inability to have any fixed moral focus in organizational actions.

I have chosen to consider Bird's analysis of moral blindness, muteness, and deafness as a kind of phenomenological and hermeneutical application of Hannah Arendt's concept of the banality of evil in the business world, but also as an explanation of moral blindness in public administration in general related to the lack of a moral dimension in the treatment of risks in the management of both organizational systems. The essential harm of the concept of moral blindness is manifest in the inability of the business manager to think morally, which is similar in kind to the moral blindness of the social engineers of totalitarian systems and found in its extreme form in the administrators of the Nazi bureaucracy.

Another interesting connection between the business world and the doctrine of the banality of evil is provided by Edwin Black's controversial discussion of the role of IBM in the Holocaust in his book *IBM and the Holocaust: The strategic alliance between Nazi-Germany and America's most powerful corporation* (2001). This case illustrates an ethical crisis of a corporation based on moral blindness and moral muteness. The management of the search for economic profits and developments of IBM is here demonstrated to be without a moral dimension. The

book can be understood as a discussion of the reach of corporate responsibilities in relation to society and about the requirement of society for corporations to be good citizens. Black analyzes the relation between a lack of responsibility, ethical and moral blindness, and the importance of information technology for Hitler's Holocaust. It can be argued that the Holocaust not only presupposed bureaucratic rationality but implied modern information technology. Black states: "The Dawn of the information age began at the sunset of human decency" (Black 2001, 104). Black investigates how IBM helped Nazi Germany to produce and update the Hollerith punch-card technology that was an important enabling technology for Hitler's step-by-step identification and cataloging of Jews in the 1930s and 1940s (Black 2001, 427–488).

Black argues that it would have been much more difficult for Nazi Germany to accomplish the Holocaust if the IBM punch-card technology had not been available. All the difficult work of confiscation of property, ghettoization, and deportation was an organizational challenge that needed the IBM punch-card. This technology, which was produced by a firm partly owned by IBM operating in Nazi Germany was an important statistical instrument to identify Jews. With this technology it was possible to efficiently store information about race, family, gender, occupation, religion, maternal language, and so forth. Consequently, the population statistics became much more easy to use as a means of identifying Jews among the population. Because of the immensity of the task, automatization was essential for the efficiency of the activity, and this process was facilitated by IBM technology. According to Black, IBM's role was not limited to selling and producing the punch-card machines but also to leasing the machines for high fees (IBM was the most important contributor with punch-card technology to Nazi Germany). Hitler gave IBM founder and director Thomas Watson a medal for his sales of punch-card technology to the Germans. The sales were done by the German part of IBM, though ninety percent of the shares were owned by IBM in the US.

In fact the case of the collapse of Enron in US-business-life is a more recent case of moral blindness in risk management. Here, ambitious managers wanted to make the most competitive and innovative company on the energy market out of Enron. However, they forgot to be aware of the moral risks of their risk management of the company. The CEO of Enron Ken Lay was before the scandal considered as a good person with high integrity, but he did not have the understanding of the moral risks that he took by making his company follow a strict economic logic of risk management. We may ask the question how it was possible that a good person could turn into evil in dealing with risk management in the Enron case and where there was a turning point from moral negligence to conscious personal opportunism and search for profits for oneself without taking care of investors or shareholders. Indeed, the background mentality of praise of the personal willingness to take risk at a highly competitive market system may have caused the lack of a sense of ethical judgment in the risk management of Enron. Also, we may suggest that it was the paradoxical effect of too much success in the beginning of the company's history where the highly risky behavior was very successful that lead to no recognition of

the possibility of failure and consequently a lack of a sense of reality in personal self-perception of the managers of the company that lead to increased risk-taking and eventually fraud in efforts to cover up for bad financial results.

To help understand how Arendt's analysis of imperialism may serve as a basis for understanding the origins of the financial crisis as the "burden of our times," we can also turn to a fictional movie character, Gordon Gekko, who appears in two movies about Wall Street from 1987 to 2010. Gekko illustrates the function of moral blindness in risk management among investment managers and epitomizes the general mentality that led to the financial crisis. Gekko's statement that "greed is good" became the motto of capitalism without anybody questioning the moral soundness of the doctrine. The two versions of the movie relate to the idea that on Wall Street greed is considered to be the core of the organizational motivation for action.

In the first movie, the Gekko character has eliminated every moral concern of both deontological respect for humanity and for the virtues of integrity, moral compassion, openness, and concern for the other. Instead, Gekko only worships a belief in the utilitarian, functional, and organizational dimensions of greed in his increased risk-taking. He conceives profit and the endless search for more money as the foundation of the capitalist system. Gekko can be said to illustrate the moral blindness of the capitalist manger and investor in the same sense that Eichmann illustrates the moral blindness of the administrative bureaucrat in the work of Hannah Arendt. Although there are considerable differences between the two figures, their shared commonality is that they are morally blind to anything other than their total commitment to the functionality of the organizational system.

In the most recent movie where Gekko reappears, the character is more reflective although still very cynical with regard to his understanding of the capitalist system. But in the second movie he shows a concern for his family and human values that places him at the limit of the doctrine of moral blindness in risk-taking and risk management. In this sense, the movie represents openness towards overcoming moral blindness, muteness, and deafness.

There is, however, in both movies a fundamental message that it is an amoral logic of self-interest and greed that is the basis of the modern business system with its focus on risk management without a moral dimension. It is this mentality of egoism, hedonism, and narcissism that characterizes post-industrial capitalism. Although there are considerable differences between the grey organization man of the bureaucratic corporation or organization who works in total obedience without questioning the organization and the charismatic investment manager – with his hedonistic search for power – they are both characterized by fundamental moral blindness. As such, they represent what Arendt understood as the banality of evil, namely the inability to think morally, have compassion, and put oneself in the place of the other.

In order to give a clarification of the institutional dimension of moral blindness Joel Bakan's (2004) book *The corporation: The pathological pursuit of profit and power* can provide assistance. This book discusses the thesis that the corporation has a personality that can be considered as a legal person according to the law.

The argument is that the personhood of the corporation, with its characteristics based on the doctrines of limited liability and cost-benefit profit maximization, does not act like a moral person, but rather one that a psychologist would describe as a psychopath.

What Bakan means is that the corporation has no sense of morality and that we do not immediately recognize the psychopathic aspects of its actions even though it appears to be an "ordinary" legal entity with a "normal" legal personhood. Bakan is in fact describing the corporation as a kind of institutional analogy to the human personality of Eichmann. The corporation is as institution with organizational identity described as irresponsible and manipulative since its goal is profit maximization. It is grandiose since it follows its own goals and ignores its responsibility for its actions. Furthermore, it cannot feel remorse and is very superficial since it never relates to other persons in a deep and profound way.

In his argument, Bakan is close to describing the conditions of moral blindness at the institutional level in the management of risk in business organizations. It can be argued that this focus on the bottom-line and profit-maximization is embedded in the legal structure of the corporation. The underlying argument is that even though individuals would like to be moral as a result of personal consciousness they are subordinated to the rules and norms of the organization in a kind of pact with evil. The result is that they cannot be responsible or altruistic but must follow the maximization of shareholder value of the corporation. This implies a description of the corporate culture of investment capitalism with neo-Darwinian metaphors such as "every day is a battle – you will have to kill the enemy" that become integrated in the daily understanding of work of the risk manager and investor. Accordingly, such an analysis would combine system and individual in a phenomenological/hermeneutical approach to moral blindness in the self-understanding of the involved actors, because there would be focus on the different dimensions of moral indifference in the organizational system of action.

## *Research Perspectives and Conclusion*

The findings of the philosophy and sociology of the banality of evil and the whole social psychology tradition relating to evil and moral blindness are very important for our understanding of business ethics and the moral dimension of risk management. There is a wide research perspective that opens from this kind of analysis. The idea is to make the same kind of hermeneutic-phenomenological analysis of the phenomenon of moral blindness like the one that Arendt makes of Eichmann. This kind of analysis looks at the actions of a person or persons in relation to their existential self-understanding and values. This analysis can then be accomplished with a social interaction analysis based on the kinds of implicit rationalities in the social psychology experiments, which bring an important perspective to help understand the choices and actions of individuals leading to moral blindness in the understanding of risk in organizations. But we do not have

to make the experiments to analyze role-playing and structures of obedience and power. This method can be applied to all kinds of case studies and the combination of existentialist understanding and analysis of social roles in systems and structures will provide valuable insight. This approach could for example be useful in order to understand case like Shell in Nigeria, Enron and Arthur Andersen, World Com, Bernard Madoff or the BP and Deepwater Horizon oil spill because it would look at individuals, and their responsibilities and self-understandings in relation to general social roles and structures in the relation to risk and management of risk, which would indeed clarify the series of events that led to the catastrophe.

However, the critical reader could still argue that it has not really been shown how the moral blindness of Eichmann and of totalitarianism is the same as the moral blindness that we find in the business world or contemporary public administration. Following this argument, it is therefore not appropriate to use the framework for analysis of moral blindness today. This reader might insist that the times of the Holocaust were so extreme and different from our times that it is impossible to compare the two kinds of organization and that the authoritarian personality of Eichmann does not really fit with the service-minded stakeholder-oriented flexible project worker and project manager of our times. Moreover, the critical reader could argue that Bauman's, Milgram's, and Zimbardo's follow-up on Arendt's analysis cannot really be applied to the institutional context of a modern business corporation that is very different from a bureaucratic, military style public organization.

To this criticism, I would say that it is correct that the world is very different and that someone raised in Nazi bureaucracy is very different from a modern businessperson or investment manager; however, at a deeper metaphorical level I would still defend the possible application of Arendt's, Bauman's, Milgram's, and Zimbardo's structural and institutional analysis on the mentality and role-play in investments management in modern business corporations. Together with Bird's analysis of moral deafness, moral muteness, and moral blindness the 15 characteristics of moral blindness and the banality of evil that we mentioned can easily be applied to today's organizations and business managers who are submitted to the goal-rationality of the organization without any ability to do moral thinking. We see many cases where managers are so dependent on the rationality of the organization that they are not able to take into account the genuine moral interests of their stakeholders. Moreover, there are many examples of how technology and instrumental rationality contribute to the dehumanization and oppression of stakeholders. Moreover, the irrationality of the actions of top leaders in organizational systems may make different kinds of stakeholders very vulnerable.

At the structural and institutional level of organizational systems, as well, many similarities exist where it would be fruitful to apply moral blindness to an analysis of organizational behavior. The consequences of moral blindness and lack of moral thinking in organizations are enormous. The present analysis of moral blindness and the banality of evil aims at providing a critical framework for understanding moral crisis and ethical problems in organizations without attributing these actions to particular evil persons who intentionally want to do evil. Rather, as the analysis above makes clear, evil in organizations is also due to moral blindness where no one

in the organization has the necessary ability to govern all parts of the organization or the ability to control the aim of the organization with focus on general ethical concerns. What we see is rather a kind of incomprehensible autonomous logic of the system where no one can take responsibility for what is happening.

In order to prevent the chaos of moral blindness we have to increase the competency for ethical formulation in risk-taking and risk management among people in organizations and give them the capacity of critical moral thinking and framing moral problems. In contrast to the limited possibility for disagreement and voicing concerns about moral issues under Nazi dictatorship, people in corporations in democratic societies luckily have more opportunities to protest and speak up against moral blindness, muteness, or deafness. The obligation to speak up was, for Hannah Arendt, very important for preventing the banality of evil. She emphasizes the duty to detect moral blindness and the need for critical moral thinking based on the autonomy of reason and the role of critical judgment (Arendt 1989). Good common sense opposes the ideology, lies, and ignorance of moral problems in organizations. Arendt emphasizes the political dimension of human action and it is a part of her republican political philosophy that human beings at all levels of their existence must be personally responsible and morally sensible according to critical judgment. This is necessary in order to protect humanity and human dignity in risk management and in organizations and their environments.

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# Transforming Risks into Moral Issues in Organizations

**Cristina Besio**

## Introduction

This contribution aims to analyze situations in which risks are communicatively transformed into moral issues in organizations. Risk management systems have proliferated in organizations in recent years. Standardized techniques that seek to forecast risks and develop strategies to prevent the "worst-case scenarios" are widespread in different types of organizations (Power 2004). Despite criticism of practical failure and a lack of evidence demonstrating their effectiveness, risk management systems are currently the preferred approach for handling risks in organizational settings. Some risk management techniques are so strongly established, in fact, that they are used to deal with different types of risks, e.g. operational or image-related risks. Other traditional managerial practices of control, in contrast, have lost legitimacy and failures in risk management are met with more risk management.

However, an alternative method of dealing with risks is also in effect: transforming them into moral issues. Instead of, or sometimes parallel to, calculating possible courses of action and deriving subsequent measures to control risks, organizations call on the responsibility and diligence of their members to abate them. Alternatively, organizational units, an entire organization or other partner organizations can be referred to as moral actors, and blamed or praised for their actions. In all these cases, a moralization of risk communication takes place. The rationale behind these practices is that bad moral behavior generates risks, while virtue keeps them in check.

This contribution focuses on describing the moralization of risks as an organizational phenomenon, and analyzes some functions and risks that it produces. The functions of moralization are related to its capability to keep communication

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going despite a high level of uncertainty and lack of knowledge (von Groddeck 2011; Luhmann 2008 [1993], 368). In situations in which technical and managerial knowledge are called into question or completely lacking, instead of producing calculations or scientific arguments, it is often possible to refer to established moral values in order to find a common ground (at least temporarily and in a specific context) to continue operating. However, this strategy generates new risks, since moral communication can suppress other types of communication.

To be sure, this contribution does not aim to develop a codex for organizations with advice on how to behave in risky situations, but to describe and explain, in sociological terms, how moral communication unfolds in uncertain situations when risks are perceived to be high. The theoretical framework that I use to analyze the transformation of risks into moral issues is Niklas Luhmann's systems theory. I start by defining the concept of risk and stress the relevance of risks in organizations. In a second step, I introduce the concept of morality as defined by Luhmann and explain how risk and morality are linked to each other. I then analyze two typical situations that involve a high level of uncertainty as well as the moralization of risks: the aftermath of catastrophes and innovation processes. I describe the positive effects and the specific new problems and risks which moralizing entails in each of these cases. I conclude with some general remarks on the close relationship between morality and risk.

## Risks and Organizations

In order to understand the nature of risks, Niklas Luhmann argues that they should not be distinguished from "certainty", but from "danger". Luhmann draws a line between risk and danger (Luhmann 1991, 9–38). Both risk and danger indicate that harm or damage is possible or even probable. However, while dangers are phenomena caused by an outside force, e.g. "natural catastrophes" or forces of nature, risks are always attributed to a man-made phenomenon: decisions. For decision makers, risks are the possible negative consequences of their own choices. Risks are contingent: they depend on decisions. They are caused and can be avoided by making decisions. In other terms, what is stressed by the distinction between risk and danger is the strong impact of decisions on the proliferation of risks in modern society.

Reversing this association, one can conclude that decisions are risky. Decisions are acts of communication involving a choice between different alternatives, a choice that always falls short of perfect rationality. Different options cannot be thoroughly analysed based on all possible alternatives and full knowledge of possible effects. The rationality underlying decisions is at most a "bounded rationality" (March and Simon 1958, 157–163). Moreover, the situation in which decisions are made is always, to some extent, uncertain and continuously changing. These characteristics of the decision-making situations undermine the chance of a rational decision occurring at all (Lanzara 1993, 112; Brunsson 1995, 131–133). While they

occur in the present, decisions change a future state which they cannot completely foresee or even control. Therefore, they can also never exclude the possibility of damage.

This is a central clue for the analysis of organizational processes, because decision-making processes are at the core of organizations (Luhmann 2000; March and Simon 1958). These can even be analyzed as systems that generate decisions. The primary aim of organisations is to reduce uncertainty (Ortmann 2009, 113) and they do this by making decisions. Without uncertainty there would be no need for decisions and or for organization. Organizations exploit the openness of the future and develop mechanisms for making decisions in uncertain situations: they continuously try to reduce uncertainty and make the future controllable. However, by deciding in the present on goals to be reached in the future, organizations can never exclude all harm or regret resulting from previous decisions. Organizational structures such as hierarchies, operating procedures, or strategies facilitate the process of decision making, but never eliminate the uncertainty which characterizes it. As a consequence, organisations which are based on decisions continuously increase risks.

Organisations are implicated in a variety of risks. These include, first of all, risks to the organization itself. Investment decisions such as the acquisition of new units or the introduction of modern infrastructure unleash economic risks. Decisions with a direct impact on the organization also imply the risk that these decisions, even if they are upheld by organizational members, are not accepted outside of the organization. Moreover, organizations may create technical risks by introducing complex technology and/or new work procedures and regulations. Risks are not contained within the boundaries of individual organizations; instead, as powerful players in modern society, organizations have an impact on processes of central societal relevance: organization affects politics, the economy, education, science, and even social work. As a consequence, the decisions of organizations can also entail damages for external parties or groups: shareholders, stakeholders, and customers, even large parts of society, the environment and future generations.

Organizations are not passive entities when it comes to risks. Rather, they often take a preemptive stance in predicting and reducing them. Risk communication is above all risk management, with the main objective of containing risks. Important instruments include the systems and tools of risk management, which are based on the identification of crucial risks, followed by the assessment and calculation of potential harm and the measurement of their likelihood and potential severity. These systems quantify uncertainty and make predictions for the future with the aim to render threats amenable to managerial interventions. Since risks can come from different sources, such as volatile financial markets, project failures, or accidents, specific methods of risk calculations have been developed for dealing with risks, for example in the context of project management, various security systems, engineering, financial portfolios, and so on. However, all of these methods encompass standardized responses to risks, which traditionally rely on statistically driven techniques, but increasingly implement “fuzzier” methodologies. In both cases, based on calculated predictions, instruments are developed to reduce risks,

and to minimize, monitor, and control the probability and/or impact of unfortunate events. These include transferring the risk to other actors, avoiding the risk, reducing the negative effects or probability of the risk, or even setting priorities and accepting some or all of the potential consequences of a particular risk.

However, not even risk management systems can operate under conditions of full rationality and therefore generate risks themselves. I will briefly consider only two aspects that clarify this point. First of all, as mentioned above, risk evaluations are often based on statistical calculations. These suppose linear processes (a normal distribution of cases) and leave no room for random events or nonlinear processes (Ortmann 2009, 99; Taleb 2007). Nevertheless, these very events often trigger catastrophes. Second, risk management cannot consider all elements of a given situation, e.g., all the technical interdependencies involved in the functioning of a nuclear plant and the possible consequences of individual marginal defects for the plant as a whole. Even if the risks caused by an individual variable can be calculated and controlled, a certain amount of uncertainty remains. The choice of which variable to consider is inescapably based on past experience, which is not a fail-proof guide for future decisions. New methodologies cannot eliminate this dependence on past experience. Even computer simulations, for example, need real, i.e. "dated", data in order to be run.

In other words, risk management systems are also bundles of decisions which change the future and therefore introduce new risks. This inherent risk of risk containment is inescapable. Once the possibility of decision is introduced, acting on this possibility holds an inherent risk (Luhmann 2008 [1993]). With the development of a new drug, for example, both the decision to use the drug and the decision not to use it have specific risks. Parallels can be found in the case of risk management: the implementation of a risk-prevention measure can also entail unforeseen risks.[1]

## Moralizing Risks

Risk management is ubiquitous in organizations; however, there is another way that organizations handle risks: by moralizing them. In systems theory, morality is not the sum of a society's values, but a form of communication oriented on the distinction between "right" and "wrong" (or good versus bad). This communication form distinguishes between good and bad behavior, and is guided by criteria such as moral values, norms, good examples, and so on. When applied to persons or other decision makers such as entire organizations, moral communication can express either esteem or blame (Luhmann 2008 [1978], 97–107, 2008 [1989], 272–281). Moral communication is a very strong communicative format, as it usually does

[1]This can be seen, for example, when warning devices, which are expected to signal problems, fail to function or malfunction and provoke damage (Perrow 1989, 39).

not refer to a specific personal trait or technical skill, but tends to attribute esteem or blame to the person in question (or another actor) as a whole (Fuchs 2010, 18). When someone is assigned moral blame, this actor loses credibility and is no longer considered a valuable communication partner. This sort of communication also takes place in organizational contexts and can strongly influence processes of decision making, since it can generate conflicts and hinder cooperation (Jäger and Coffin 2011).

The transformation of risks into moral communication is possible because both morality and risks have a similar basic structure: they operate by attributing responsibility to a person or larger decision-making entity. That is to say, both communication forms attribute responsibility to entities considered able and free to make choices.

Moreover, in modern society, one person's decisions can often inflict harm on others (one can think of environmental risks or financial risks). The victims in these cases were not the source of the problematic decisions. Although they are not responsible for the decision, and could not control and cannot change it, they can eventually suffer because of the poor judgement of others. For them risks become dangers as they do not see how it is possible to change the situation by making a decision. As a consequence, discourses surrounding risks can stress the distinction between decision makers and victims (Luhmann 1991, 111–134). In this case, there is a strong probability that moralization will occur. Moral communication can blame decision makers for placing others, the innocent third parties, in harm's way. Organizations are often considered the powerful decision makers that act without considering the consequences of their decisions for third parties who cannot intervene in organizational processes. This kind of moralization characterizes the communication on risks which takes place in the mass media.

When considering these discourses, it should be taken into account that the moralizing which accompanies risk communication has a specific form (Roth 2010). Since in the realm of risk communication, decision makers are believed to make rational decisions about risks, to act autonomously, to control their actions, and to engage in relationships which are trusting and straightforward, when problems emerge, decision makers are blamed, e.g., because they did not act rationally or failed to consider the consequences of their actions, or because they took to many risks (Roth 2010, 480). A typical moral argument in this context is that the decision makers followed their own interests without considering the possible harm to third parties. As a consequence, they discounted the risks and caused damaging situations for others.

## Risk Management in the Wake of Catastrophes

One typical situation where a strong moralization can be observed is after a catastrophe. In this case, moral communication can, of course, pervade the media, but organizations also take part in public debates, for example by trying to blame

other organizations or individual organizational members. Internally, the catastrophe can be attributed to single actors or groups in the organization who are considered incompetent or morally irresponsible. In this case, the accused serve as scapegoats and are instrumentalized in order to avoid extending the search to other responsible parties (e.g. in upper management or at more basic technical or managerial levels) (Bonazzi 1983).

As an example of this kind of communication, I describe the communication strategy of BP after the Deepwater Horizon oil spill and the ensuing environmental damage in 2010. BP implements this strategy as an attempt to preserve the company's image as a morally correct actor, tries to explain the catastrophe as a moral failure, and introduces morality as an important element for handling future risks:

1. After the oil spill, BP's main focus was image improvement. The company's objective was to reduce its perceived accountability as the main perpetrator of events leading up to the catastrophe. What mattered most in this context was regaining trust and not providing an explanation of facts.[2] This was particularly important for BP as the organization had focused since the 1990s on improving its image as a "green company". In 2001, the company introduced a new logo and even a new name: BP was no longer the abbreviation for "British Petroleum", but "Beyond Petroleum" (Balmer et al. 2011). For a company that had framed itself as a moral actor committed to environmental protection, a catastrophe such as the Deepwater Horizon oil spill could be extremely damaging at the reputational level. Having set the bar this high, more intense societal scrutiny would be inevitable.

   In the context of this strategy, BP's main focus after the catastrophe was to demonstrate its willingness to provide compensation to the region for the damages. BP participated in clean-up operations and promised to refund all those affected. The CEO, Tony Hayward stated, "We are taking full responsibility for the spill and we will clean it up and where people can present legitimate claims for damages we will honor them. We are going to be very, very aggressive in all of that." (Macalister 2010)
2. After a certain period, the "blame game" began. Three months after the explosion of BP's Deepwater Horizon oil rig, Tony Hayward stepped down as the group chief executive in mutual agreement with the BP board. This development can be read as a reaction to the criticisms expressed in the media, but above all in the U.S. Congress by politicians who accused BP and Tony Hayward of having worked only to increase profit without any regard for the potential consequences of their actions. Moreover, Hayward has been criticized for downplaying the consequences of the catastrophe and stating "I'd like my life back" to reporters as Gulf residents struggled to deal with the spill (Mouawad and Krauss 2010).

[2]This is explicitly recognized by the Incident Commanders for Louisiana (Austin and Laferriere 2011).

A scapegoat had been found: Hayward's actions were judged to be morally wrong and he had shown himself unable to demonstrate empathy for the victims. Because he occupied a high place in BP's hierarchy, Hayward was also a credible scapegoat (Bonazzi 1983).

3. The moral blame was not limited to one person. Executives of the three principal companies involved in the drilling that triggered the crisis (BP, Halliburton and Transocean) tried to shift responsibility to each other. On January 5, 2011, the National Commission on the Deepwater Horizon Oil Spill and Offshore Drilling released a final report detailing the faults by the companies that led to the spill. The panel found that BP, Halliburton, and Transocean had all attempted to cut corners in terms of costs and thus helped to trigger the explosion and ensuing leakage. The report states: "Whether purposeful or not, many of the decisions that BP, Halliburton, and Transocean made that increased the risk of the Macondo blowout clearly saved those companies significant time (and money)." (National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling 2011, 125).
4. Another interesting point concerning the moralization of risks is that the catastrophe unleashed an internal discussion about security norms and safety culture. In an interview, the director of the Human Resources of the BP Group Helmut Schuster stressed that BP has important ethical rules; however, these must be enforced, e.g. through more focused instructions or by introducing incentives related to ethical correct behavior (Lehky 2011).
5. Moral communication was a central aspect of BP's strategy. However, it was not the only aspect. The firm also completed a risk analysis on internal technical devices which led to recommendations including measures at both the technical and at the managerial levels, such as strengthening contractor management, well control, pressure-testing for well integrity, emergency systems, cement testing, rig audits and verification, and personnel competence (BP 2010).

In this example it becomes clear that morality is not only used to attribute responsibility in retrospect, that is to say, to explain the catastrophe, but also to influence future behavior and the handling of risks. In fact, if a catastrophe can be explained by "bad" behavior, the prevention of future risks should first of all concentrate on improving morality. As a result, a thorough analysis and criticism of established institutions is replaced by the idea that a few changes to the technical system accompanied by the morally impeccable behavior of all personnel are enough to prevent future risks. In the end, the institution of oil exploration and production remain unchallenged and BP continues to drill in the Gulf of Mexico, even if some critics consider this activity too risky to be pursued.

On the subject of catastrophes, Charles Perrow (1989) has provided several examples, on the one hand, of how moral communication unfolds in the aftermath of catastrophes and the search for scapegoats begins. On the other hand, he has also shown that after a scientific analysis of the processes involved, a moral explanation of catastrophes is implausible. A catastrophe can then only be explained by considering the interactions between complex technical systems, the decisions

of operators in an uncertain and unclear situation and the organizational structures which, for example, are not designed to handle infrequent but dangerous events. Moreover, the situation is complicated by the fact that complex technologies involve different organizations with different goals and knowledge. When systems are complex, interrelated process chains are involved, outputs and inputs cannot be clearly attributed to decision makers, and circular feedbacks are the norm, morality is a useless device for dealing with risks (Ortmann 2010, 253).

Despite these problems, morality can be vital to organizations in the short term, because it has the capacity to temporarily protect system dynamics. This is important in situations such as catastrophes in which former decisions made based on risk analyses are called into question. Catastrophes threaten existing institutions (Hoffman and Jennings 2011), technical devices and, above all, the credibility of risk management systems themselves. Since catastrophes make it clear that, to a certain extent, technologies are not fully controllable, they also reveal the limits of risk management. Moralizing often occurs in the wake of catastrophes because these events show that former analyses of risks and chances were insufficient or wrong. Organizational decisions led to failures. In this situation, instead of discussing basic decisional structures and admitting the impossibility of a complete analysis which would lead to a correct decision, moral communication, together with a search for scapegoats, can be initiated. Morality allows a system to keep operating in a situation of high uncertainty, when the rules of the game themselves are likely to be called into question. Put another way, by identifying and sanctioning scapegoats, organizations can position themselves as moral actors and maintain the internal and external backing necessary to continue operating in difficult times.

However, moral communication also entails new risks. These are manifold (Luhmann 2008[1993]), but in the case of catastrophes the central problem is that moralization suppresses other forms of communication, for example communication based on technical or scientific analysis. This can be a problem in the long run, as the renunciation of a deep and thorough analysis of risks can cause errors and problems to go undetected and unremedied. Risky systems continue to operate while a discussion of the problems and the basic risks does not take place. In the end, morality protects the status quo, which also encompasses current risk management systems, from criticism.

## Risks by Innovation Processes

Another situation in which the moralization of risks can be expected is with innovation processes. Innovation always causes uncertainty for organizations (Dougherty and Heller 1994; Levinthal and March 2003; Ortmann 1999). Organizations struggle to set up business plans for innovation processes and to calculate which resources are necessary, or how long will the innovation process will last. The market success of more radical innovations is difficult to forecast. One cannot calculate the technical consequences, revenues or future social acceptance. As a consequence, it is also difficult to develop risk management systems.

In these situations, moral communication can be advantageous for innovation processes. This is, for example, the case of small firms concerned with the development or the diffusion of "green" technology (e.g. Blättel-Mink 1998; Guggenheim 2005; Mautz et al. 2008). One sector in which a moralization of risk accompanied a successful process of innovation is the renewable energy sector in Germany (Bruns et al. 2009; Mautz et al. 2008). In this sector, moral communication is a discourse oriented toward environmental values, which, on the one side is pushed by groups of highly engaged actors and, on the other side, reinforced by public opinion:

1. Innovation processes in the renewable energy sector in Germany are accompanied by value-oriented communication. Starting in the 1970s, moral criticism of the industrial society inspired various activist efforts. These were not limited to protest and political advocacy. The broader potential of renewables began to be (re)discovered. This phase of development generated new and somewhat utopic ideas. New technical devices were used in the private sector by those who were willing to experiment with new ways of energy production. Later on, starting in the mid-1980s, concepts were developed for more concrete projects often funded on a private basis and sustained by groups of environmental activists. During this decade, several pioneer projects are initiated to develop devices which can also be used in practical applications and produced on an industrial scale. In this phase, concepts such as "ecology" and "environment" gain moral weight and exercise a motivating influence.[3] However, the true catalyst driving the rise of successful firms was the value of "sustainability" which became increasingly established in the 1990s.[4] A value-oriented discourse began to encourage investments, as it stressed the worth of risk taking in the name of a just cause. Following a number of setbacks, the energy sector in Germany, dominated at the beginning by little enterprises, gained strength and the ability to challenge even major energy suppliers. Currently, even major companies are forced to enter this discourse due to the moralization of environmental risks. Some visible consequences are the introduction of corporate social responsibility measures such as "sustainability reports" and the implementation of complex risk analyses which integrate economic, technological risks and, increasingly, the risks related to social non-acceptance, e.g. of specific projects in specific regions.
2. Over the years, a number of committed groups backed these values and became a driving force behind technological developments, above all in the biomass and wind sectors. In times when big companies are reluctant to invest because they cannot see rapid financial returns, activists are willing to take risks fueled by their

[3]While environmental values are crucial, the process is also accompanied by other values such as the idea of a decentralized energy supply or justice toward third world countries. This can motivates projects with the aim of diffusing technology or adapting existing technology to different economic and natural conditions (Mautz et al. 2008).

[4]While the value of sustainability can motivate different actors, it diverts attention to the question of climate protection and the economic potential of renewable energies. Traditional environmental values such as nature or biodiversity protection become secondary (Bruns et al. 2009, 477).

moral engagement. Committed groups guaranteed continuity in the innovation process, even in instable phases in which political and societal support is not available (Bruns et al. 2009, 27, 474–475; Mautz et al. 2008).

In morally motivated innovative firms, single persons are often highly relevant in development projects. Company founders can play a central role (Guggenheim 2005; Holzer 2010, 80). In many cases, it is the figure of the founder as a highly engaged and morally laudable individual who motivates others and stands for the moral value of the project.

3. Innovation processes have not only been driven by the high moral commitment of smaller groups in the renewable energy sector; the moral discourse propagated by the mass media and the associated impression that environmental values are supported by public opinion have also constituted a further driving force. When the acceptance of certain values by the population is perceived as strong, politics tend to support projects based on these values. This was the case in Germany, where special regulations and funding programs starting in the early 1990s protected the takeoff of the renewable energy sector in the beginning and increase growth in a second phase (Bruns et al. 2009).
4. While morality played a central role, references to morality are not enough in order to explain the success of this sector. Other elements must be considered as well, i.e. elements that enable moral concerns to be taken into consideration by different societal instances. For example, renewable energy has become an issue which politician can use in their election campaigns and the renewable energy sector is now an economic opportunity not only for groups such as farmers but also for broader parts of the population, offering occupational opportunities in industrially weak regions (Bruns et al. 2009, 475–476). Technological developments have also even made some renewables a viable economic opportunity for big energy suppliers. This has applied to wind energy, for example, since the technology to install offshore wind power plants has become available (Mautz et al. 2008, 93). While purely moral communication can only provoke diffuse reactions, when a moral concern is translated into a political and/or economic issue, politicians and enterprises are able to provide specific backing for innovation processes.

In the case of innovation processes, moral communication can trigger new ideas. Some authors stress that it functions as a heuristic device, i.e. a search strategy (Homann and Blome-Drees 1992, 142), and fosters innovation. The innovative potential of morality is high if one considers the fact that this kind of communication can be very critical and direct our attention toward the pathologies, inadequacies, and shortcomings of current practices (Luhmann 1997, 404–405) under specific conditions. As a critique of the status quo, it can motivate the search for alternatives.[5]

[5]The experience that value-oriented projects can lead to innovation is not new. Jackall's analysis of the morality of bureaucracy (1983) shows how there had been no significant innovation had occurred for several decades in production technologies in the U.S. chemical industry well into

With regard to risks, another function is even more relevant: morality can protect new ideas and referring to moral values can give the innovation process time. Actors can set aside a complete analysis of technical or economic risks, for a while at least, when their activities are guided by moral aims. In other words, morality "permits ignorance". Since time is necessary in order to experiment and allow trial and error processes to unfold, "allowing for ignorance", doing away with plans and complete information, at least temporarily, are essential factors for innovation (Ortmann 2009, 123–132). A moral orientation not only allows for ignorance, but also motivates actors to take even greater economic or operational risks. To a certain extent, a value-based orientation mitigates the risk of failure.

In the case of the renewable energy sector, while a moralization of risks can have positive effects, it also introduces new risks. If decisions are made on the basis of moral values instead of organizational programs, planning, and other organizational devices, the organization as a system loses control. Organizations make their own autonomous decisions using organizational structures such as programs or procedures. Unlike the latter structures, the organization does not make decisions based on "right vs. wrong" as a scheme of observation. Since this scheme allows for alternative patterns of communication, it can pose a danger to organizations (Ortmann 2010, 218–219). In other words: it is difficult to control the values that are introduced by moral communication and the ensuing consequences. As a result, on the one hand, many examples can be found of how morality supports innovation with positive effects on organizational activities. On the other hand, there are also several examples of how moral communication hinders innovation. In the case of the renewable energy as well, moral discourses focusing on problems resulting from these new technologies have slowed development. Examples include arguments stressing that certain technical devices imply the use of ample natural spaces and resources, or that technical installations or facilities deteriorate the aesthetic quality of locations.

## Conclusions

Certain characteristics of moral communication can explain why it is capable of fulfilling the described functions, as well as unleashing the new risks.

First of all, the central communicative advantage of morality is that references to moral criteria make it difficult to avoid communication (Nassehi 2006, 374). Issues such as sustainability or transparency cannot be easily negated. Rejecting a contribution based on moral communication makes one an easy target of blame.

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the 1970s. Then, a wave of innovation was suddenly sparked by a discussion of the health risks associated with cotton dusk. This moral discourse, which also reached the political level and prompted new regulations, acted as a trigger that led a relatively conservative industry to improve its production processes (Jackall 1983, 129).

This is rooted in the fact that morality tends to set rules that claim universal validity (Luhmann 2008 [1989], 276–281). Consequently, actors who adopt moral communication are considered to be guided by concerns for general welfare and not their own particular interests. On the contrary, those who reject moral communication are ascribed selfish motives. Its universal or near-universal claims and acceptance are what lend moral communication legitimacy. This legitimacy plays an important role in the treatment of both catastrophes and innovation processes.

Second, it should be considered that in modernity, moral communication does not have direct consequences for actions and decisions (Luhmann 1996, 65, 1997, 800). In contrast to communication in functional systems such as economy, politics and law, moral communication today is a "weak medium" (Luhmann 2008 [1989], 334). That is to say, it operates on an abstract level and does not deliver operating programs that can result in concrete decisions. To clarify this point, it could be helpful to draw a comparison between moral and legal communication. It is nearly impossible to make decisions, e.g. regarding medical research in controversial sectors, based on moral values: a wide range of different and conflicting values can be called upon in order to justify opposing decisions. On the contrary, relating discussions to existing regulations, e.g. on the "professional liability" of physicians or "informed consent", has the effect of limiting alternatives and supporting the decision-making process. Correspondingly, it has been observed that even in ethical commissions, legal arguments are dominant and crucial to arrive at decisions, while moral arguments are often pushed back (Bogner 2009). The characteristic decoupling from concrete specifications for decisions, which can be considered a weakness of moral communication, has also a positive side. Since specific consequences are not in sight, moral communication can be easily activated in difficult situations such as catastrophes. Its criticisms can also go deeper and therefore give morality the capacity to trigger new ideas.

Finally, morality can have a simplifying effect. Morality can be used to simplify complex situations, for example by attributing failures to the incorrect behavior of individual executives instead of considering market dynamics or the internal dynamics of organizations. Questioning systemic failures of this kind would be too complicated and probably impossible to process and deal with. For innovation processes, morality also allow actors to dispense with a throughout analysis of risks and thus facilitates decision-making processes. The simplification achieved by morality clearly has a positive side.

With regard to the moralization of risks, the cases of catastrophes and innovation processes showed that in particularly uncertain situations characterized by a crisis of established institutions, when divergent opinions about specific technical questions collide and organizations risk losing their orientation, moral communication can become a temporarily functional manner of dealing with risks: It can protect organizational operations or provide an initial input in the search for new ideas. The temporary suspension of other criteria is advantageous. This characteristic allows morality to give an organization time to build or reconstruct adequate structures. However, morality cannot deliver a thorough analysis of problems, nor can it

give precise indications on how to operate. Since morality sets high expectations, suppresses other ways of handling risks and at the same time gives little specific advice for action in complex systems, it is viable in the short term, but, if left alone, can be dangerous over time.

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# Decision-Making as Navigational Art: A Pragmatic Approach to Risk Management

**Matthias Gronemeyer**

## 1

## *Risk/Uncertainty: The Economist's View*

> Whenever, in short, there is a definite damage, or a definite risk of damage, either to an individual or to the public, the case is taken out of the province of liberty, and placed in that of morality or law. (Mill 1859/2008, 91).

What John Stuart Mill initially wanted to describe with this statement was that the liberal state needs a strong juridical fundament. It is the core conviction of any liberalist that any action is just as long as it is legal. Damaging others is not compatible with this conviction. So far, so well known. But Mill gives us, maybe by accident, also a more subtle information. He speaks of risk of damage and remains undecided whether risk is a matter of morality or law, or both. In any case, he lets us know, risk is nothing that could be left to the self-organising forces of a free market society. Why that? It is because imposing risks on others resembles cheating for it is the essence of a risk to be unknown. If I know the probabilities, the thing I am talking about is not risk, but chance: if I play roulette, I have a chance to win and a chance to lose money, but we would not call gambling a risk in Mill's sense. As he speaks of 'definite' risks he seems to escape the problem with risk: when definite, it is a probability, not a risk. But even probabilities pose severe problems: only factual breach of law can be prosecuted, not possible ones. When I drive a car,

*Thesis: Only the combination of several moral principles will yield a desired limitation of risk in business.*

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there is always a probability of a certain percentage that I might hurt somebody or cause other damage. The usual answer to this is guaranteed compensation for the victims, for which reason I am obliged to have liability insurance. Robert Nozick has shown that compensation is only a superficial or modus vivendi kind of solution to the risk problem, for given equal rights to everyone, somebody might legitimately disagree with the compensation rule. We only have to imagine somebody asking us: do you agree being killed in a car accident when compensated? Nobody of us would light-heartedly say: yes; but we would experience different attitudes towards risk. Some people are more anxious about what might happen than others. This cannot be regulated by law. The natural right not to be harmed by any other forbids the other to play e.g. Russian roulette with me, even if by chance he fires no live bullet at me. But natural rights theory has problems with comparably low risks: Anything I decide might slightly affect somebody else, and taken natural rights theory rigidly, I either cannot account for any decision or else have to face endless prosecution. Given risks and uncertainties, natural rights theory needs a dogmatic termination. (see Nozick 1974, 73–78 and Altham 1984).

I will not discuss Russian roulette scenarios here, but assume that any decision under risk or uncertainty affects at least the decision maker, and that he is truly interested in handling the risk. Nor shall natural risks (tornados, tsunamis, earthquakes) be my topic here, connected with the question whether we are morally obliged to help each other in such dire situations. Moreover, my focus shall be on economic risks, for example the risk of losing money in an investment. “Risk” and “uncertainty” are often used synonymously. In fact, I do not see any use in artificially forcing any differentiation between the two, although they do not exchange one for the other: we might imagine situations of uncertainty which contain no risks (for example when I am undecided which car to buy) as well as situations which are certainly risky (smoking is proven to affect my health, but I do it anyway). In the economic context, risk/uncertainty also contain the meaning of “chance”, i.e., of the possibility of gaining more than expected, whereas in a pure physical context they are more related to “danger”. We must not confound natural and economic growth, for the former is no growth but a circle of genesis and decline, and only the latter knows real surplus. Since both are interconnected, i.e., economic prosperity adds to human genesis as well as economic losses may cause physical decline, we can use the terms “risks” and “uncertainty” in a broader sense.

What do I understand by economic risk? It is the risk of a business to fail, the risk of losing money instead of gaining it. Usually, economic risk is expressed in a risk-return-ratio: return expectations relate to the estimated risk of loss. We know this from the variation of interest rates banks demand in accordance to the debtor’s creditworthiness. But neither can we say that high return expectations are a true indicator of risk (we know about businesses which realise dreamlike return rates with virtually no risk, like some quasi-monopolists in the energy sector), nor does the relation work the other way round, so that we just had to lower our return expectations to minimize risks. Interest rates should mirror the risk involved in the investment, but they often do not.

One attempt to drill down the risk/uncertainty issue has been the *common prior assumption* (CPA). Based on classic economic theory, it was assumed that uncertainty in economic decisions and therefore risk can be completely explained by a deficit in information. The fully transparent market with likewise informed agents would in turn never contain any risks. Now that we find the fully transparent market counterfactual, risk/uncertainty are expressed in the *probable* truth of given information. And this probability could either be measured by frequency, by individuals' willingness to bet on a certain proposition, or by the extension of logic sentences. Stephen Morris shows that this reduction does not work (Morris 1995): On which ground do I decide which way to follow, whether relying on experience (e.g. charts), on what the others do, or on applied mathematics? When I know that buying certain government bonds has a 10 % chance of complete loss, and I observed 90 successful cases, shall I then invest or not? The problem is that a statistic investment does not exist: it either succeeds or fails, but it does not so by any percentage. So, which common prior I stick to has to be pre-decided; turning e.g. to logic cannot itself be a logical decision. The CPA approach tends to focus only on the information issue of uncertainty and disregards that a plus of information itself could add to uncertainty, because it baffles the agent.

Another approach to the risk problem is the *efficiency argument for profit maximization* (EAPM). The efficiency argument for profit maximization says that corporations and their managers should maximize profits because this is the course of action that will lead to an 'economically efficient' or 'welfare maximizing' outcome. The basic idea behind the EAPM is usually attributed to Adam Smith and his famous concept of the *invisible hand*. Whilst for long it has been suspected to cause too much collateral damage when taken normatively, Michael Jensen (2002) showed that the concept is reconcilable with stakeholder theory (he calls it 'enlightened value maximization'), and therefore could be a candidate for solving the risk problem: the individual problem of risk/uncertainty is shifted to a higher level where it fades away. Against Jensen we have to argue, that EAPM is no solution for the risk problem, but *is* the risk problem for it insinuates that value maximization is always possible and does not take into account that a larger part of a national or global economy could break down (as recently observed). And there is a second weakness to which Waheed Hussain (2012) has pointed recently: the EAPM model is insensitive towards the personal sphere. It might be right that, given value maximization as the overall corporate objective, managers are obliged to pursue maximum profits – but what motivates them to do so? Private vices might or might not deliver public virtues (EAPM argument); the larger connected the economy I work in, the less I can know how the return of my personal input will be. So I am well advised to do at least some things which are obviously good for me (or for neighbours), like learning to play piano or nursing my child. It is not clear why waiving my personal welfare in favour of system efficiency should deliver me more welfare in the end. Obviously, there is a sphere which we can call the economy, and one which we call the private sphere. Unfortunately, the borders between these spheres are blurry: it is the essence of *oeconomia* to serve the household.

When contaminated with risk/uncertainty, both the CPA as well as the EAPM model tend to drive a safety rally, i.e. more and more restrict individual liberties as a possible source of unsound and therefore risky behaviour.

## 2

## *The Metaphorical Approach or: Why De-Globalisation Is Not an Answer to Economic Risk*

Starting with the title, the reader will find a considerable use of metaphors in this article. This may appear odd to those who are accustomed to analytic scrutiny. However, the mere work on the concept too often proved to be reductionist when it comes to applied ethics. I would not go so far as Max Hocutt (2010) does and reduce moral philosophy to behavioural science, but I agree that "it is variable customs worked out by the members of diverse groups to help them get along with each other while they serve their biologically based needs." Now that our traditional customs ceased to do a proper job in times of globalised economy, it shall be the task of the philosopher to make the difference.

Knowing about the risk-return-relation, the author prefers the richness of metaphors at the expense of being blurry from time to time. "In the great metaphors and allegories", says Hans Blumenberg (1979/1997), "is reflected, altered, and expanded the imaginative orientation once gained". Orientation itself is a metaphor. The metaphorical approach capitalises on the fact that metaphors transport more than their literal meaning. When arguing against reductionist approaches, this helps me not to drift into metaphysics. Now, one might respond that I cast out devils through Beelzebub, for metaphysics is at least logical, whereas metaphors are not even that. But as we have seen regarding the CPA model and will see again below, rationality or non-contradiction alone do not make the point. Since risk is something blurry and my objective here is to find out how to handle it – not how to eliminate it, using metaphors might be the adequate method.

It has for long been an article of faith among economists that having entire information about the market leaves no room for risks. I have already rejected this notion above for empirical reasons, but from a normative point of view one could ask, if size matters and too much information is baffling, why not fencing in the economy and cut it into manageable portions?

When business once started going abroad in the ancient times, with the Phoenicians and Greeks, it did so at sea. The sea was full of risks: bad weather, pirates, shoals – not to mention the uncertainty, whether the fright could be sold at the destination for the desired price. Trading at sea, or in short: the sea, metaphorically represents a non-linear, reciprocal, if not chaotic system; predicates which are ascribed to modern global economy as well. So, further on I will work with this image of the sea.

Now, if the risk is at sea, a first answer could be: then stay at land! This was exactly the advice ancient Greek authors gave to their readers: buy a little farm and you will lead a decent life without troubles. Here is what Hesiod recommended his readers: *But if desire for uncomfortable sea-faring seize you when the Pleiades plunge into the misty sea to escape Orion's rude strength, then truly gales of all kinds rage. Then keep ships no longer on the sparkling sea, but be sure to till the land as I bid you* (Works and Days 618ff). Hesiod is generally sceptic about trading at sea and regards it but as a last resort from "wretched poverty". To those who seek wealth in *emporia* he certifies a "misguided heart". In his marvellous essay *Shipwreck with Spectator*, Hans Blumenberg suspects the seafarer for blasphemously bridging what the Gods wisely once had divided. However, the idea of a disconnected economy as an answer to risk didn't work then and it does work much less today: due to a constantly rising population, Hellas was permanently short of grain, and had to export oil, vine and pottery to Egypt and the Black Sea region to trade in wheat. And in our days, no one with any sense would call for cutting overseas trade relations. So, the sea is everywhere, and even those who stay at land are at sea on a second level.

Then, one might say, let's have a look at the ships and the navigators. Robust vessels and skilled pilots will definitely lower trade risks. Yes indeed, and much was done on at least one of these topics, if you think for example of the Basel I-III guidelines, or the ratings of creditworthiness. Concerning the navigators, i.e. the managers, things are not so clear. This is troubling in so far as, according to Schumpeter (1982), the absorption of risk, the bearing of uncertainty, belongs to the role of the entrepreneur (for a larger discussion of this point see Gronemeyer 2007). The pilot's conduct shouldn't add to the bad weather. The traditional concept of the 'honourable merchant' points in this direction, but in contrast to the reductionist economist view of Horst Albach, the concept of honour is not intrinsic to managerial sciences. As we will see below, it instead requires strong virtues (for a discussion of the 'honourable merchant' concept see Beschorner and Hajduk 2011). But anyway: robustness always is at the expense of fright capacity and/or speed and there is more to this point than the fresh strawberries to your champagne on New Year's Eve. Better formation of the pilots might be an issue, but in the end it's their personal experience which lowers risks. Navigation cannot be done from land (i.e. by academics). And: even the best pilot cannot look behind the horizon (which truly points to the existentialist core of our issue). This matters insofar as we observe less a limit of growth than a growth of the limits (i.e. contrary to popular forecasts of the 1970s, economies all over the world still seem to have much headroom for growth). In short, focussing on corporations and their leaders means shifting the problem, not solving it.

Since "business" increasingly developed a bad reputation, it has become popular to show off with one's economic ignorance. But there is no moral gain in it. Everybody is in business, everybody is a subject in economy, at least as a consumer, often as an employee, as someone who makes savings for the future, as a housekeeper (even if your apartment has phone booth size), as a *oecodespotes* – to track back the matter to its ancient Greek roots. Hence, we never are merely passengers, we all have to keep our own small boats above the water (at least), and

if we want to sign up on a larger vessel (for good synergetic reason), we should be able to make a sound decision. So, the business class are all of us. Those, who retire to the passenger position will soon end up as live stock on the lower decks. … *vous êtes embarqués* is Pascal's unmistakable statement. Or, in Nietzsche's words: *We have left the land and have gone aboard ship! We have broken down the bridge behind us, – nay, more, the land behind us! Well, little ship! look out!* (The Joyful Science III, 124: In the Horizon of the Infinite).

That we cannot escape risk reveals a severe weakness not only of natural-right-theories (as mentioned above), but also of contractualist models like the Rawlsian one. Isn't it peculiar that risk/uncertainty do not play any role in the original position and the two principles of justice? Altham (1984) points out that the required rationality of the agents in the original position makes up with different attitudes towards risk/uncertainty. The maximin rule instead presupposes that all agents are entirely risk-averse, and that trading in larger opportunities for larger risks could be anything but rational. But this is exactly what we do in business every day. So, if agents have different attitudes towards risk/uncertainty, it is "hard to see" how they could ever agree on the known two principles. A similar objection is raised by Hocutt (2010) against Kant: non-contradiction as proof of morality requires acceptance of non-contradiction as constructive principle of reason as a prerequisite. Economically spoken, "… behaving rationally is … to achieve your personal ends" (not abiding by any formal logic). As we will see below, non-contradiction can be an *indicator* for morally sound acting, but as long as risk/uncertainty are involved it cannot be the sole source of moral law. It is the essence of risk that it cannot be handled by any a priori principle. This is because a risk by definition is something unknown; what appears to be a risk to some person might not be one for someone who experienced a similar situation before. Risk situations are non-ideal situations, and they are analytically non-reducible. Thus, Altham concludes, "the most that can reasonably be attempted is to see what kind of modus vivendi might be arrived at, in so far as the differing preferences are rooted in differing attitudes towards risk."

## 3

## *It Is Not Liberalism Which Is Responsible for Economic Turmoil, But Individual Economic Immaturity*

Maybe, the phrase about the live stock was spoken too quickly, and maybe all my argument until now has in tow an unmentioned approval of liberalism. What if the critics are right? Perhaps, liberalism, at least the open market economy, indeed is something worth to be thrown away (was it not the homeland of liberty from where the severest economic crisis arouse?), thrown away in the same way in which I do not hesitate to reject communism or fascism.

We see that the call for virtue ethics in the face of economic crisis does only make sense on the background of an open society. In a coercive system, morality indeed reduces to behaviourism, and we could ask every reductionist: where do you anchor the moral point of view? It is not the place here to argue for an open society and free markets in a normative way. For my case, it is sufficient to point out that *if* we want *this*, we have to consider *that*: if we want an open society with equally economic opportunities, we need individual virtues. For not becoming dogmatic, we have to show the link between an open society of free people and the necessity of them being virtuous. I cannot spread the argument here at length, but in short it is a very simple three-step argument which I borrow from Aristotle and which runs completely without any metaphysical or transcendental fuel. (1) He asserts that justice is a matter of the polity (Pol. I, 2), that (2) the polity cannot be established but by free men, and that (3) among free men nobody is more entitled to rule than any other one (Pol. VII, 14). Sure, the argument lives and dies with the acceptance of justice as the principal objective of politics in ensuring the "good human life" (in contrast to mere existence; "fed up, cleaned, healthy"), but given this precondition, the logic is striking: Since the domestic household is, according to Aristotle, built upon the natural relationship of master and slave, and since justice is a matter of logos (i.e. speech as well as reason), not of nature, it is evident, that neither the domestic household, nor its political mapping: the kingdom (at best) or the tyranny (at worst) could be a dwelling for justice in this regard. Step two follows directly out of premise one: if we cannot assume any natural sovereignty, but see the need of a rule-based organisation of our living-together, it has to be established by peers. And step three is nothing but an explanation of the intrinsic nature of the concept of liberty. Any opposite position had to show that there are any natural differences among men which justify that we make one the master and the other one the slave.

One possible objection has to be mentioned here: couldn't we think of a society of free men who, knowing about their deficiencies in character, decide to establish a system of supervision which guides them through the shallows of (economic) life? It is this the idea of joint rationality and moral self binding as for example proposed by Jürgen Habermas (1992). And in fact, this is what we currently observe with authorities narrowing the limits of permissible individual action. I will come back to this point in the next chapter.

Although the equality of men is constitutional for the liberal state (in theory), liberalism practically cannot avoid the emergence of slavish natures, i.e. of people who are not capable or not willing to conduct their life by guidance of their *own logos* only. A liberal society needs reasonable members. If a significant number lacks the ability "to use [their] understanding without guidance from another" (Kant) we then face a tendency towards paternalism which is contradictory to the idea of liberalism. And this is the true *paradox* of liberalism: that it owns no intrinsic recipe against its careless abolition. The lack of individual prudence is billed to all of us: as depreciation on dishonoured credits, and tax expenses for social welfare and the like. The liberal, thus, does not want his fellow citizens to fail, but he needs to refer to some external principle. And this external principle is the above mentioned second-order principle of risk limitation.

My point is that it is neither egoism, nor market failure, nor the fact that, according to Kant, man is made of "such awry wood" that "nothing straight can be carpentered from him", but immaturity ("Unmündigkeit") – or, in Aristotle's words: a slavish nature – which threatens our open societies most. The recent economic crises raised calls for etatistic intervention in unknown measures, and the hailing or booing of political leaders – depending on their performance as a saviour, gives cause for severe concern.

So, *if* we want to reject interventionism or at least limit it to a reasonable size which is compatible with individual liberty, it is not sufficient to point out that there is no moral problem with economics. This economistic view, as shared for example by Christoph Lütge (2007), falls short of the motivational question. His argument is, in short, that any rules which are not intrinsic to economy would not be abided by (for this were not rational), and he therefore pleas for what one might call contractualism without morals. The gain of this approach surely is that it works without any metaphysical remains (which we observe with the models of Rawls, Habermas, or Buchanan), but it misses, as already mentioned, the personal sphere: what for? why being economic?

## 4

## *There Is No Institutional Solution for Moral Issues in Economics, or: How to Become Mature in Business Ethics*

Thus, if each of us has to know where to go and how, the idea of maps may be apparent to escape the existentialistic coercion to decide beyond vision. Or, for those who lack the literacy for reading maps, these little GPS-devices. Why not equip everyone with little devices which give us all the information we need, about where routes are safe and where slippery, which one is the fasted between two points, and which one the most economic? Shouldn't it be the task of all the business ethics guys at the universities to develop such items? My answer is no. And this no does not primarily derive from the notion that externalizing mental skills leads to degradation of the humane personality and the formerly autonomous self will become an appendage to its smart phone. Moreover, this no arises from the fact that you cannot map winds or icebergs or pirates. It arises from the fact, that with non-linear, reciprocal and complex systems our metaphorical GPS-devices deliver nothing but bogus accuracy. This goes in line with Stephen Morris' argument against the common prior assumption: "If individuals had common prior beliefs then it would be impossible for them to publicly disagree with each other about anything, even if they started out with asymmetric information. Since such public 'agreeing to disagree' among apparently rational individuals seems to be common, in economic environments as elsewhere, an assumption which rules it out is surely going to fail to explain important features of the world." It doesn't help to know your position

by the inch, if you are stuck on a sandbank. And in addition, in a realm where every direction might be a possible route maps are completely senseless! The risk problem, again, is not an information issue.

My argument is also pointed against any institutional solutions like corporate social responsibility or legal rules. Whilst I am far from denying their necessity at all, my point is that institutionalised ethics veil the risk problem. How to act or react in an uncertain situation depends largely on the situation and the abilities of the actor – it must be but by accident that a priori rules match any individual case. In consequence, the rules either have to be wide enough to cover every expectable situation (not to mention the unexpected ones!), but then leave the proper adaption again with the individual, or they become a bureaucratic monster when trying to regulate every possible case. Additionally, rules are insensitive towards individual abilities and therefore tend to be infringed upon or undermined, if someone considers himself smarter than the rules. Others blindly rely on the rules, only cross the street when lights are green, and get killed by an inattentive driver. It is hard for contractualists to imagine that their whole construction might not work. Rawls' parties in the original position do not discuss what they will do in case of state bankruptcy, a corruptive government, or a national breakdown of the banking sector. In short: rules don't rule.

We have to reject the idea of a technical or geometrical solution of the risk problem. We have to dismiss the idea of eliminating individual risk on a corporate level as well. What remains is the call for the economically mature citizen. But how to produce him or her?

If navigation is the art or *techne* of steering a vessel safely to its destination, we should take a closer look on what it is about. All navigational techniques involve locating the navigator's position compared to known locations or patterns. This might be landmarks, lighthouses, stars, the position of the sun, and so on. Without any such mark no navigation is possible; having only one known mark you must know speed and direction for dead reckoning, which is very unfaithful (and for real experts only). For adequate positioning, you need at least two marks for cross bearing. On the other hand, more than three at a time do not add to the solution of the task. You shall sail, not loose yourself in artistic (or academic) exercise. If I use the metaphor of bearing here, especially that of dead reckoning, it points to a weakness of many attempts which try to map a single ethical principle to economic conduct (for example a neo-Aristotelian or neo-Kantian approach, not to mention the ubiquitous adaptations of utilitarianism in business ethics). Such an amount of additional assumptions has to be made to get that thing running that I prefer, according to the nautical metaphor, to combine multiple principles – which also has the nice advantage to make bearing and navigating as easy as possible for the laymen (if becoming mature were only for few, we had to dump the whole project).

The idea of moral cross bearing must not be confounded with what John Rawls called reflective equilibrium, although, at first sight, there are some similarities. The method of reflective equilibrium consists in working back and forth among our considered judgments about particular instances or cases, the principles or rules that we believe govern them, and the theoretical considerations that we believe bear

on accepting these considered judgments, principles, or rules, revising any of these elements wherever necessary in order to achieve an acceptable coherence among them (Rawls 1971). As a universalist, Rawls favours a *wide* reflective equilibrium, namely 'justice as fairness', and the two principles of justice which he derives from it. I already pointed out that an universalist approach misses the risk problem for it has to cover any possible case and therefore does not help in a concrete situation. Shall I ask my bank for a mortgage credit and buy a house or shall I stay in my rented apartment? – Both decisions are fully compatible to the two principles of justice. It is the idea of the wide reflective equilibrium that it is steady and needs no revision in short terms. But maybe the method could be transferred to gain a *narrow* reflective equilibrium for individual cases. Isn't it the case that we act like this when forced to make a decision whose outcomes we cannot overlook? Yes, but also the narrow reflective equilibrium aims at steadiness and coherence, and misses the point that we are at sea, i.e. on floating grounds. The idea of moral cross bearing is, moreover, to deliver what I might call a *floating equilibrium*.

## 5

## *Moral Cross Bearing: Risk Handling as Navigational Art*

Referring to its origin in ancient Greek, ethics means a certain composure in mind and conduct which arises from knowledge and training and helps leading a good human life. Transferred to economics, it is the art of *right* gaining and spending. When we return to the cradle of humanism, be it in ancient or modern times, we might realize that man finds his destiny only by going off shore. At least, our economy is built upon the history of seafarers – not of peasants. Ship wreckage thus is inherent to market economy, it is not a systemic failure. My argument now is, that the search for a single truth will turn out to be fruitless – for logical and practical reason. The logical reason is, in short, that any second-order justification of its first-order moral meter takes this meter as a prerequisite and is therefore circular or has to make metaphysical assumptions: Rawls parties have to accept fairness prior to their further deliberations, Habermas' participants must be willing to find a consensus in their debate, a Kantian must believe in non-contradiction as morality, a utilitarian has to reduce morality to welfare, and so on. But, even if I am wrong with this and there is a single moral principle which allows me to measure any action I am confronted with (but I don't know any such principle), there remains a practical reason for not taking the effort of searching for it. It is based upon the risk-return-relation we know so well from business: Any single principle bears the risk of being either circular, deficient, or blurry in practical application. Why take this risk, if quick decision is a must?

The underlying idea of what I call 'moral cross bearing' is that every moral philosophy is right in a certain way. And, very important, if we waive their universalistic claims, we can be lenient towards their deficiencies on the deductive

level. It is a pragmatist approach. But pragmatism should not be mistaken for arbitrariness. As I will outline below, any of the moral principles is good for some business cases, but not for all. Being an Epicurean might be good for you, but not for the public; utilitarian distribution might be just, but paternalistic; and deontic approaches always lose sight in the fog of ignorance. But it is not my aim to propose a matching moral principle for every economic uncertainty – this would raise the same deductive shortcomings which I criticise with the universalistic approaches. Moreover, the idea is that developing a stable moral habit makes the successful seafarer.

Let's start with an Aristotelian-style virtue ethics. Aristotle wrote his Ethics for a mature society whose public budget was very much under pressure not at last due to excessive claims of the lower classes. He was confronted with the task to defend the participatory idea of the polity on the one hand and at the same time protect it from being plundered by majority vote on the other. The societal equilibrium is endangered by as well an excess as an insufficiency of wealth, and thus Aristotle considers "that the middle course of life is the best – such a middle course as it is possible for each class of men to attain" (Pol. IV, 11). Concerning the aspect of gaining, the rule would be: gain at least what covers your basic needs by yourself, but do not sacrifice your whole life on gaining (unless you want to lead the life of a mule). Regarding the side of spending, one might say: Do not spend more than you can earn; do not be a slave to your desires.

If we bear a deontic, Kantian mark, we may come to the following imperatives: your freedom of gaining is limited by the same freedom of others (anti-piracy argument); and: your consumption shall not cut into the rights of others to access the same resources. And, as already mentioned above, inconsistency can be a good indicator of something going wrong.

Following a consequentialist or utilitarian approach, a rule for gaining might be: gain in a sustainable way; and the complement on the side of consumption: do not eat the seeds. Also Rawls' difference principle fits here and endures a utilitarian re-reading, because there is empirical proof that societies with a low Gini coefficient, i.e. ones with a relatively homogeneous spread of wealth, are more stable than those without. Thus, paying your taxes on your earnings as well as taking concern that everybody gets fed limits the risk of loss.

For those who prefer hedonism as their way of conduct, risk limiting behaviour on the gaining side is to refrain from exploitive jobs, and on the consuming side not to bite off more than you can chew.

Considering the fact that a surplus of information often does not limit risks (and may in contrast contribute to some sort of moral blindness, at least déformation professionelle), one might also stick to a sceptical principle saying: keep some ignorance about economics.

I would be non-credible, if I claimed that this overview of possible moral cross bearings is *it*. The list is notoriously incomplete, as are countless the cases to which they shall apply. The reader has to find out himself which bearings suit him best to find his floating equilibrium. And he has to exercise the navigational *techne*. Any ostrich algorithm is not an answer to the risk issue.

**Biography** Matthias Gronemeyer holds a Ph.D. in philosophy. He worked as a business consultant, and in 2007 published his book *Profitstreben als Tugend?* – a fundamental research on Aristotle's political economy. Currently, he is lecturer in philosophy & ethics at Ludwigsburg University of Education.

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# Part IV
# Philosophical Issues of Risk Management

# Beyond Risk Management, Toward Ethics: Institutional und Evolutionary Perspectives

**Thomas Beschorner**

## Introduction

The management of risk – on a societal level or related to organizational measures in businesses – is important and it is clearly related to moral concerns in life. The risky speculations in the financial sector in the past years have demonstrated this in the same manner as the nuclear catastrophe in Fukushima. Corruption cases, fraud issues, irresponsible mismanagement, risky products and other examples clearly show the importance of compliance measures in firms to manage risk on an organizational level. The main logic is "avoiding harm" to others – and who would deny that this is not ethically relevant. Of course it is.

In this paper, however, I argue that considering risk in business ethics is necessary but not sufficient for addressing these moral concerns since ethics in general is not merely about avoiding harm, but also about "a good life", and because business ethics in particular is not merely about avoiding "bad practices", such as corruption and fraud, but also about reflections on "good business practices". Hence, risk management is neither identical with business ethics nor do the notion and concepts of risk management reflect the main challenges in the field of business ethics.

In the following sections I will first elaborate on some general normative perspectives in business ethics and then, based on these reflections, suggest two complementary institutional measures for firms. I will argue that compliance approaches need to be supplemented with by so-called integrity approaches that not only bring the individual as (moral) actor back into play but also characterize more reflective institutional measures within the organization to foster corporate social responsibility.

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## Extending the Perspective in Business Ethics

In the past decades we can observe the negative consequences of a decoupling process between the private and public domains. The lack of national regulatory mechanisms has enabled fraud and unethical behavior within businesses. However, this rise in ethical problems seems to have raised interest in some aspects of social responsibility among businesses in modern societies. Since the late 1980s, an increasing number of publications on business ethics and an increasing number of business practices related to certain ethical issues have emerged.

We suggest interpreting these developments against the backdrop of the re-composition of society. Owing to the breakdown of the public and private dialectics, the tacit contract between firms and society – to maximize your profits, provide the population with work, the consumers with low prices for goods, while the politicians regulate our activities within the political framework – has lost some of its binding capacity. Firms are increasingly the focus of a critical society. Firms *are seen* as being responsible for their economic actions.

In the academic debate on business ethics we can identify two dominant streams of argumentation. The one can be located within the economic paradigm: 'Neo-classical free-market libertarians believe that we need to rely more – not less – on markets and economic rationality. They argue in favor of self-interested economic actors and highly deregulated markets. Consequently, businesses ought to take ethical issues into account if – and only if – there is a pay-off. The other stream – we can call them the 'radical critics' – argue for the exact opposite: Their critique is aimed at what they believe are the foundations of market economies, such as managers' and bankers' 'greed'. They want companies to engage in ethically sound behavior, and for the state to regulate economic actors strictly.

I argue that both perspectives have serious shortcomings, since they are limited to either, on the one hand, economic circumstances and the assumption that businesses are merely motivated by profits without considering the normative justification of such a motive (free-market scholars), or, on the other, to discussing firms' "dos" and "don'ts" without taking into consideration societal realities.

We suggest extending the debate in business ethics by rephrasing it with the following questions*: What do businesses actually do to contribute to a "good society"? What do they want to, what can they, and finally, what should they, do in order to better contribute?*

The first question refers to concrete practices and empirical facts. "What do they want to do?" concerns the motivation of businesses to get involved in corporate social responsibility (which can be profit seeking or other motivations). "What can they do?" asks about the capabilities that are needed to be a "good corporate citizen" (on an individual as well as on an organizational level). And "what should they do?" reflects the role of businesses in society far beyond the other three elements.

If we apply this typology to the business ethics debate on risk management we can see that it somehow touches on the first three questions, but also that the

businesses' role of contributing to a good society is somehow less present and much less debated. Here "pure market systems" are either implicitly taken for granted or explicitly justified on a normative basis with a combination of Friedman's (1970) well-known phrase that the social responsibility of a business is to increase its profits and the necessity of political regulations.

Indeed, if it would be possible through national regulations to fully internalize negative external effects into the cost-benefit calculation of businesses, then there would be no need to talk about corporate social responsibility. Firms – the players – could then maximize their profits, while questions of social justice could be realized through political regulations, the rules of the game (Homann and Blome-Drees 1992; Homann 1993). Unfortunately, this simple idea does not work so well anymore in times of a "world society," where the economy and business interactions and transactions are globalized while the major regulatory measurement – law – is still mainly limited to a locally acting nation state. This is certainly a pity but a fact of modern societies that cannot be overlooked.

This new societal configuration (Beschorner 2004) has led to a different understanding of businesses and their role not just as economic but also as political actors (Palazzo and Scherer 2006; Scherer et al. 2006). We cannot, whether empirically or normatively simply describe, explain or justify businesses in a given political framework (Beschorner and Vorbohle 2007). Rather we need to extend our analysis to a *more complex interplay of different actors (including political actors) that contribute to new forms of normative contexts* (purposefully three times plural).

What is important are the normative roles of businesses in these "enjeux" that are often collected under the heading of "corporate citizenship": The firm is an actor with liberal rights as well as republican duties or responsibilities (Matten and Crane 2005). Businesses are de facto contributors to governance structures; they are quasi-governmental actors. The question is: How can they contribute proactively to a "good society?" I regard this normative premise, this "ideal" of businesses as "good corporate citizen" as widely accepted in the international debate on business ethics.

However, a remaining question beyond this "ought to be" is obviously how to bring this into practice, or, more precisely, how to bring the "ought to be" and the "is" into fruitful interplay?

## Institutional and Evolutionary Perspectives

In approaching an answer to this question, I will discuss two economic approaches to highlight different theoretical perspectives of business ethics. These are, on the one hand, what we call traditional economic perspectives, (neoclassical ideas, but especially approaches in New Institutional Economics) and, on the other hand, an alternative economic approach mainly oriented toward ideas associated with Evolutionary Economics. It will be demonstrated that neither one can serve as a

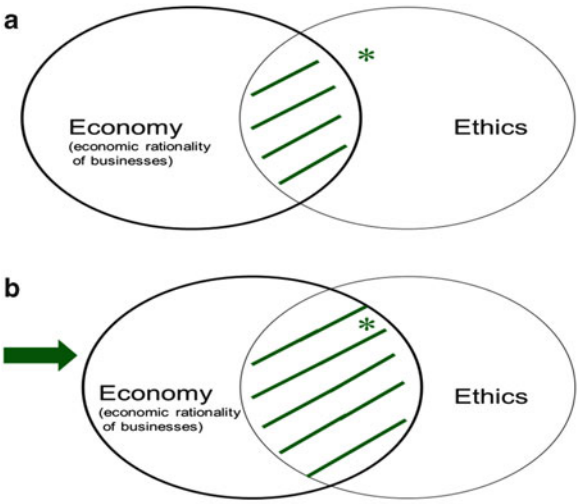


**Fig. 1** Business ethics from a neoclassical perspective

general theory of business ethics, but that both approaches highlight some of its important dimensions. The two main theses are:

1. Individual leadership is important for ethics of organizations. However, ethical leadership has to be embedded in suitable institutional frameworks. Institutions matter!
2. Pure compliance approaches (closely related to risk management) show serious shortcomings. They have to be supplemented (not substituted) by integrity approaches.

## *Theory of Business Ethics I: Traditional Economic Approaches*

From a neoclassical perspective on business ethics, it is argued that constraints for businesses have been changed. In addition to the constraints set by the nation state, a more and more professionalized and better organized civil society limits the actions of businesses. Businesses at the end of the twentieth century and at the beginning of the twenty-first century cannot undertake business activities "at all costs" but increasingly have to legitimize their actions. Since the absence of legitimacy results in increased costs and/or reduced profits, businesses try to deal with these new requirements. This very simple idea is illustrated in the following figure (Fig. 1).

From a neoclassical perspective, businesses take ethical issues into account if – and only if – "they pay off". The (*) symbolizes an ethical issue, such as child labor in developing countries, products or production processes that lead to negative ecological consequences, and so forth. While in situation (a) these aspects are not part of the rationality of the firm, in situation (b) they are included in the costing

process and utility calculations since the economic constraints have changed. This shift might have different reasons: a new law (such as an obligation to use new industrial filters to avoid $CO_2$ emissions), new market opportunities resulting from a value shift in society (such as "ethical" (niche) products), or the need to "avoid negative attention" (Nell-Breuning) by NGOs, the media, and finally consumers (such as in the case of child labor). To sum up, we can distinguish three important *external*, societal reasons for businesses to incorporate ethics into their economic rationality (Paine 2003): changes in the political framework, risk management as a form of "civil positioning", and market positioning.

Apart from these external drivers of "sustainable change", businesses see ethical, *or better,* moral issues as an important means for *improving the performance of their organizations*. While neoclassical economics has assumed firms to be black boxes, the *New Institutional Economics* investigates – among others – the coordination mechanism of social actions within organizations. It is well known that this field of research has led to a huge number of publications and the emergence of three interrelated approaches within the New Institutional Economics (see also the overview by Williamson 2000): property-rights-theory (Alchian and Demsetz 1972), agency-theory (Fama 1980), and, last but not least, transaction cost economics (Williamson 1975, 1985).

Whereas early concepts for an institutional foundation of a theory of the firm particularly emphasized aspects of hierarchical control and economic incentives (hard facts) to deal with the problem of social interaction within organizations, in recent years *soft facts*, such as trust, integrity, credibility and fairness, have become increasingly important in economic literature. We want to outline three important reasons for this development:

1. *Coordination*: Social coordination through soft facts can reduce transaction costs since expensive control and incentive mechanisms can become redundant.
2. *Motivation*: Transaction cost economics have been criticized as "bad practices" (not only for ethical, but also for economic reasons) because control mechanisms tend to become a self-fulfilling prophecy of one basic behavioral assumption of transaction cost economics, which is opportunism. An increase in opportunism (such as fraud), however, leads also to the necessity for better and more expensive control systems (Ghoshal and Moran 1996; Moran and Ghoshal 1996). As a consequence it is argued that the "atmosphere of transactions" and hence values have to be taken into account.
3. *Cooperation*: While economic analyses usually stress the dimension of competition in a global economy, the German business ethicist Josef Wieland (1996, 1997, 1999, 2001) argues that there is another side of the coin. In conjunction with increased trade and competition, one can also observe an increase in cooperation among businesses owing to factors such as mergers and acquisitions as well as business networks and more complex supply chains. The ability to cooperate has become an important economic resource in times of globalization, which can lead to positive economic consequences for businesses.

It is important to note that this last argument of "governance ethics" (Wieland 1999, 2001) has a slightly different theoretical status in comparison with the rather mainstream arguments of transaction cost economics. It is argued that values in business organizations are *sui generis (ontologically)*: Trust and fairness are *not the result of utility maximization*; communicating such values has to be seen as an original type of action and as an original type of interaction constituting social relations. According to Max Weber's theory of action, this can be regarded as value rationality (*Wertrationalität*), which is not a subtype of utility maximization (*Zweckrationalität*) but an original type (Beschorner et al. 2012; Beschorner 2002). In this respect, businesses are seen as multi-lingual actors. They not merely speak and understand economic terms (profits) but also communicate in juridical, political and moral terms as well as through other "language games". Communication in terms of values is the basic and constitutive element of cooperation within the organization (intra-organizational) and between organizations (inter-organizational). Intra- and/or inter-organizational cooperation may have an economic advantage for businesses (Wieland 1999, 2001) since it helps stabilize social relations. This argument by Wieland represents an important improvement in economic analyses.

In relation to business practices, implementing an institutional mechanism called the *compliance approach* has been suggested. The main characteristic of this approach is a system of explicit and unambiguous rules, such as codes of conducts, to deal with certain moral issues. There are rules to prevent corruption, which deal with the handling of gifts for example. And there are rules to prevent fraud, irresponsible or abusive management, and mismanagement, as described above.

## *Theory of Business Ethics II: An Alternative Approach*

The suggested measures associated with compliance approaches are important and relevant for certain issues in business ethics. However, I argue that these standard procedures undermine ethical actions in the long run since a strict compliance to defined rules lead to a *lack of reflexivity* within the organization. On the one hand, this seems to be bad for business practices from an economic standpoint since it tends to produce bureaucracy in the worst sense. On the other hand, a compliance approach misinterprets the term "ethics" as "moral". Ethics includes the requirement of (*ethical*) *reflection* about moral problems and not just compliance with moral rules.

Unlike compliance concepts, *integrity approaches* (Beschorner 2005; Paine 1994; Steinmann and Olbricht 1998; Thielemann 2005) emphasize institutional arrangements focused on a more dynamic and reflexive character of organizations. Thus, integrity management should not be misunderstood as a pure form of individual ethics but as a more fruitful *linkage between individual actions and institutional arrangements* that fosters ethical behavior. Such a change in perspective leads to a different understanding of business ethics since intra- and inter-organisational (institutional) arrangements differ from compliance approaches. They emphasize

the need for an open organization (open dialogue with external as well as internal stakeholders) rather than the closedness of the organizational processes (through certain compliance rules) (Badura 2002; Ulrich 1997).

Moreover, I argue that there is a need for a *more dynamic* theory of the firm in general and business ethics in particular, than is suggested by New Institutional Economics. Here, we consider Evolutionary Economics as an interesting candidate for providing us with new insights into firms. While New Institutional Economics emphasizes the role of businesses as reactive adaptors *within* the market system, an evolutionary perspective stresses the proactive function of businesses as a guiding metaphor. Hence, Evolutionary Economics is also interested in the *transformation* of market economies through businesses. As a matter of fact it is crucial that *a theory of firms deals with the most important 'cultural engine' in modernity*. Businesses have to be seen as more than just responders to somewhat external signals (Beschorner 2007; Pfriem 2009). Businesses influence de facto the institutional contexts through their (economic) actions and, thus, should be seen as important actors that either limit new forms of societal and economic organization or contribute to it in a positive manner. Current circumstances, especially ecological problems and situations in developing countries, necessitate a systematic shift toward a different society. To work out the relevance of businesses for sustainable change – the limitations but also the opportunities – is the real challenge for businesses ethics. Evolutionary Economics helps us achieve such an understanding.

An evolutionary theory of the firm leads us – at least from the point of view of mainstream economists – to a radical change in perspective, where the principle of utility maximization is questioned and replaced by *routines* as the basic analytical unit. I will demonstrate that this perspective enables us to put the spotlight on crucial but neglected issues in economic theory: the origin of capabilities within corporations and innovations. Thus, businesses will be unchained from an underlying incentive-response model in traditional economics, and economic theories will be opened to recent discussions in economic sociology. The theoretical perspective from Evolutionary Economics can contribute to a better understanding of the above-mentioned integrity approach to business ethics.

The basic idea in Evolutionary Economics was developed by Nelson and Winter (1982). They argue that traditional economic theories have little understanding of innovations and economic change. While the existence of innovations in traditional economics comes out of a "book of blueprints", economic change is mainly explained through somewhat external shocks. The term "evolutionary" in Evolutionary Economics seems directly linked to Darwin's ideas in evolutionary biology and lets us assume a naive transfer of biological metaphors and mechanisms to economic theory. This, however, is not the case for most scholars in Evolutionary Economics. "Evolution" is seen as a term that focuses on aspects of development and change. Blind selection in Darwin's evolutionary biology is merely a subtype of a general process of change and development (Hodgson 1993). Indeed, a Darwinian approach is rejected by most evolutionary economists. In contrast, they argue that their "theory is unabashedly Lamarckian"(Nelson and Winter 1982, 11) and so Evolutionary Economics is based on an interpretative theory of action; hence, on a more adequate conception for social sciences.

The basic category of this theory of action is *routines or habits*. As in transaction cost economics, it is argued that actors act through bounded rationality. However, unlike transaction cost economics, bounded rationality is not explained as a lack of information (due to opportunism). Bounded rationality from an evolutionary perspective is the result of the actor's cognitive limitation. Hence, Evolutionary Economics emphasizes *thick* versus *thin* bounded rationality (Foss 2001; Lindenberg 1998). The terms *routines* or *habits* characterize cognitive schemata or cognitive frames that are the basis for decision-making processes and thus – in comparison to traditional economic approaches – "the explanatory arrow [runs] in the opposite direction: instead of habits being explained in terms of rational choice, rational choice ... [is] explained in terms of habits" (Hodgson 1998, 178). In this regard, five aspects of an evolutionary theory of the firm are relevant here.

*First*, a business is seen as a bundle of routines. Business performance strongly depends on the ability of businesses to organize these routines in a fruitful way. Hence, unlike markets, firms have the ability to accumulate knowledge and to innovate. While markets are built on exchange, businesses are built on (the organization of) knowledge.

*Second*, Coase's (1937) question about the existence of the firm can therefore be answered by Evolutionary Economics in a manner different from, albeit complementary to, that of New Institutional Economics. Firms exist owing to the fact that markets cannot produce innovations. Firms are neither regarded as a somewhat strange anomaly within a fantastic coordination mechanism called the market (Neoclassical), nor are they merely seen as a facilitator to reduce the cost of social contracts (New Institutional Economics). As an alternative, the organization of firms is described as an *original* modus of coordinating social actions with an original outcome: capabilities, knowledge and innovations.

*Third*, since knowledge within firms is not completely available in explicit form but mainly part of implicit routine-orientated actions, it cannot be bought on markets or copied from competitors.

*Fourth*, institutional arrangements within organizations do not merely have to take into account the effective coordination, motivation, and cooperation of social actions (New Institutional Economics, see above) but have to simultaneously foster circumstances under which certain capabilities can emerge. This perspective permits us to develop a richer understanding of the relevance of certain organizational capabilities. While transaction cost economics merely emphasizes the effects of one certain resource for transactions, an evolutionary perspective also raises the question of the *origin* of this important organizational resource. Moreover, the resource- or competence-based approach in Evolutionary Economics regards cooperation abilities as just one important organizational resource. *Creative, learning, and innovative capabilities* are at least as important as cooperation.

The following figure summarizes the above arguments from Evolutionary Economics, compares them with Transaction Cost Economics, and outlines the relationship with ethical issues (integrity versus compliance approach) (Table 1).

**Table 1** Transaction cost economics, evolutionary economics, and ethics

| | Transaction cost economics | Evolutionary economics |
|---|---|---|
| **Theory of action (bounded rationality)** | Weak bounded rationality (lack of information) | Strong bounded rationality (lack of cognitive abilities) |
| **Existence of firms** | Reduce transaction costs | Enables innovation |
| **Organizations as** | Nexus of contracts | Bundle of routines → knowledge, capabilities (explicit and implicit) |
| **Institutional arrangements** | Stabilizing social relations | Enabling change |
| **Relevance of soft facts** | Cooperation in and between organizations | Development of organizational capabilities, especially creative, learning, and innovative capabilities |
| **Relation to ethical issues** | Avoidance of opportunism, fraud, etc. (defensive) | Enabling sustainable change through business practices (proactive) |
| **Institutional arrangements related to ethical issues** | Compliance approach | Integrity approach |

**Table 2** Ethical measures in corporations (examples)

| | |
|---|---|
| **Compliance approach to avoid ... through ...** | Risk management systems |
| | Codes of conducts |
| | Corrective organizational measures |
| | Avoidance of opportunism, fraud, etc. |
| | Specific anti-fraud training for management |
| | Social standards to Bind on certain values (e.g. SA 8000) |
| **Integrity approach to enable sustainable change through ...** | Fair dialogs with stakeholders |
| | Ethical corporate philosophy (mission and vision for a just society) |
| | Organizational measures to build ethical capabilities |
| | Ethical learning processes |
| | Development of personal integrity |
| | Social standards to foster reflexivity and dialogs (e.g. AA 1000) |

## Business Ethics: Toward a Socio-Economic Perspective

What are the consequences of the general firm-theoretical perspective we have outlined with respect to New Institutional Economics and Evolutionary Economics for business practices? And how are the compliance and integrity approaches related to each other? Table 2 outlines examples of ethical measures applied by corporations from compliance and integrity perspectives.

I consider risk management and compliance approaches mainly as direct strategies for preventing fraud (as noted above), economic crime, and irresponsible or

abusive management and mismanagement. As such they are helpful in avoiding "bad practices" in businesses. However, as stated earlier a strict compliance approach has some serious shortcomings:

1. Compliance approaches tend to moral positivism since the orientation on certain rules is underlined. This leads to a decrease in reflexivity about actions.
2. Compliance approaches are defensive in the sense that the main focus is on the avoidance of "bad practices" rather than the development of "good practices".

In contrast, *integrity approaches* emphasize ethical learning processes that should lead to sustainable change in and through businesses. For example, (fair) dialogues with external and internal stakeholders as facilitators to increase (ethical) reflexivity are stressed. Businesses are seen as proactive actors, as cultural engines that do more than merely react to external stimuli. Consequently, visions of "a just society" and so forth are included in this perspective. In summary, the radical idea of integrity approaches is the permanent reflection of businesses practices in the light of ethical principles. As such, integrity within organizations is seen as a core competency for businesses for economic reasons: If businesses extend their perception, they can react and adapt more flexibly to economic and societal change.

I regard compliance and integrity approaches as complementary. Neither one alone would contribute sufficient results. This is true for economic as well as ethical "success". From an economic perspective, a compliance approach tends to build bureaucracy in the worst sense (Weber's "iron cage"). The alternative, however, of a high degree of reflexivity and permanent learning processes would also fail in a pure form. Social relations and organizations need a certain degree of stability through institutions. As the "management guru" Henry Mintzberg once correctly pointed out, we cannot permanently learn: sometimes we have to work, too.

With respect to the ethical dimension, the arguments are similar: While compliance approaches tend to moral positivism, integrity approaches overemphasize ethical reflections. Eventually, the later would even undermine ethical behavior. Whistle-blowing, as an example of a certain type of open communication with external stakeholders, can obviously destabilize trust and credibility within organizations. In summary, we understand compliance and integrity approaches as two ideal types and quite contrary ideals that mark extreme positions in the field of business ethics.

However, given the dominance of compliance approaches in academic business ethics as well as in business practices, I want to make it clear that these models cannot serve as a general theory of business ethics since important issues are neglected. Further research and concrete practical measures within firms should investigate and work out a proactive role for businesses as drivers for sustainable change rather than assuming them to be located in a given frame.

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# Consequentialism, Deontology and the Morality of Promising

**Nikil Mukerji**

## Introduction

In normative ethics there has been a long-standing debate between consequentialists and deontologists. To settle this dispute, moral theorists have often used a *selective approach*. That is, they have homed in on specific aspects of our moral practice and have attempted to show that their side can offer a more plausible theory of the normative factors that pertain to this specific field. Many theorists have, e.g., focused on the issue of lying (e.g. Bok 1978; Hodgson 1967; Kant 1785; Kant 1799; Ross 1930/2002; Sidgwick 1907). Others have taken up special obligations and duties of friendship (e.g. Aristotle 2010; Cocking and Oakley 1995; Sidgwick 1907). Yet others have discussed duties to oneself (e.g. Donagan 1979; Hill 1973; Kant 1785; Parfit 1986). One of the problems which has always occupied centre stage is the morality of promising. In this paper I consider this issue from a general moral-philosophical perspective.[1] I review arguments that have been put forward by consequentialists and deontologists and examine how far it is possible to adjudicate their dispute. I focus, in particular, on a new argument by Walter Sinnott-Armstrong who has claimed, contrary to received opinion, that consequentialism has the upper

[1]It seems that the morality of promising is one of the aspects of the general moral philosophical debate which should particularly interest business ethicists. Business ethicists, after all, often stress the central moral importance of contracts Sollars (2002). Some of them even go so far as to claim that the whole subject is based on the notion of a contract Lütge (2005). Since contracts are, in effect, mutual promises, business ethicists should, it seems, be most interested in what deontologists and consequentialists have to say about promissory obligations.

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hand. My overall conclusion is negative. Given the arguments on the table, neither consequentialists nor deontologists have successfully established that their account of promissory obligation is the more plausible one.

The remainder of the paper is structured as follows. First, I consider the deontological and the consequentialist accounts of promissory obligation. Then, I examine how the issue of promissory obligation has been used to make a case against consequentialism. I focus, in particular, on the influential and much discussed arguments by Hodgson (1967) and Ross (1930/2002). After that, I consider the aforementioned argument by Sinnott-Armstrong (2009) which seeks to establish that consequentialists have a better conception of promissory obligation. Having rejected both the case against consequentialism and the case against deontology, I conclude in the last section with a few methodological thoughts on how the debate about the morality of promising may be adjudicated, if any.

## Two Theories of Promissory Obligations

A good way to start the investigation is, I think, by getting clear on the two rival views that are at issue. There are certainly various ways of delineating both consequentialism (Sinnott-Armstrong 2011) and deontology (Gaus 2001a, b) from other moral outlooks. The following broad characterization, however, seems to be fair. Consequentialism, we may say, is roughly the idea that the rightness of an act depends solely on the goodness of its consequences, utilitarianism being the most paradigmatic instance of such a view. Deontologists, it seems fair to say, are united in their rejection of consequentialism.[2] To be sure, most of them agree that consequences matter morally. However, they reject the consequentialist idea that *only* consequences count. They believe, rather, that there are further aspects which determine the moral status of an act. These include, in particular, the intrinsic nature of the act itself (Kagan 1992). This said, we can move on to a tentative characterization of the consequentialist and deontological accounts of promissory obligations. Let us consider the latter first.

Deontologists such as Kant (1785), Prichard (1940/2002) and Ross and Stratton-Lake (1930/2002) believe that promises are one of the many factors which determine the rightness or wrongness of an act. They believe that the fact that I have promised to do X *ipso facto* creates an obligation for me to do X. There are, however, two main differences between the various deontological views. One difference lies in the way in which deontologists conceptualize the relation between promissory obligation and obligation in general. As Kagan (1998) explains, deontologists can view a

[2]Note, however, that certain theorists (e.g. Birnbacher (1999) and Nida-Rümelin (1993)) have proposed a taxonomy that makes room for "deontological consequentialism".

promissory obligation either as fundamental obligation or as derivative obligation. Those who opt for the latter view can explain the obligation to keep a promise, e.g., as a special case of the duty of veracity. This does not seem all too implausible. After all, if I break my promise to do X, my assertion "I promise to do X" might be taken to have been a lie. Another way to make sense of promissory obligations in terms of a more fundamental moral requirement is to regard them as special cases of our duty not to harm others. If I have promised you to meet you for lunch, you will probably show up. If I then break my promise, I plausibly harm you in the sense that I frustrate your expectation and waste your time. The second way in which deontologists differ in their attitude towards promissory obligation concerns the weight with which they invest the duty to keep a promise. Radical deontologists, e.g. Kant (1785), interpret the obligation to keep a promise as an uncompromising moral duty that allows of no exceptions. Moderate deontologists, e.g. Ross (1930/2002), take it to be a *prima facie* duty. They allow it to be overridden when there are other moral concerns which seem to be more important.

While deontologists agree that promissory obligations have intrinsic normative significance (and disagree only regarding their weight and place in the system of moral duties), the consequentialist moral outlook seems to imply that there is no such thing as an *intrinsic* moral duty to keep a promise. Promises, after all, are a thing of the past, while consequentialism focuses only factors that pertain to the future, viz. consequences (Rawls 1955). Nevertheless, it is generally acknowledged that consequentialists can account for the fact that we *normally* have an obligation to do what we have promised (Habib 2008). It seems plausible to assume that under normal circumstances keeping a promise will have better consequences than breaking it. There are at least two reasons for this. The first reason is the fact that breaking a promise may have a bad immediate effect. It may harm the promisee in the way I have described above. The second reason is that the breaking of a promise may have a bad mediated effect. When I break my promise to you, you may tend to disbelieve my future promises. And this may make it harder for us to coordinate our behaviour in mutually beneficial ways. Breaking a promise may, in other words, affect the stability of the practice of promising.

The bottom line seems, then, to be this. Deontologists believe that a promissory obligation possesses intrinsic normative significance. On their view, the fact that I have promised to do X always counts in favour of doing X, even though moderate deontologists may, on occasion, allow this obligation to be overridden by more important moral concerns. In contrast, consequentialists appear to be committed to the view that a promise is, in and of itself, never a weighty moral reason, though they can explain why we should normally keep our promises. As far as promissory obligation is concerned, the dividing line between deontologists and consequentialists seems to be this. Deontologists believe that even a promise whose breaking causes no harm at all can be a weighty moral reason, while consequentialists are apparently committed to denying this. This, at any rate, is received opinion.

## The Case Against Consequentialism

Many ethicists believe that the consequentialist position on promissory obligations should be rejected (and with it the doctrine of consequentialism itself). There are, broadly speaking, two arguments to this effect. I shall briefly examine each of them in what follows. One argument claims that the consequentialist position on promissory obligation is radically at odds with our moral intuitions. The other maintains that it is essentially self-defeating. I shall start with the latter argument.

Why should the consequentialist position on promissory obligation be self-defeating? Influential arguments to this effect have been proposed by Hodgson (1967) and Nida-Rümelin (1995). The reasoning proceeds in two steps. In the first step, it is established that the practice of promising is desirable on consequentialist grounds. This is a rather plausible idea, as David Hume has persuasively argued. He describes the notion of a promise as a "human invention" that is "founded on the necessities and interests of society." (Hume 1888/1960, 519) The reason why its existence is consequentially desirable is that it provides us with an effective means to facilitate mutually beneficial interactions. When two individuals, A and B, exchange goods and services there is sometimes a time delay, such that either A or B has to move first. But they will do that only if the other party credibly assures that they will keep their end of the deal. This is where the institution of promising comes in. In order to incentivize A to move first, B has to promote the expectation that he will, in fact, do her part, given that A has done hers. She can accomplish this by promising A to keep to her end of the deal, thus creating a moral obligation to in fact do so. It is clear that making the promise is not only in the interest of A. B has a like interest in the regulation of his conduct. For if B does not commit herself to doing her part, A will not do hers and both will miss out on the opportunity to engage in a mutually beneficial interaction. It is sensible to suppose, therefore, that the practice of promising is desirable on consequentialist grounds. It makes everyone better off! (Theorists of the order-ethical tradition in business ethics, e.g. Homann 2002; Lütge 2005; Mukerji and Schumacher 2008 as well as Petrick and Pies 2007, have re-emphasized that this is the point of moral rules generally.)

In the second step of the argument, it is shown that the practice of promising could not arise in a consequentialist society. This, it is claimed, holds even under ideal conditions, that is, where everybody is a consequentialist and everybody knows that everybody else is a consequentialist and everybody knows that everybody knows that everybody is a consequentialist and so on. To see this, consider A's and B's problem again. For the practice of promising to get off the ground it is essential that B's promise to A promote A's expectation that B will do what she has promised. But how is this possible? By assumption, B is a consequentialist and A knows this. So when B says to A "I promise you to do X", A will assume that B will do X only on the condition that this will have better consequences than not doing X. Since B knows that A knows that B is a consequentialist, B will expect that A will expect her to follow through on the promise only if she, B, judges this to be the best course of action. For this reason, B will not even bother making the promise, since it

would be a waste of time. It seems, then, that two consequentialist agents, A and B, cannot utilize a social institution which is morally desirable according to their *own* moral outlook – a result that can, of course, be generalized to society as a whole. The issue of promising, it seems therefore, illustrates the fact that consequentialism is a self-defeating moral view. At least some moral theorists have taken this to be a disturbing conclusion (Stocker 1990).

The other argument seeks to establish that the consequentialist position on promissory obligation, as we have tentatively circumscribed it above, is counter-intuitive. We said that the obvious interpretation of the consequentialist view is that there is no intrinsic moral duty to keep a promise. To be sure, the consequentialist seems to believe that we often do have the obligation to do what we have promised, but not *in virtue* of the fact that we have promised this. The reason is, rather, that under normal circumstances keeping a promise will have better consequences than breaking it. Now suppose we face an abnormal case, such that breaking a promise would, in fact, have slightly better consequences than keeping it. In that case the consequentialist view might appear intuitively problematic, as Sir David Ross has famously pointed out. He asks the following question.

> Suppose ( . . . ) that the fulfilment of a promise to *A* would produce 1,000 units of good for him, but that by doing some other act I could produce 1,001 units of good for B, to whom I have made no promise, the other consequences of the two acts being of equal value; should we really think it self-evident that it was our duty to do the second act and not the first? (Ross 1930/2002, 34–35)

Ross, of course, answers this question in the negative. And this appears to be in line with common sense. The consequentialist position, however, appears to imply the opposite. It seems, therefore, that it is not only self-defeating, but also counter-intuitive.

What can consequentialists say in reply to these arguments? I believe that they can reply in two distinct ways. First, they can confront the two criticisms head on. They can argue that it is not at all clear whether the arguments go through, even when they are targeted at the paradigmatic form of consequentialism, viz. utilitarianism. A number of theorists have pursued this line of counter-argument and have formulated interesting and powerful replies (e.g. Hörster 1973; Lewis 1972; Norcross 2011; Singer 1972; Sumner 1969). I shall neglect them, however. Instead, I want to focus on a second line of defence which makes a more fundamental point.

As a number of scholars have emphasized, consequentialism is an extremely capacious view (Dreier 1993; Portmore 2011). Utilitarianism which is one specific variant of the idea may (or may not?) fail by the arguments that we have considered above. But it is far from clear that this is the case with *every* version of consequentialism. The crucial point is this. Both arguments presuppose the position that I have tentatively ascribed to consequentialism above. I said that consequentialists seem to be committed to the view that the keeping or breaking of a promise does not, in and of itself, have any normative significance. But is this characterization adequate? To be sure, the idea is fairly wide-spread. And it is *prima facie* plausible. Consequentialism, after all, seems to focus only on the future, viz. on what happens

*after* the act. Promises, one may say, are a thing of the past and do not pertain to the future. Nevertheless, this reasoning can be challenged. To show this, I shall make two brief points before I connect the dots.

One reason why one may doubt that consequentialists can acknowledge the intrinsic normative significance of promissory obligations is the belief that the breaking of a promise is an *act*. Hence, one may reason, it cannot be described as an act's *consequence*. This, however, would be necessary to make it accessible to consequentialist evaluation. The first point that consequentialists may make, then, is that such reasoning presupposes a sharp and clear distinction between acts and their consequences when, clearly, there is no such thing.[3] As Larry Sumner points out, what I do "may be described variously as making marks on a piece of paper, signing a cheque, paying a bribe, or ensuring the survival of my business." (Sumner 1987, 166) In other words, the boundary between the act and its consequences can be pushed back and forth, depending on the chosen description of the events. For this reason consequentialists can claim that the act itself should routinely be included amongst its consequences (Scheffler 1982/1994).[4] This, in turn, means that consequentialists can, in principle, take the fact that an act constitutes the keeping or breaking of a promise into account. (Critics of consequentialism may find this interpretation overly charitable. But it is clear that any attempt to show that consequentialists cannot do this would require us to restore the distinction between the act and its consequences in an arbitrary place).

Critics of consequentialism, I presume, have to grant this point. They can, however, make a second objection. They can argue that consequentialists cannot get any mileage out of this first point. For even if they can take into account the act itself, they cannot *evaluate* the fact that a given act constitutes the breaking of a promise. This fact about an act pertains, after all, to an event in the past, viz. the promise. And, as we know, consequentialism cannot take such past-regarding factors into account, as it is essentially a forward-looking moral view (Rawls 1955). This objection, however, suffers from a confusion. Of course, consequentialists can only consider features of the act that pertain to the present and the future. But they can use an axiology that takes past factors into account. As Derek Parfit explains, they may say that it is

> better, for example, if benefits went to people who had earlier been worse off, or if we kept our promises to those who are dead, or if people are punished only if they earlier committed some crime. (Parfit 2011, 373–374)

How can consequentialists theoretically underpin these ideas? As Vallentyne (1988) suggests, they can commit to a historical axiology. Such an axiology does not evaluate the act merely in light of its impact on the present and the future.

[3]This issue has been discussed by many scholars, e.g., Allen (1967), Atwell (1969), Broome (1991), Macklin (1967a), Macklin (1967b), Oldenquist (1966), Rachels (1997), Rechenauer (2003), Schroth (2009) and Trapp (1988).

[4]It seems that the only exception are so called "basic actions" (Danto 1965) which cannot be factorized into smaller component parts.

It evaluates how it impacts a whole world history, that is, past, present and future. Of course, no act can change the past. But it can *fit* the past in a way that is more or less morally adequate. Hence, consequentialists can claim that the axiological value of an act depends at least partly on how well it *fits* into world history *as a whole*. This idea seems to sit rather well with G. E. Moore's well-received notion of organic unity. According to Moore (1903/1959), the organic value of a whole is not necessarily equal to the value of its parts. It may be greater or smaller, depending how well the individual parts fit together. In the present context that means that the axiological value of an act may not only depend on the act itself and its consequences, but also on how the act and its consequences fit into a given world history as a whole. It is plausible to assume that when an act constitutes the keeping of a promise there is at least one respect in which it fits well with its history. And this aspect, one might say, should plausibly materialize in its evaluation. As it turns out, then, consequentialists can recognize the intrinsic normative significance of a promise.

This result can help consequentialists to rebut the two aforementioned arguments. Let us consider each in turn. The first, recall, says that the institution of promising could not exist in a consequentialist society. Would-be promisees would recognize that promisors will keep their promises only if this has the best consequences. Hence, they will not believe the promise. Since the latter know this, they will not even bother making a promise and the institution of promising collapses. Now consider what changes if we allow consequentialist agents to hold a historical axiology of the appropriate kind. In that case they can consider the breaking of a promise to be a bad consequence of the act (Broome 1991). Suppose, again, that B promises A to do X. By hypothesis, A knows that B is a consequentialist and that she considers the breaking of a promise to be a bad consequence. A will, then, judge that if B promises her to do X, she will have a good consequentialist reason to keep her promise. Hence, A will expect B to keep her promise. B, in turn, will know this. She will, hence, make her promise. Self-defeat is, thus, averted.

The second argument, recall, claims that it is counter-intuitive to suggest, as consequentialists do, that a promise may permissibly be broken, even if this has only slightly better consequences than keeping it. We considered David Ross's example where keeping a promise confers upon the promisee a benefit of 1,000 units of good and breaking it confers upon somebody else who is not the promisee a marginally greater benefit of 1,001 units of good. Under these circumstances, thinks Ross, it is not reasonable to judge that the promisor should break the promise. But, as we have seen, consequentialists are not committed to this view. Those who accept the intrinsic normative significance of promising may judge that the badness of breaking the promise in this situation outweighs the marginal increase in overall welfare that is thereby effected. Their recommendation will therefore be not to do it. To be sure, I do not mean to suggest that any historical axiology will do this trick. All that I claim is that consequentialists seem to possess the theoretical resources to bring their moral outlook in line with our common-sense moral judgements about Ross's example. This, however, should be enough to address the objection.

## The Case Against Deontology

As we have seen, it seems that the deontologists' case against consequentialism rests on a shaky foundation. Consequentialists, it appears, can account for the intrinsic wrongness of promise-breaking just as well as can deontologists. This prevents their view from being self-defeating and furthermore brings it into line with our intuitive moral convictions. As far as the issue of promissory obligation is concerned, the jury is still out on consequentialism and deontology. But perhaps this changes once we consider the consequentialists' arguments against deontology. Contrary to received opinion, the consequentialist account of promissory obligations may, after all, have more to offer than the deontologist account. In a recent paper, Sinnott-Armstrong (2009) has argued towards precisely this conclusion. In what follows I shall consider and reject his reasoning.[5]

Sinnott-Armstrong's argument is based on a change in perspective. He notes that the question whether consequentialists or deontologists can give us a more plausible conception of promissory obligation is usually discussed under a particular presupposition. It is assumed that we are after an explanation and systematization of our intuitive conviction that it is somehow morally wrong to break a promise. But this, Sinnott-Armstrong thinks, is only part of what we should expect from a philosophical account of promissory obligation. We should also be interested to know how and why different promissory obligations differ in *strength*. Consequentialists, he claims, can do a better job than deontologists when it comes to explaining this. He suggests that the consequentialist doctrine can easily be extended for the purpose at hand. On consequentialism, it may be said, I am obligated to do an act $A$ to the extent that this has better consequences than doing anything else. If the difference in goodness between doing $A$ and doing the second best act, $B$, is small, I have a weak obligation to do $A$. If this difference is large, I have a strong obligation to do $A$. Therefore, it seems sensible to suppose that I have an obligation to keep a promise to the extent that this has better consequences than anything else I might do. Sinnott-Armstrong hypothesizes, therefore, that the strength of a promissory obligation should be strictly proportionate to the harm that breaking the promise causes (at least when there are no other morally relevant consequences). If this was correct, it would seriously embarrass deontologists who, thinks Sinnott-Armstrong, do not possess an explanation that is similarly congenial to their moral outlook. This, however, is not the case, as I shall go on to show. First, however, let me state Sinnott-Armstrong's argument.

Sinnott-Armstrong's argument builds on John Stuart Mill's method of concomitant variation. This method is used to check whether two empirical phenomena, $x$ and $y$, are causally connected. We may conclude that variations in $x$ cause variations in $y$ if $x$ and $y$ are correlated and if we have ruled out alternative

[5]Note that Sinnott-Armstrong has a slightly different conception of consequentialism. This makes it a bit hard to connect his ideas with my own. I hope, however, that what I say nevertheless captures the gist of his argument in a fair way.

explanations which may explain this correlation. In particular, we have to rule out that (i) the correlation is accidental, (ii) variations in $y$ cause variations in $x$ (rather than vice versa) and (iii) variations in some other factor, $z$, cause variations in both $x$ and $y$.[6] To confirm his claim that the strength of a promissory obligation is strictly proportionate to the harm that breaking the promise causes, Sinnott-Armstrong proceeds, then, along the lines of Mill's method. First, he observes that the harm which is done by the breaking of a promise is correlated with the strength of the associated obligation of the promisor to keep the promise. He does so by looking at two cases:

> *AIRPORT*: I have promised you to drive you to the airport. If I break my promise, you will miss your flight and this will have quite bad consequences for you (e.g. you have to buy an expensive new ticket, you miss an important meeting and so on).
>
> *LUNCH*: You have invited me and some other folks over for lunch. I have promised you to come. If I break my promise, the harm that is thereby done is very little. You will be a bit disappointed, but you will still have an enjoyable lunch with your other friends and we can still see each other some other time.

As it turns out, my promissory obligation in *AIRPORT* appears to be much stronger than in *LUNCH*. There seems, then, to be a correlation between the harm of promise-breaking and the strength of the respective promissory obligation.

The second step in the argument consists in ruling out the alternative explanations for this correlation: (i) The correlation is accidental. (ii) The strength of a promissory obligation explains the level of harm which is caused by the breaking of the promise. (iii) There is a third factor which explains both the harm of promise-breaking and the strength of the obligation. Sinnott-Armstrong rules out these possibilities with a few parsimonious remarks. (i) is off the table, he says, "because consequences are at least part of what matters in morality" (Sinnott-Armstrong 2009, 440). Hence, a correlation between the strength of an obligation and the consequences of violating it should not be accidental. (Indeed, only radical deontologists would deny this.) (ii) should be dismissed, because the strength of an obligation apparently cannot explain the harm of violating it. E.g., in *AIRPORT* the comparatively greater strength of the obligation "cannot explain ( . . . ) why it is so bad to miss this flight" (ibid., 440). Finally, he rejects (iii) with a rhetorical question: "what would that third factor be?" (ibid., 440).

In the remainder of this section, I shall focus on two aspects of the argument: the alleged correlation between strength of obligation and harm of violation and the dismissal of the alternative hypothesis (iii). I shall conclude that there is, indeed, a correlation between strength of obligation and harm of violation. But this correlation is not perfect. And I shall argue that Sinnott-Armstrong falsely dismisses (iii), since there is a third factor which explains both the harm of violating an obligation and its strength. The first point disproves his hypothesis. The second explains why it is wrong. After that, I shall propose a more plausible account of the strength of promissory obligations.

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[6]It may be noted that a further possibility is (iv) that variations in $x$ cause variations in $y$ through some intermediary factor $w$. This, however, shall not concern us in what follows.

Let me start with the correlation. If the strength of an obligation to keep a promise is, indeed, fully explained by the harm that violating it causes, then there should be no two cases in which the levels of harm are different, while the promissory obligations are equally strong. As I shall argue, however, there are pairs of such cases. Consider the following modification of *LUNCH*.

> *LUNCH**: You have invited me and some other folks for lunch and I have promised you to come. As in *LUNCH*, if I break my promise, the harm to you is very little. You will be disappointed, but you will still have an enjoyable lunch with your other friends and we can still see each other some other time. But there is this one person, Walter, whom you have also invited. Walter is a philosopher like me. You have told him that I have found a mistake in a paper of his which he intends to present at a conference on the very next day. This conference is really important to him. So he has a very strong interest in seeing me about the apparent problem in his paper.

If I break my promise in *LUNCH**, I disappoint you. The harm to you is the same as it is in *LUNCH*. But there is an *additional* harm, the harm to Walter, whose (much stronger) interest in seeing me is also disappointed, if I do not show. If Sinnott-Armstrong's claim that the strength of an obligation and the harm of its violation are perfectly correlated was correct, I would have a stronger obligation to keep my promise in *LUNCH** than in *LUNCH*. But the obligations are equally strong. To see this, we need to turn to the question how the strength of an obligation is measured.

Sinnott-Armstrong explains that the relevant strength of an obligation "is measured by how much is needed to override the obligation" (ibid., 439). In *LUNCH*, he says, a reason which may justify that I break my promise is that my teenage child is sick at home, even though the kid would be safe without me while I am away. It suffices that I say something like this: "Hey, I know I have promised you to come to your lunch and I know you would like to see me. But my son is sick and I feel that I should stay at home with him." Now it seems to me that I could say the very same thing to excuse my promise-breaking in *LUNCH**. If you then pointed out that Walter would be extremely disappointed if I did not come, I could say something like this: "Oh, that's too bad. Please tell Walter that I am very sorry I can't come, since my son is sick."

Now this comparison, in and of itself, does not establish my claim that my promissory obligations in *LUNCH* and *LUNCH** are equally strong. The reason why the same justification suffices to justifiably break the promise in both cases may not be that my obligations in *LUNCH* and *LUNCH** are equally strong. Rather, it may be that my justification is strong enough to override even my *stronger* obligation in *LUNCH**. So let us consider a third case which indicates that this is not so:

> *LUNCH***: You have invited me and some other folks for lunch and I have promised you to come. If I break my promise, you will be mildly disappointed, because you would have liked to see me (as in *LUNCH* and *LUNCH**). More importantly though, you will not get my feedback on a paper of yours which you will present at a conference. Apparently, I have found a mistake in it and it is really important to you that I tell you about it before the conference.

In *LUNCH*** there is no Walter. The interest he had in seeing me is now *your* interest in seeing me. The overall amount of harm that I do if I break my promise is

then the same as in *LUNCH**. So if, as Sinnott-Armstrong believes, the harm done by breaking a promise determines the strength of the obligation, the justification that sufficed to break the promise in *LUNCH** should suffice in *LUNCH*** as well. But it does not. At any rate, so it seems to me. In *LUNCH***, I cannot say: "Listen, I can't come to your lunch. I know I have promised to come. And I know you need my opinion on your paper before you go to that conference. But my son is sick and I feel I should stay with him." If I said this, you would have every right to ask me: "Is your son so sick that he needs you twenty-four-seven? Can you not come over for an hour or two? You have promised that you would. And you know that I *really* need your opinion on my paper before I go to that conference." I would have to concede: "No, I guess he can stay by himself for an hour or two. And you're right. I have promised you to come and I know that you really need my comments. So I guess I should come over."

Our intuitive responses to *LUNCH*, *LUNCH** and *LUNCH*** establish, then, contrary to Sinnott-Armstrong's claim, that the harm of promise-breaking does not explain the comparative strength of promissory obligations. Nevertheless, Sinnott-Armstrong is not entirely on the wrong track. In general, the harm of promise-breaking seems to go hand in hand with the strength of obligation, as his paper shows. This is an important insight which, however, Sinnott-Armstrong fails to adequately explain. In what follows, I shall draw out an account of promissory obligations which rectifies this. It can explain cases like *LUNCH* and *LUNCH*** in which the strength of obligation and the harm of violation are correlated *and* cases like *LUNCH** in which this correlation breaks down.

Let me start with an important distinction. Sinnott-Armstrong talks about *the* harm of promise-breaking. I think, however, that we should discern two kinds of harm a promisor may do by breaking her promise. The first kind of harm is the harm that is done to the promisee, $harm_P$. The second kind of harm is the overall harm which is done, $harm_O$, that is the harm which is done to the collective of morally relevant subjects which includes not only the promisee. These two kinds of harm are, of course, closely connected. Usually the two are identical, since the harmful consequences of a broken promise are typically all borne by the promisee. This is the case in *AIRPORT*, *LUNCH* and *LUNCH***. In all three cases, you, the promisee, are the only person who is harmed if I break my promise. In *AIRPORT*, the harm of my promise-breaking is the fact that you miss the flight (plus all bad consequences this may have for you). In *LUNCH* it is your slight disappointment that I do not come. And in *LUNCH*** it is your disappointment about not seeing me plus the fact that you do not get my comments on your paper. There are, however, cases in which $harm_P$ and $harm_O$ come apart, such as in *LUNCH**. In *LUNCH**, if I break my promise, the harm to you, the promissee, is as small as in *LUNCH*, while the overall harm which includes Walter's disappointment is as great as in *LUNCH***.

Now my account of the strength of promissory obligations turns on the distinction between $harm_P$ and $harm_O$ and goes as follows:

> The promissory obligation in CASE A is at least as strong as the promissory obligation in CASE B if and only if $harm_P$ in CASE A is at least as great as $harm_P$ in CASE B.

If this account is correct, it means that Sinnott-Armstrong made a mistake by dismissing hypothesis (iii) in step two of his argument. There *is*, then, a third factor which can explain both the strength of the obligation to keep a promise and the harm of its violation. This third factor is $harm_P$. Variations in $harm_P$ explain both variations in the strength of a promissory obligation, as my account says, and variations in $harm_O$, since $harm_P$ is a part of $harm_O$. Cases like *LUNCH** in which the strength of the obligation does not correlate with the harm of its violation can be explained by the fact that variations in $harm_O$ may occur not only because of variations in $harm_P$, but also for independent reasons.

Now let us check whether my account fits our intuitions about *LUNCH*, *LUNCH** and *LUNCH***. We observed that the strength of my promissory obligations in *LUNCH* and *LUNCH** were equally strong, while the obligation in *LUNCH*** was stronger. According to my account, the levels of $harm_P$ must then be the same in *LUNCH* and *LUNCH**, while the level of $harm_P$ in *LUNCH*** is greater. Indeed, this is the case. If I break my promise in *LUNCH*, the harm to you, the promisee, is your mild disappointment about not seeing me. The same goes for *LUNCH**. In *LUNCH***, though, the harm to you, the promisee, is your mild disappointment about not seeing me *plus* your more severe disappointment that you do not get the comments on your paper. So, in *LUNCH***, $harm_P$ is greater than in *LUNCH* and *LUNCH**. It seems, then, that Sinnott-Armstrong is partly right. The harm of promise-breaking can apparently explain the strength of an obligation. However, it is only the harm to the promisee that is relevant to the strength of the promissory obligation.

Now it may be objected that my view has a somewhat absurd consequence. Imagine a case in which the breaking of my promise involves very little $harm_P$, but an enormous amount of $harm_O$. Assume, e.g., that in *LUNCH** Walter will not only be very disappointed if I do not come. Rather, he will die. Does this not increase the strength of my obligation to keep my promise and come to your lunch? No, it does not, since "[u]nlike paradigmatic moral duties, the duty not to harm for example, *promissory obligations are not owed equally to everyone, but rather only those we have promised*." (Habib 2008; emphasis added) In *LUNCH**, you are the promisee. Hence, I owe it to you, and you only, that I keep my promise. $harm_P$ is the only factor which determines the strength of my obligation to do that. Note, however, that there may be *independent* reasons to act in keeping with my obligation (or otherwise). The fact that Walter would otherwise die is one such reason. To be sure, then, I am not claiming that $harm_O$ is a morally irrelevant factor. I am only claiming that it is a factor which is irrelevant to the strength of a promissory obligation, since a promissory obligation is owed only to the promisee(s).

A few qualifying remarks seem to be in order. It is, I believe, important to stress that the account that I have presented as an alternative to Sinnott-Armstrong's hypothesis pertains only to the question how the strengths of promissory obligations are to be compared *relative to one another*. It is silent on and, therefore, compatible with the view that promises have intrinsic normative significance which, as we saw above, can be held both by consequentialists and deontologists. There is, then, no reason to think that my account represents a stage victory for the one or the other

side. But it may, perhaps, seem that my account is somehow more congenial with the consequentialist paradigm, because it proportions the strength of a promissory obligation to the bad consequences, viz. the harm, that breaking a promise causes for the promisee. But I do not see why this should be the case. Deontologists generally recognize the normative significance of doing harm (Kamm 2007). And, as I said above, some of them even conceptualize the obligation to keep a promise as subcategory of the duty not to harm. They of all moral theorists should be able to recognize that the strength of the obligation to keep a promise is proportional to the harm for the promisee that would result from breaking it. As it turns out then, on closer inspection there is nothing in Sinnott-Armstrong's interesting and insightful paper which can show that the consequentialist position on promissory obligation is superior to the deontological one.

## Conclusion

Let me review the dialectic. I have argued that when it comes to the morality of promising neither deontologists nor consequentialists can claim the upper hand. I substantiated this assertion by reviewing arguments on both sides. First, I reviewed the case against consequentialism. I addressed the concern that the consequentialist position on promissory obligation is self-defeating and the allegation that consequentialists cannot account for our intuitive judgements about the morality of promise-breaking. I argued that both arguments can be addressed once it is granted that consequentialists can, contrary to received opinion, account for the intrinsic normative significance of the obligation to keep a promise. After that, I considered whether the consequentialist position on promissory obligation may, in fact, have an edge over the deontological one. To this end, I looked at a new argument by Walter Sinnott-Armstrong. He claims that consequentialists can make more sense of the relative strengths of our promise-keeping obligations. I showed why and where he errs and introduced a more plausible account of obligational strength which appears to be compatible both with the consequentialist and the deontologist perspective. The bottom line of all of this is that there seems to be nothing in the debate about promissory obligation which makes the consequentialist or the deontological position appear preferable.

How, one may ask, should we then choose between the two views? How, that is, can we figure out whether we should think of our obligation to keep promises in consequentialist or deontological terms? In concluding, I would like to suggest an answer to this question which can, I think, teach us a valuable methodological lesson about the way we should approach practical matters. Some applied ethicists seem to believe that all we need to do in order to settle on a normative conclusion about a practical question is to check which of the available moral-philosophical answers to a given case appears to make most sense. As we have seen, however, this is not always possible. In the case of promissory obligation, at any rate, there is no clear-cut answer to the question whether the consequentialist or the deontological

account is preferable. In such a situation, I think, we should back up and look at the bigger picture. We should consider the respective positions in light of their general merits. Should it turn out that consequentialism is more attractive than deontology on independent grounds (or vice versa), then this would give us a reason to prefer its conception of promissory obligation and to address practical issues of promissory obligation in its terms. The ways in which theory and practice are connected are not often obvious. Nevertheless, more often than not it may turn out that we have to climb up the greasy pole of theory before we can give a truly justified answer to a practical question. As Kurt Lewin rightly remarked, "Nothing is more practical than a good theory." (Lewin 1951, 169)[7]

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# Part V
# Case Studies in Risk Management

# The Nuclear Power Plant: Our New "Tower of Babel"?

**Julie Jebeile**

## Introduction

On July 5, 2012 the Investigation Committee on the Accident at the Fukushima Nuclear Power Stations of Tokyo Electric Power Company (TEPCO) issued its final, damning report.[1] Apart from the precise facts for which TEPCO, the Nuclear and Industrial Safety Agency, and the Japanese government have respectively been reproached, one can draw from this report at least two worrying conclusions.

The first is that the accident at Fukushima Daiichi on March 11, 2011, the date on which seism and tsunami raged on the nuclear site, was foreseeable and thus could have been avoided. According to the report, since 2006, both the operator and the nuclear safety agency knew the risks of a total power outage and the loss of seawater pumps in the case of a tsunami reaching the site level. However, studies and concrete measures of these risks were never undertaken. One of the main arguments used to justify this omission was that the probability of a tsunami of such size occurring was very low.

The second conclusion is just as alarming as the first one: a better response to the accident could have been given and thus the effects of the accident could have been lessened. As the report notably mentions, there was a lack of knowledge and preparation from the personnel on the site, and an absence of clarity and rapidity in the decisions made by the direction. The report also shows that the communication to the public and, in particular, to the residents close to the site (and therefore the most affected by the high levels of radioactive contamination) was vague and, in many cases, too late.

[1]The English version of this report is on the website http://naiic.go.jp/en/. An interim report was delivered on December 26, 2011. See http://icanps.go.jp/eng/interim-report.html.

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Both conclusions show that the human group – constituted by the employees of TEPCO and the control organism – had partial and imperfect epistemic control on the nuclear power plant and its environment. They also testify to a group inertia in decision-making and action. Could it have been otherwise? Is not a *collective of human beings*, even prepared in the best way against the nuclear risk, *de facto* prone to epistemic imperfection and a kind of inertia?

In this article, I focus on the group of engineers who, in research and design offices, design nuclear power plants and model possible nuclear accidents in order to calculate the probability of their occurrence, predict their consequences, and determine the appropriate countermeasures against them. I argue that this group is prone to epistemic imperfection, even when it is highly prepared for adverse nuclear events. I consider that a group is epistemically imperfect when it does not prevent individual errors from propagating and when it does not have optimal epistemic control on the nuclear machine. I show that difficulties stand in the way of its optimal epistemic control on such a machine. These difficulties might have consequences in case of exceptional issues. Under normal circumstances, one can consider that there are sufficient precautionary systems so that nuclear power plants run correctly.[2]

My work falls within an epistemology of human groups facing nuclear risk. The method I have adopted is not common and might surprise the philosopher insofar as my reflections build on work in the science of sociology. Indeed, the question of the efficiency of human organizations facing nuclear risk has been extensively discussed in the sociology of organizations. In this article, I take stock of the debate and examine the results of previous studies before presenting my own philosophical criticism. This allows me both to highlight an important scientific debate, and to situate my work within the existing scientific framework.

The political component of my work, if there is one, is to draw decisional bodies' attention to the following point: the organization of human resources, based on a division of labor and distribution of knowledge, constitutes a risk factor. This risk factor must be seriously taken into account when making decisions concerning future energy steps.

## Normal Accidents and High Reliability Organizations

Can a human organization, implemented within a nuclear power plant, adequately face a nuclear risk? This question has been addressed by sociologists of organizations. More generally, sociologists have examined the efficiency of human organizations in high-risk enterprises, e.g. chemical plants, air traffic control stations, ships, dams, nuclear weapons, and space missions. This topic divides sociologists into two rival schools of thought. On one side are the proponents of the *Theory of Normal Accidents,* who think that nuclear power plants are hazardous

[2]My intention is not to give the impression that nuclear power plants are always unsafe.

enterprises which inevitably lead to accidents. According to these theorists, nuclear accidents are to be expected. They argue that better human organization would allow one to reduce the accident risk but not to remove it completely (Perrow 1984; Sagan 1993). On the other, the proponents of the *Theory of High Reliability Organizations* (HROs) claim, on the contrary, that, under specific conditions, enterprises, such as nuclear power plants, display organizational specificities which explain their very high level of reliability (Roberts 1993).

In what follows, I first present the theory of normal accidents. I then present the conditions under which an organization is said to be highly reliable by the theory of high reliability organizations. In sub-section "Theory of Normal Accidents", I show that, even under these conditions, a group is prone to epistemic imperfection. In this way, I propose arguments in favor of the theory of normal accidents. Nevertheless, I consider that the theory of high reliability organizations is correct when it claims that organizational improvements must be made in order to increase security. However, I claim that the organizational improvements of the theory are not optimal and need to be revised.

## *Theory of Normal Accidents*

Charles Perrow is one of the leading figures of the theory of normal accidents. He argues that, in high-risk technologies, "no matter how effective conventional safety devices are, there is a form of accident that is inevitable" (Perrow 1984, 3). Unavoidable failures, either mechanical or human, can occur anytime during the processes of design or operation. They can also be induced by the system's external environment.[3] Accidents in high-risk technologies are qualified as normal not because they are frequent (fortunately, they are relatively rare) but because they are unavoidable: their occurrence is an inherent property of high-risk enterprises. In the same vein, Perrow writes: "It is normal for us to die, but we only do it once" (1984, 5).

According to Perrow, high-risk systems commonly present two particular properties, which are hard to get around, and which favor the occurrence of an accident. On the one hand, they display a complex interactivity which complicates the functioning of the system and makes it difficult to understand; while on the other hand, the tight coupling between their components prevents a quick recovery to a normal state of functioning in the case of an accidental situation.

A system displays a complex interactivity when its components serve several functions at the same time. The complex interactions are defined by Perrow as "those of unfamiliar sequences, or unplanned and unexpected sequences, and either not

[3]The different stages during which failures can occur are called the the DEPOSE components (*Design, Equipment, Procedures, Operators, Supplies and materials, and Environment*) by Perrow (1984, 8).

visible or not immediately comprehensible" (1984, 78). They are opposed to what he calls linear interactions, which can be predicted and understood and, therefore, can be controlled. Take, for example, a pressurized water reactor.[4] In such a reactor the steam generator carries out two roles at once. It is used not only to absorb heat given off by nuclear reactions in the core, but also to produce steam that is necessary for the rotation of the turbines. In the case of a steam generator breakdown, the nuclear core overheats, as the excess of heat in the primary cooling loop is not properly absorbed anymore. There is a risk of reaching the critical point of heat flux, which will then destroy the fuel cladding, and thereby create a breach of the first containment barrier, causing the release of fuel material into the reactor core. Further, if the steam generator malfunctions, the secondary system can become too cool for producing enough steam. The steam generator has a functional relation with two distinct components – the reactor core and the turbines. If it fails, its functions, namely cooling the reactor and producing steam, cannot be ensured. During the accident at Three Mile Island, a breakdown of the main feedwater pumps in the secondary loop was responsible for a failure in the steam generator. After the reactor shut down, it continually generated decay heat. As the auxiliary secondary pumps also failed, the core was not correctly cooled. Its temperature and pressure increased. In addition to that, small failures in the safety system occurred. Thus, the pressurizer relief valve of the primary loop, which opened up automatically in order to avoid a drastic increase in pressure, could not be closed in the sequel. And yet, the warning light indicated the opposite to the operators. Hence, a sequence of unfortunate events and unexpected interactions led to the well-known catastrophe.

When the components of a system are tightly coupled, a small failure in one of them can quickly induce a series of problems in the other components. For example, an unforeseen increase in reactivity in the nuclear core has direct and immediate consequences on the other components with which the core is in relation. Thus recovery of the system to its normal state of functioning is more difficult. Additionally, because of the propensity of a failure to spread into the whole system, the operator cannot take the time to intervene; it is constantly in a hurry to solve the small failures. Lastly, a system that presents a tight coupling between its components requires a fine maneuverability. Thus, if the operator wants to lower the level of reactivity in the core, he can intervene, for example, by incorporating boric acid, a neutron poison, into the core. The amount of boric acid to be poured must be measured with accuracy. Because of their time-dependence and sensitivity, these systems do not allow for improvisation in the case of a problem.

Would it be sufficient to simplify the system and to avoid any tight coupling between components in order to make the system safer? In addition to the technical difficulties it would entail (see Perrow 1984, 89), this solution seems to be quite counterproductive. Indeed, if we are to believe Perrow, the complex interactivity and the tight coupling of high-risk systems are the very factors that make these

[4]Perrow takes instead the example of a chemical reactor in his book. But the heat process is similar to nuclear power plants, and the conclusions remain the same (1984, 72).

systems efficient. Thus, for example, the double function of the steam generator guarantees a better energy yield of the nuclear power plant. More generally, according to Perrow, "complex systems are more efficient [...] because there is less slack, less underutilized space, less tolerance of low-quality performance, and more multifunction components. [From the point of view of] design and hardware efficiency, complexity is desirable" (Perrow 1984, 88).

Because of their complex interactivity and tight coupling of their components, nuclear power plants are prone to accidents. Thus according to Perrow, the accident at Three Mile Island was not unexpected. He writes, concerning it, that: "[N]o matter how effective conventional safety devices are, there is a form of accident that is inevitable. This is not good news for systems that have high catastrophic potential, such as nuclear power plants, nuclear weapons systems, recombinant DNA production, or even ships carrying highly toxic or explosive cargoes. It suggests, for example, that the probability of a nuclear plant meltdown with dispersion of radioactive materials to the atmosphere is not a chance in a million a year, but more like one chance in the next decade." (Perrow 1984, 4). This was a dreadful prophecy which, during last few decades, has gained credibility: at the time when Perrow wrote,[5] in 1984, only Three Mile Island (on March 28, 1979) was classed as an accident resulting in a nuclear meltdown. Since then, two nuclear accidents of the same type have followed: Chernobyl (on April 26, 1986; 7 years after Three Mile Island) and Fukushima Daiichi (on March 11, 2011; 25 years after Chernobyl).

I agree with Perrow that nuclear power plants are prone to accidents because of their complexity. Furthermore he is right when he says that they are far too complex for one to be able to anticipate, analyze and face an accident in the best way. And, as I will show in sub-section "Theory of High Reliability Organizations", the division of labor and the distribution of knowledge, highly required by their complexity, are also sources of risk in that they hinder optimal epistemic control of the nuclear machine.

I now want to present the theory of high reliability organizations. This theory proposes four organizational improvements that have to be made in nuclear power industry. While these improvements seem appropriate in principle, as I will show in sub-section "Theory of Normal Accidents", they are not efficient enough in practice.

## *Theory of High Reliability Organizations*

The theory of high reliability organizations relies on an inference that is the inverse of the one that the normal accidents theorists make concerning the relatively low frequency of technological catastrophes. Although these catastrophes are not very frequent, for the normal accident theorists, the very fact that these accidents even arise is a sign of their normality. For the high reliability theorists, the low

[5]Note that Perrow has wrotten an article in reaction to the accident in Fukushima (Perrow 2011).

frequency of technological catastrophes proves that there is exceptional organization behind high-risk technologies. Roughly speaking, the disagreement between the high reliability theorists and the normal accident theorists is of the same kind as the disagreement between people who see the glass half full and those who see the glass half empty.

Among the high reliability theorists, there are three groups of sociologists whose working assumptions are slightly different (see Sagan 1993 for a presentation). Despite their methodological differences, they all agree that the dangers of high-risk technologies may be avoided by human organizations if they are designed and managed in an appropriate manner. These organizations are called high reliability organizations. According to Sagan, "the common assumption of the high reliability theorists is not a naive belief in the ability of *human beings* to behave with perfect rationality; it is the much more plausible belief that *organizations*, properly designed and managed, can compensate for well-known human frailties and can therefore be significantly more rational and effective that can individuals" (1993, 16). Furthermore, high reliability theorists think organizations can avoid the intrinsic danger of high-risk enterprises.

The high reliability theorists agree in their identification of four factors that must be improved in order to ensure the safety of dangerous technologies. At first sight, it seems that the improvement of these factors results in better security. But, as I will show, this is not enough. And moreover, some of these factors may contribute to epistemic imperfection of the group. They are listed by Scott Sagan (1993) and I briefly take them up here before examining some of them in section "Theory of Normal Accidents".

First, according to the high reliability theorists, safety and reliability must be considered by the decision-making bodies, namely the political elites and the organization's leadership, as priorities of the first order. It is only in this way that all the necessary financial means will be utilized with the aim of improving the level of safety in the enterprise. Additionally, in promoting safety and reliability above all, the decision-making entities are able to send a clear message to everyone, thus creating a climate of trust within the group.

Second, redundancy, either technical or human, must absolutely be optimized. Redundancy is the multiplication of independent channels of communication, decision-making, and implementation. Thus an employee can be led to check the tasks of a colleague. Redundancy aims, in principle, to compensate for possible human errors – including mistakes made due to irrational behavior or cognitive limitations.

Third, one must reduce individual errors by establishing a policy of decentralization of decision-making authority, a culture of reliability, and constant training of the personnel. The decentralization of decision-making authority must allow the individuals that are closest to the concrete problems to quickly and appropriately respond to dangers. The culture of reliability is established with precise rules and procedures given to the personnel. This culture allows employees that are far from the decision-making centers to act in compliance with what is expected from them by the authority. Lastly, a constant training of the personnel, punctuated

by on-the-job formations and simulations of emergency crisis, must break their routine, which is often favorable to slackening and negligence, and put employees in an unusual situation, thereby forcing them to remain awake and reactive in their decisional and operational powers.

Fourth, the organization must show a strong capability to learn by accelerating the adjustment of its procedures in the case of an emergency. Agents have to learn through constant process of trial and error, which allows for retention of the most efficient operations and an abandon of those that are not performing as well. This process can be performed experimentally (e.g. with crisis exercises) or by working with simulation and imagination.

In what follows, I will show that there are difficulties of an epistemic kind that arise within high reliability organizations, when these four precautions are taken. In other words, these four precautions are not enough to prevent accidents and that is where my view differs from the theory of high reliability organizations.[6]

## Epistemic Imperfection Within High Reliability Organizations

The four precautions advocated by the high reliability theorists are conceived mainly to apply to human organizations dedicated to the operation of nuclear power plants. I assume in this work that they should also apply to organizations in charge of their design. In order to face nuclear risk it is necessary to have good organization on the site, but it is also necessary to have it in the design and research offices in order to correctly predict and prevent possible accidents. Thus, the precaution of redundancy, the decentralization of decision-making authority, and the culture of reliability should, in principle, help engineers to properly perform studies of nuclear power plants, and therefore to gain epistemic control on the nuclear machine.

However, as I would like to show, it is not enough to distribute the tasks, to increase the number of controls, to decentralize the decision-making center, or to create a culture of reliability in order to improve the epistemic control of the machine. Furthermore, as I argue, although these practices seem in principle to be genuine improvements, some of them may, in implementation, cause a loss of optimal epistemic control on the machine. I will show that, when one applies these practices, they sometimes have undesirable effects. Some of these effects are of psychological kind but have real epistemic impacts. In particular, they may prevent the group from catching individual errors. In some cases they also contribute to the isolation of individuals within their specialized work, and to a loss of know-how that the group accumulates over time. My intent is to proceed as follow: I propose an epistemological analysis of some elements, which have a psychological foundation, but can be given an epistemic interpretation. In addition to the psychological effects,

[6]Normal accidents theorists also address these factors (see Sagan p. 36–43 for a summary of their arguments).

there are economical constraints that are specific to any profit-making enterprise. These constraints sometimes have (harmful) epistemic consequences on the daily work of the engineers. However, the epistemic consequences of the psychological effects and the economical constraints are not systematic. In some cases they can be dangerous.

Before going further, I should draw to the attention of the reader the fact that organizational rules are generally documented internally within the enterprises in charge of designing the nuclear power plants; they are not publicized. Nevertheless, in France, where nuclear power represents approximately three quarters of the electric production, these rules are partly determined by the Order of August 10, 1984 related to the quality of the design, construction and operation of basic nuclear installations. This order has been abrogated and replaced by the Order of February 7, 2012.

## *Unavoidable Individual Errors*

According to Sagan's analysis, the high reliability theorists consider well-designed and well-managed organizations to be potentially more rational than individuals can be. Consequently, in their view, the collective is able to overcome errors potentially made by individuals. At first sight, that seems to be a fair judgment because the division of labor, the specialization of workers and the systematic check of studies seem to serve this purpose.

For example, the division of labor is obvious as a rational choice of organization. It seems preferable to subdivide the work into different tasks and to attribute each of them to the most competent person rather than to give all of them to the whole group. Further, one expects from the verification of a study, performed by a different person than its author, to increase the chance of removing residual errors of judgment or calculation. If two people, independently of each other, carry out reasoning, there ought to be a low probability that they both make precisely the same error. Further, because a "checker" should pay close attention to possible errors, he thus has a good chance of finding them.

However, in the context of civil nuclear industry, the organizational properties of the collective display retroactive effects on the individual which lead to error.

First of all, in design and research offices, the tasks assigned to engineers – in neutronics, thermohydraulics, metallurgy or mechanics – are often precise, repetitive and procedural. Even if they require a high level of qualification, their ultra-specificity can weaken the interest they have for their work, and their concentration, and thus can lead them to make mistakes.

Further, in order to detect possible individual errors, organizational rules compel that each study be performed, controlled, verified, and endorsed by four distinct agents: the author, the technical referent, the checker, and the hierarchical manager. Therefore the rules respond to the search of redundancy, decentralization of decision-making authority, and the culture of reliability. However, this produces

two negative side effects: on the one hand, it minimizes the responsibility of each individual; on the other hand, it increases the trust one puts in other members of the collective.

In addition to this second effect, there is also the phenomenon of *epistemic injustice* highlighted by Fricker (1998). That is, individuals give credit to the most powerful, and therefore, not necessarily to the best. In the industrial context, it is not always easy to identify the most reliable informants. A great number of personal variables (such as the age of one's coworkers – which is not necessarily proportional to their level of competence) can exert influence. Generally, in a design and research office, the most powerful people are the hierarchical managers, or the employees whose self-confidence produces a *de facto* form of authority. As for the best, those are the employees whose competence is likely to bring reliable and efficient solutions to technical issues that are addressed to them.

The trust in other members is increased when one has no time to deliberate by oneself. There are indeed budgetary constraints that concern the authors of studies, but these also affect checkers and technical referents (hence, let us note in passing, the interest remains to grant a special budget to young recruits). Likewise, one can easily figure out that a hierarchical manager has little time to endorse a study performed by one member of her team and sign it. They are obliged to trust their quick judgment that cannot concern only the quality of the study. This trust, which is sometimes distorted, does not favor the catching errors.

Lastly, the nuclear risk is a less concrete notion for engineers in offices than for operators in nuclear power plants, for example. If the employees tend to forget that they actually work for a high-risk enterprise, they might relax their vigilance.

## *The Scientific Isolation of Individuals*

We have seen that the division of labor, the specialization of workers and the systematic verification of studies does not allow for the complete avoidance of individual errors. Further, these things also prevent optimal epistemic control. Optimal epistemic control requires not only reliable information about the machine and correct predictions about its possible behaviors, but also a systemic understanding of the machine, i.e. an understanding of the whole system down to the smallest but relevant details.[7]

Optimal epistemic control cannot be met in the nuclear industry because individuals are isolated in their highly specialized work. As Perrow notes (1984, 87), the specificity of their task, inherent to the complexity of the machine, has the

[7]According to a strong criterion of optimality, the group must prevent any individual errors from propagating. But this criterion is idealistic and many errors have no major impact on the accuracy of the predictions made by the group. A looser criterion can be that the group must stop any individual error that significantly impacts the predictions made by the group. But the importance of an error on the predictions can hardly be assessed a priori. Nevertheless we shall consider the looser criterion in this paper.

effect of depriving them of a global understanding of the system. Besides, the lack of intellectual interaction between the individuals hinders the dynamics that is necessary for optimal epistemic control of the machine. The distribution of tasks reduces the possibility of interaction between individuals with different functions and specialties. Individuals generally restrict themselves to the tasks that have been assigned to them.

Furthermore, as they are subjected to budgetary constraints, the agents generally have no time to fill their gaps in the technical domains adjacent to theirs. And yet, for example, if there is a lack of interaction between the design engineers and the developers of computer programs required for the studies, an inappropriate use of these programs can be the result. Errors can occur in studies, and, because of the fluctuating confidence between workers that I have previously mentioned, they can be whisked off the control of checkers. The major problem of such a collaborative organization is that everybody thinks that if she does not know something, someone else in the firm surely does.

Let us take the example of orders made between two teams of different disciplines, two distinct epistemic communities. Engineers in thermohydraulics sometimes need neutronics inputs for their own studies. They might, for example, need to know about the nuclear reactivity in the core when doing calculations of critical heat flux. The neutronics engineer, who has to provide them with such data, often has little knowledge of thermohydraulics, and therefore has to trust his interlocutors, the thermohydraulics engineers. She will not check for her colleagues whether the question they raise is coherent or justified, or whether the input data she gets from them are plausible.

## *The Non-Conservation of Accumulated Know-How*

Epistemic control is also in jeopardy because nothing seems to guarantee the conservation of accumulated know-how. This know-how includes not only the set of knowledge required for the achievement of the studies of accidents and design, but also the set of information about the history of the nuclear power plant in question (like, for example, the technological choices at the base of its construction). Know-how differs from mere propositional knowledge in that it includes all the "recipes" that an employee learns by doing and that are useful in performing studies, solving trivial computational issues, finding relevant information, and so on. In order to control power plants during their life-span, one often needs to come back to earlier technical studies. Thus, the organizational rules require that, for each study, a technical file that lays out the sequence of the study and the technical choices, be created and stored. In this sense they meet article 2.5.6 of the Order:

> The important activities for the protection, the technical controls, the actions of verification and assessment are the subjects of a documentation and a traceability allowing one to demonstrate a priori and to check *a posteriori* the respect of the defined requirements. The corresponding documents and recordings are recorded, easily accessible and readable, protected, preserved, and stored during an appropriate and justified term.

However, these files can lack clarity, comprehensiveness, or even get lost. In these cases, one sometimes needs to directly contact the author of the file by every possible means, but it is necessary that the author still be available. Indeed, while a nuclear power plant has an average life-span of 30 years, a professional career at the same position, and in the same firm, is often much shorter. Further, people often communicate orally – both in person and by phone, and such communication is generally not stored, and thus is not systematically mentioned by authors in their study files.

This lack of continuity in the studies is aggravated by a lack of transmission: individuals often have no time to learn from each other. This is, I think, an aspect one must not underestimate. There might be a crisis in the nuclear sector at any time. Such was notably the case in the nineties in France. The nuclear industry did not, at the time, hire enough workers, and it pursued a policy of early retirement of its executives. Also, the age pyramid of the current personnel shows an ageing pattern. For several years, the nuclear industry has hired young, freshly graduated, engineers en masse, and these people are, by definition, inexperienced. The question arises – and I will keep it open: how is it possible to educate all these young arrivals when the most experienced will soon retire?

Further, there is the crucial problem of archive. Because of a comprehensible lack of physical or computer space, a great number of data and studies cannot be stored properly or are hard to access. This leads to a loss of "collective memory" in that the group loses the pieces of information it has accumulated over time. And yet, according to the article 2.1.1 of the Order, it is required that:

> The operator holds internally, in its subsidiaries, or in companies under its control [ . . . ], the technical competences to understand and appropriate in a perennial manner the foundations of these activities.

In summary, the work of high reliability theorists shows that it is conceivable, and even highly desirable, to do improvements of an organizational kind so that better control of the group can be possible. However, three difficulties of an epistemic type remain. These prevent the collective from reaching optimal epistemic control of the nuclear machine. These three difficulties are: (i) unavoidable individual error, (ii) the scientific isolation of individuals and (iii) the non-conservation of accumulated know-how over time. I will now show that the division of labor and the distribution of knowledge are at the origin of these epistemic difficulties, and therefore are responsible for the epistemic imperfection of the group. And yet the theory of high reliability organizations does not seem to recognize this.

## The Tower of Babel

A first sight, the division of labor and the distribution of knowledge are compatible with the search for optimal epistemic control. The division of labor is absolutely indispensable in the operation of complex technologies, which requires various competences and a high level of specialization from the employees. The division

of labor allows the group to save time in the areas of both education and work. It takes much longer for a single individual to develop multiple skills than for several individuals to specialize in only one of these competences. Further, a single person would take much more time to perform 30 intellectual tasks than 30 persons dedicated to only one operation.

However, the division of labor and the distribution of knowledge are at the root of the bursting of knowledge and systemic understanding of the machine within the group. Thus it is worth questioning whether the nuclear power industry is, to some extent, a real Tower of Babel. In the group, each member has a specific education and particular scientific competencies. Each member possesses specific pieces of knowledge about a part of the machine, but not about the whole, and thus cannot possess a full understanding of the plant. The operators can claim a certain understanding about how things work since they effectively manipulate the machine, they know the functional roles of its parts and the effects of their operations on them (see Dretske 1994). But this understanding, gained by the manipulation of the machine, does not really help to answer what-if-things-had-been-different questions. Besides, neither the design engineer (and which one? the engineer in thermohydraulics? in neutronics?), nor the constructor, possesses full understanding of the machine, so neither is able to anticipate all possible failures or accidents. Each member holds only partial knowledge of the nuclear power plant. The one and only cognitive unit, which could claim a full understanding, is the group itself. The group must therefore be considered as a distributed and extended cognition. It is a distributed cognition in that its memory and its knowledge are split into its different members. It is an extended cognition in that a part of its memory and knowledge is not possessed by human beings but rather placed on material support, such as paper or computers. However, the pieces of knowledge of the group do not exceed the sum of knowledge of its members. We cannot even claim that the group understands how the machine works in its entirety more than only one of its members. How, then, could it foresee any possible failure or accident?

In order for this to be possible the group must be more rational than its members. But, notably, because of the mutual trust between members of the same team, it seems to be difficult to eliminate individual errors. Furthermore, its parts must be perennial, so that the "collective" memory is conserved. In other words, knowledge must be preserved and be at its disposal at any time. And yet, nothing seems to guarantee the conservation of the accumulated know-how: traceability can be difficult (due to the quality of technical files, and problems of storage); there is a difference in scales between the length of careers and the span-life of power plants, which also contributes to the problem; and lastly, because the parts of organizations are mortal agents who get sick, go on vacation, are fired, quit, retire or die, this too contributes to the problem of continuity. Further, if the members of the group do not interact with each other, overlap of competence and knowledge is not possible. Each member becomes indispensable for the survival of the whole and such a situation is not desirable.

Additionally, in order to reduce nuclear risk, the group must not only predict any failure, but also it must offer a specific forecast in case of a problem, in a

sufficient time. It has to speak as one in order to indicate the actions to follow in case of emergency. And yet this is possible only if there is an orchestra conductor who gives instructions and decisions to the whole group. This conductor cannot be an individual. It can only be the group itself. But the group often has difficulty in expressing its own decisions, as I would like to show.

If each member has his own *opinion*, there will be a divergence in the group: in one word, "chaos". And the nuclear power plant would be a genuine Tower of Babel. The decisions must therefore appear as unified results of the work of the whole group. In order for the group to divulge them in concert, at least one of its members, not necessarily the same one every time, must be able to explicitly express them so that its decisions can be publicly known, thus allowing the group to act. Thus, the constraint of a "final single voice" is absolutely mandatory for the good management of the group. It states that an individual, who is at the end of a long chain of informants (engineers, builders, designers, experts, etc.), must be able to express the group's decisions. This last 'link' of the informational chain must know enough information to formulate them. She must at least possess the minimum amount of information required for expressing it.

However, the constraint of a "final single voice" cannot be met in practice. The inherent complexity of nuclear power plants requires from employees a high level of specialization. Thus, the employees understand only a part of the big machine through their own perspective, i.e. their specialty. Further, it is difficult to say if an approximate knowledge of the machine is enough to anticipate its possible failures. Most people roughly know how a nuclear power plant works. But, in most cases, they do not have knowledge of all of the details which are required to predict failures. These details are precisely hard to identify by a social organization. An example of missing details, in the case of the Fukushima Daiichi plant, is the height of sea walls. If there had been optimal epistemic control of the plan, the group of engineers in charge of its design would have thought that the plant, built on a seafront, could be exposed to a risk of seism or tsunami. The group would then have modified the height of the sea walls and thereby protected the diesel generators from a possible drowning.

## Conclusion

Even the production of a simple bicycle requires diversity in specialized knowledge. As highlighted by André Gorz (1989, 55), in the manufacturing of a bicycle, each worker possesses a small fraction of the required knowledge, but no one is in the position to appropriate the entire production process. The same can be claimed for the much more complex design and construction processes of a nuclear power plant. However, a bicycle does not involve the same environmental risks as a nuclear power plant, and thus it is worth questioning whether the division of labor and the distribution of knowledge are compatible with conditions of safety in the civil nuclear industry.

It is possible, and highly desirable, to make improvements of an organizational kind within the nuclear power industry so that the group can gain better control of, and can act more efficiently against, nuclear risk. Thus, the four precautions recommended by the theory of high reliability organizations should be taken seriously even if they do not completely prevent certain epistemic difficulties. However, one must take into account these difficulties and find solutions for preventing them. Thus, for example, human resources policies could be improved by increasing the value of technical work and experience in order to encourage engineers to dedicate themselves more fully to their work, by setting up work sessions with the explicit aim of promoting knowledge transmission between elders and youth, and by reducing the workload of engineers.

However, the division of work and the distribution of knowledge still hinder the search for an entire epistemic control on the machine. Indeed, nobody has a full and deep understanding of how nuclear power plants work: not the design engineers in R&D, nor the operator of a plant. Moreover, the American or French expert, invited to make a diagnosis in Fukushima, does not possess full knowledge about the plant, since she is a specialist in a specific area. If nobody really knows how a plant works, this is a problem. When designing and maintaining a machine require too many specialized skills, the machine may be similar in all respects to a Tower of Babel.

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**Biography** Julie Jebeile is a Ph.D student in philosophy of science at IHPST, Paris. In her work, she questions the explanatory value of scientific models that are used both as representations of natural and social systems, and as inferential tools. In particular, she examines how the intensive use of computers in modeling may impact the justification of model results and our search for understanding of the modeled phenomena. Julie also has an interest in the epistemological issues that arise with the distribution of knowledge within epistemic communities, particularly in the research and design offices of civil nuclear engineering where she worked as a neutronics engineer before turning to the philosophy of science.

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# The Global Economic Crisis as a Risk for the International Trade in Hanoi

**Hoang Anh Nguyen**

## Introduction

Risk is understood as the effect of uncertainty on objectives, whether positive or negative[1] and risk management is "the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events or to maximize the realization of opportunities".[2] Risks can come from uncertainty in financial markets, legal liabilities, credit risk, accidents, natural causes and disasters as well as deliberate attack from an adversary, or events of uncertain or unpredictable root-cause. The recent global economic crisis can be considered as a huge risk for economic development in general and for international trade in particular, especially for an emerging economy like Vietnam.

According to General Agreement on Tariffs and Trade (GATT) 1957, international commerce consists of international trade of goods and services, such as tourism, finance and banking and education, etc. International commerce always plays an important role in Vietnam in general and Hanoi city in particular. If taken total export turnover over GDP to measure the economy's integration level and dependence on the global economy, Vietnam is definitely one of those that have the highest rate. In 1990, the export turnover accounted for 36 % GDP, but in

[1]ISO/IEC Guide 73:2009 (2009). *Risk management – Vocabulary*, International Organization for Standardization.

[2]Hubbard, Douglas (2009). *The Failure of Risk Management: Why It's Broken and How to Fix It*. John Wiley & Sons.

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2010, it amounted to approximately 70 %. Goods export has promoted the country's economic growth and development for a long time.

Since Vietnam joined the World Trade Organization (WTO) in 2007, its service market has opened to foreign firms. The number of foreign tourists coming to Vietnam is increasingly high, which considerably increases the government budget. More and more international banks have been operating in Vietnam, which made the banking field livelier. However, this also means that Vietnam economy is becoming more vulnerable and dependent on the changes of the world's economy cycle.

Hanoi is an important cultural, economic and trade center of Vietnam. Its export turnover accounts for about 10 % of the total export turnover of the whole country.[3] Moreover, Hanoi is also a travel destination of many foreign tourists. Hence, the global financial and economic crisis has an enormous impact on the city's global trade activities.

The next sections will provide an overview of Hanoi's level of international trade and how it has been impacted by the global economic crisis, which is followed by the methodology and main findings of the present research.

## Overview of International Trade of Hanoi

### *Import Export Turnover*

In 2008, the export turnover in Hanoi was USD 6,900.4 million, increased by 35.5 % in comparison with that of 2007, in which the local export increased by 25.2 %. The import turnover in Hanoi in 2008 was USD 23,108.8 million, soared by 26.8 % compared to that of 2007, in which the local import rose by 23.1 %, machines, equipment and spare parts 20.6 %, materials 29.3 %. In general, in 2008 the import and export turnover of Hanoi grew in comparison with that of 2007, but huge trade deficit still existed.

However, since 2009 the export turnover in Hanoi started to decline. In 2010 the export turnover of the first 7 months was USD 4,225.3 million, increased by 16 % in comparison with that of the same period, but far from that of 2008. The exportation of 2011 was brighter; for 11 months the export turnover estimated to be USD 9122 million, increased by 26.5 % in comparison with that of the same period of 2010.[4] However, the trade deficit was still very high, the trade deficit of Hanoi for the first 11 months in 2011 was USD 13,574 million, equals 148.8 % of the export turnover, nearly equivalent to that of the same period of 2010 (150.4 %), and considerably decreased in comparison with that of the first 6 months (almost 200 %).

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[3]Hanoi Statistics Office (2008), Hanoi' Export report.

[4]Department of Commerce and Industry, *Hanoi's import/export activities in November and 11months of 2011*, http://congthuonghn.gov.vn/default.aspx?page=&lang=0&cat=126&content=609.

### *Major Export Markets of Hanoi*

In 2008–2010, the import export turnover of Hanoi had dramatic changes in two reverse trends, in which the most worrying was in 2009 when both import and export turnover fell sharply. In this period, the main cause for the import value decrease is that the prices for many items dropped due to the effects of the world's economic decline so businesses could not sell their products and decreased their demands for importing materials for their production; and the imports of consumers' goods also fell because of the decline in the domestic purchasing power. Strong decrease in the export turnover is due to the major export markets of Hanoi. The most declining markets include ASEAN, China and some other Asian countries as these countries' goods are similar to those of Vietnam. They have promoted the demands for domestic consumption during the difficult period for export, so Vietnam's goods encounters difficulties entering those markets. Another cause is that the market is directly affected by the economic decline of such power as EU and US; for the first months the export turnover into these markets fell significantly, but for the last months of the year these markets gradually recovered, so for the whole year of 2009 exports to the US markets increased by 3.8 %, but that to EU went down by 4.2 %. However, as these markets account for large shares, they greatly impacted the export turnover growth of the whole city of Hanoi (Fig. 1).

## Impacts of Economic Crisis on Hanoi's Import and Export

### *Changes from Export Markets*

- Major export markets also faced troubles in exporting, so they promoted domestic consumption, which makes Vietnam's goods difficult to be sold in these markets, thereby decreasing exports.
- Huge export markets like EU and US are badly affected by the economic crisis with a sharp decline in consumption demands.
- In 2010 when the economies gradually recovered after the crisis, export markets started to increase. However, the recovery was not yet unshakeable, so the international trade of Hanoi has not yet totally prospered.

### *Price Changing*

Export and import prices dropped sharply in 2009, which is the main cause for the decline in the export and import values of Hanoi (Table 1).

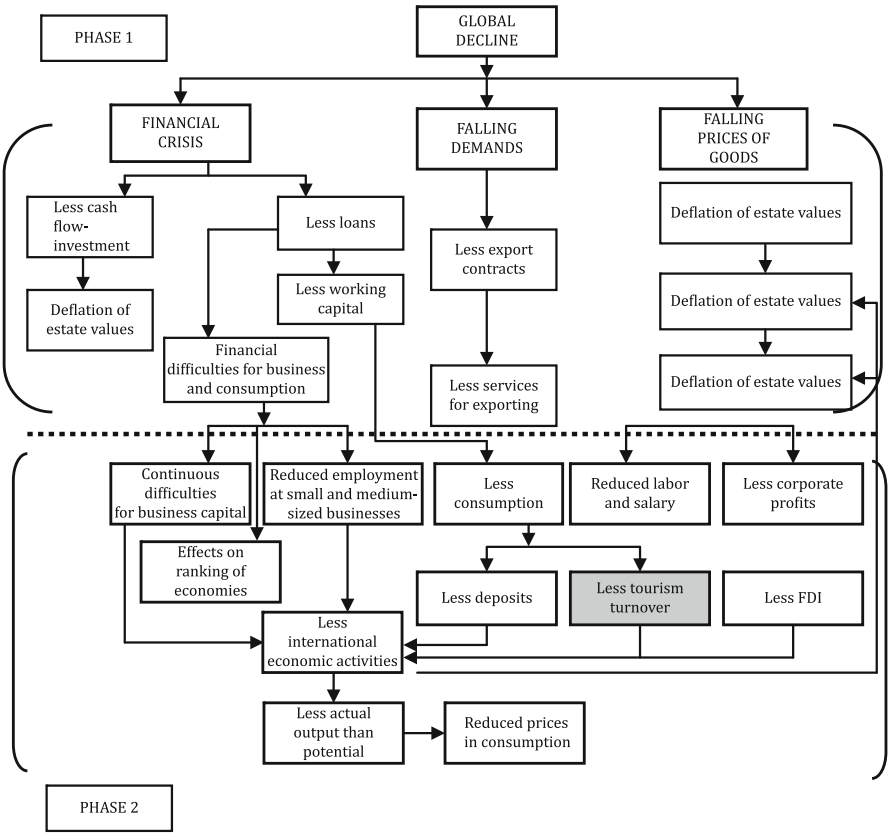


**Fig. 1** Impacts of economic crisis on the countries' economies in the world (Source: Asia Development Bank Report (ADB 2010))

Typically, the decline in prices is of the following goods:

**Export price**

- Crude oil price fell by 54 %, decreasing by USD 2319 million (the volume of exports increased by 20.2 %, but due to the sharp fall in prices, so the export turnover of crude oil declined by USD 1,597 million, equivalent to 44.7 %).
- Coffee price reduced by 26.4 %, declining by USD 291 million (although the volume of exports rose by 18.8 %, due to the price fall the export turnover of coffee decreased by USD 117 million, equivalent to 12.6 %).
- Rubber price dropped by 42.7 %, decreasing by USD 163 million. Rice price declined by 4 %, falling by USD 48 million.
- Pepper price went down by 34 %, dropping by USD 47 million. Cashew price fell by 13.8 %, causing to decrease by USD 29 million.

**Table 1** Index of export and import prices (previous year = 100)

| | *Unit: %* | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
| **General import price index** | | | | | | | |
| **General index** | **109.3** | **112.0** | **113.9** | **107.3** | **107.2** | **124.8** | **88.1** |
| **Consumers' goods** | **105.3** | **104.1** | **104.1** | **103.6** | **105.8** | **115.8** | **96.3** |
| Cereals and foodstuff | 108.9 | 106.6 | 108.7 | 106.6 | 110.8 | 126.0 | 93.8 |
| Non-cereals or foodstuff | 101.2 | 101.3 | 99.9 | 101.1 | 101.8 | 107.3 | 98.4 |
| **Means of production** | **116.7** | **126.6** | **132.4** | **114.2** | **108.7** | **140.9** | **71.0** |
| Materials and fuels | 117.4 | 127.8 | 134.2 | 115.1 | 109.4 | 143.8 | 68.5 |
| Machines, equipment and spare parts | 100.7 | 97.9 | 100.5 | 100.5 | 105.2 | 112.1 | 88.2 |
| **General import price index** | | | | | | | |
| **General index** | **103.4** | **109.6** | **107.8** | **103.8** | **105.1** | **118.2** | **88.4** |
| **Consumers' goods** | **101.1** | **100.8** | **102.2** | **101.3** | **106.9** | **110.2** | **95.3** |
| Cereals and foodstuff | 103.5 | 105.9 | 103.4 | 104.0 | 117.5 | 121.6 | 90.4 |
| Non-cereals and foodstuff | 100.6 | 100.3 | 102.1 | 100.8 | 1054 | 108.4 | 96.1 |
| **Means of production** | **103.8** | **112.6** | **109.5** | **104.6** | **104.7** | **120.5** | **86.5** |
| Materials and fuels | 104.8 | 114.8 | 111.6 | 105.3 | 106.0 | 127.1 | 82.3 |
| Machines, equipment and spare parts | 100.4 | 101.1 | 101.6 | 100.8 | 101.0 | 103.6 | 97.4 |

Source: http://www.gso.gov.vn/default.aspx?tabid=393&idmid=3&ItemID=10365

**Import price**

- Petroleum price decrease of 51 % led to a decline of USD 1746 million. Plastics price decline of 34.5 % resulted in a decrease of USD 382 million. Steel and iron price decreased by 22.7 %, causing a decline of USD 340 million; only steel core price fell by 39.9 %, causing a drop of USD 140 million.
- Fertilizer price fell by 26.9 %, causing a decline of USD 172 million. Textile price dropped by 34 %, leading to a decrease of USD 64 million. Wheat price went down by 35.4 %, resulting in a decline of USD 54 million.
- Paper price of various types decreased by 6.8 %, causing a fall of USD 14 million. Cotton price declined by 11.9 %, leading to a decrease of USD 10 million.

## *Fluctuations in Exchange Rate*

In this period, there were many fluctuations in USD/VND exchange rate (Fig. 2).

The exchange rate of USD/VND is a factor which has direct impacts on the import and export values, as the type of currency used in payment in Vietnam's importing and exporting is still foreign currency. The constantly fluctuating exchange rate significantly affects businesses' decisions on signing the contracts.

A decline in USD/VND exchange rate will promote exporting, but this will make importers hesitant to process the contract as they have to pay more in foreign

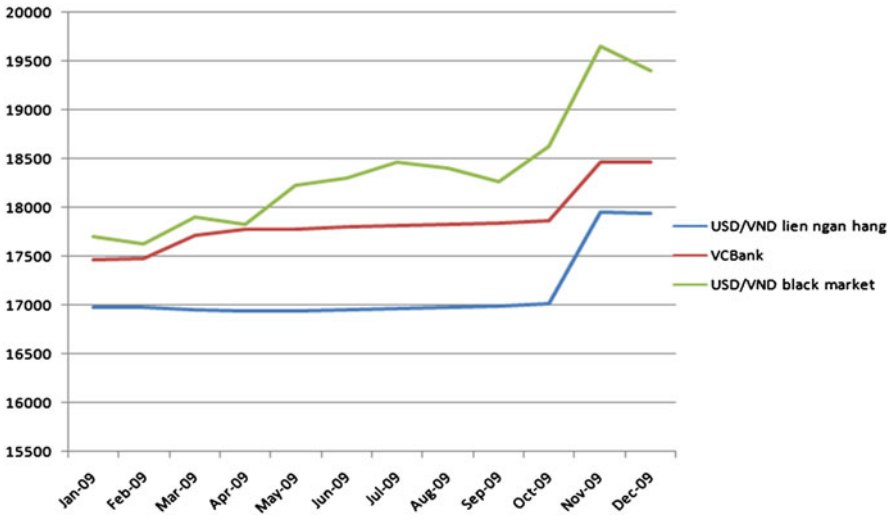


**Fig. 2** Statistics of USD/VND exchange rate in 2009 (Source: Vietcombank report 2010)

currency. Vice versa, when USD/VND exchange rate increases, exporters do not want to process the signed contracts. Therefore, constantly fluctuating exchange rate leads to changes in ambitions on the future contract values, which may result in embarrassing situation when small and medium-sized import/export businesses in Hanoi make decisions.

## *Other Factors*

Besides the above-mentioned factors, a number of changes in the world market also significantly affect the importing and exporting of Vietnam in general and of Hanoi in particular:

- Since February 2009 the US issued new regulations on product safety for garments and textiles imported into the US and completely eliminated quotas for China. This causes many difficulties for Vietnam's garments and textile products.
- Since March 27, 2009 India applied a special tax rate (anti-dumping tax) for fabric fiber imported from Vietnam.
- The number of anti-dumping cases and anti-subsidizing ones is on the rise when importing countries are more concerned with obtaining the markets for their domestic businesses during the economic crisis. For instance, the US sued anti-subsidization for PE plastic bags exported to the US; India investigated the steel anti-dumping of Vietnam and 13 other countries and territories.
- The economic crisis of Euro area and decline in the US economy after the global crisis also directly affect the international trade of Hanoi.

## Methodology

In order to verify the impacts of the global crisis on the businesses' global trade activities in Hanoi in 2010–2011, the research group has conducted a survey. Questionnaires were carried out directly at companies. Respondents were firms working in such global trade fields as Import/Export, International Tourism, Finance and Banking, Labor Export and International Communication, etc. in the city.

By studying documents about import/export business of those firms, the author set out five hypotheses about the impacts of the economic crisis on international commerce firms in Hanoi as follows:

*First hypothesis: Well-established firms are less affected by global international crisis than start-ups.*
*Second hypothesis: The more skilled the labor are, the larger impacts of global economic crisis on average wage are.*
*Third hypothesis: Because of the impacts of global economic crisis, non-state firms tend to downsize more than state-owned ones.*
*Fourth hypothesis: Goods import/export firms are more affected than service import/export ones during the crisis.*
*Fifth hypothesis: Macroeconomic stimulus measurements have positive effects on import/export firms in Hanoi.*

To identify the impacts of the global crisis to activities of international trade firms in Hanoi in 2010–2011, the author surveyed 217 firms in this city. The results are analyzed by SPSS software version 14 for statistics and hypothesis verification in the model. SPSS clears the data and proves standard distribution hypotheses and linear of variables in the research model. Single-variable and multi-variable regression function is also run on SPSS.

## Findings

*First hypothesis: Long-established firms are less affected by global international crisis than new-born ones.*

There are 232 out of 241 firms who answered this question, in which state-owned firms account for 8.7 %, private firms 70.1 % and FDI firms more than 17 %. Average year of establishment of surveyed ones is 2002. This is enough for the author to study the impacts of economic crisis on international commerce firms in Hanoi (Table 2).

Research results show that the longer the firms have been in operation, the less effects of crisis they are. It is proved by the sign of variables of the year of establishment. If it is negative, it means 1 year of establishment is added or 1 year of age of the enterprise decreased by, the proportion revenue of international trade in the total revenue reduced by 0.53 % at a 5 % significance level. Thus the first hypothesis has been proved.

**Table 2** Year of establishment

| | Observed numbers | Smallest | Largest | Average | Deviation |
|---|---|---|---|---|---|
| Year of establishment | 232 | 1956 | 2010 | 2002.25 | 8.619 |

Source: Calculated on research results by the author

*Second hypothesis: The more skilled the labor are, the larger impacts of global economic crisis on average wage are.*

During the research, labors are divided into three groups: direct labor; indirect labor and management labor. The research shows that in 2007, average monthly wages of direct labor were VND 2.84 million; and VND 3.23 million, VND 3.58 million and VND 4.03 million are of 2008, 2009 and the first half of 2010 respectively. The average monthly wages of indirect labor were similar to those of the direct one. However, average monthly wages of management labor were different from the other groups. VND 4.80 million, VND 5.51 million, VND 6.28 million and VND 6.97 million are the wages of 2007, 2008, 2009 and the first half of 2010 respectively. We can also see that the wages increased steadily year by year. However, it is interesting that the average wages of indirect labor were higher than those of direct labor, but during the crisis, things were reversed. It was due to reduced costs and apparently, the wage for indirect labor was the first to come. Moreover, although absolute wage had increased, does this really mean anything? Research revealed that in 2008, wage growth rates of the three groups were 13.73 % (indirect); 9.30 % (direct) and 14.79 % (management); this was tiny in comparison with inflation rate of 23 % that year. Better condition was seen in 2009, but with inflation rate of 6.9 %, wage increase was not significant. In the first half of 2010, only wages of indirect and direct groups had a little improvement but the wage of the management decreased; in other words, firms tended to reduce wage of labor working at the office. Therefore, the second hypothesis cannot be proved.

Nevertheless, research results also demonstrate another aspect. By calculation, average monthly wages of all three groups increased in comparison with those of 2007, when we fixed other factors as follows:

- Average monthly wage of direct labor in 2008 increased by 12 % in comparison with that of 2007 with significance level of 5 %.
- Average monthly wage of indirect labor in 2008 rose by 11 % compared to that of 2007 with significance level of 10 %.
- Average monthly wage of management labor in 2008 went up by 8.45 % in comparison with that of 2007 with significance level of 10 %.

While verifying the impacts of the crisis on average monthly wages of labor working in various types of firms, it can be seen that average monthly wages of labor in private sector declined by 38.4 % with significance level of 1 % and 51.3 % with significance level of 1 % of labor in FDI sector. This demonstrates that labor's interests in state-owned firms were better protected than in private and FDI ones. It affirmed the effectiveness in protecting labor's interests of state-owned firms but on the contrary, it restrained the competitiveness in labor market.

**Table 3** The average number of labors of firms in years

| Group | Year | N | Average | Deviation |
|---|---|---|---|---|
| Direct | 2007 | 157 | 139.32 | 502.06 |
| | 2008 | 170 | 146.76 | 542.34 |
| | 2009 | 194 | 206.94 | 1115.50 |
| | First half 2010 | 206 | 218.98 | 1108.68 |
| | Total | 727 | 181.68 | 895.40 |
| Indirect | 2007 | 149 | 34.96 | 71.79 |
| | 2008 | 164 | 40.77 | 89.73 |
| | 2009 | 185 | 48.91 | 140.29 |
| | First half 2010 | 194 | 50.71 | 138.48 |
| | Total | 692 | 44.48 | 116.79 |
| Management | 2007 | 173 | 14.63 | 48.22 |
| | 2008 | 190 | 15.19 | 50.00 |
| | 2009 | 214 | 16.16 | 49.31 |
| | First half 2010 | 224 | 16.89 | 48.66 |
| | Total | 801 | 15.80 | 48.98 |

Source: Calculated from research results by the author

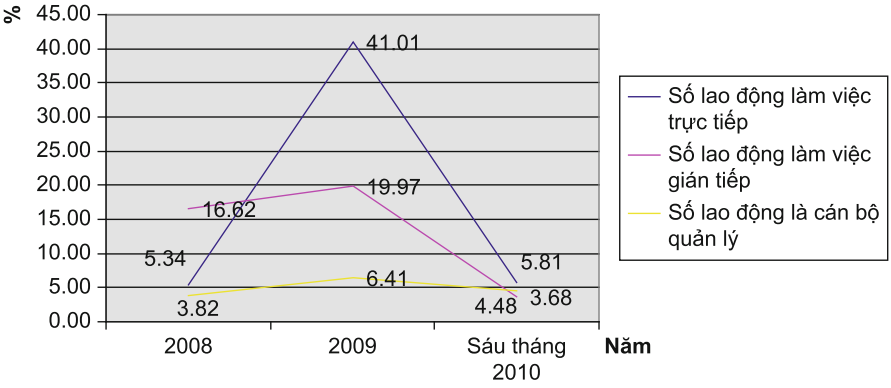


**Fig. 3** Growth of number of labors in each group in year (2008-first half 2010) (Source: Calculated from research results by the author)

*Third hypothesis: Because of the impact of global economic crisis, non-state-owned firms tend to downsize more than state ones.*

Next, we will discuss the impact of global economic crisis on labor adjustment of international trade firms in Hanoi.

Table 3 exhibits an increasing number of all three groups every year. But does this really make sense?

Figure 3 shows that during the economic crisis (from 2008 to early 2009), international trade enterprises tended to cut down jobs, but they recruited more employees when they started to recover in 2010. The data shows that labor growth rate through years does not make sense and the number of labor growth does not depend on the firms' export/import sector.

The calculation is only applicable when comparing the labor growth for different types of enterprises. Research has shown that the computed indices for all the three columns, two of which present data for the private and FDI firms, are negative numbers. This proves that the labor growth rates of these two types of firms are decreasing and even more sharply when comparing with that of state-owned firms. To be specific, if other factors are fixed, then:

- Direct labor of private firms reduced by 164.4 % compared with that of state-owned firms with significance level of 1 %.
- Direct labor of FDI firms reduced by 55.2 % compared with that of state-owned firms with significance level of 5 %.

So the conclusion is that non-state firms cut down the labor force more than state-owned firms during the global economic crisis. The third hypothesis is proved.

*Fourth hypothesis: Goods import/export firms are more affected than service import/export ones in crisis time.*

This is one of the most difficult criteria to investigate. While conducting the survey with some general questions like "What percentage international trade contributes to total revenue?" or "How much profit comes from international trade?" we give the promise to respondents that all the data will be shown as their public reports while the names of respondents and enterprises are kept confidential. However, only 149 out of targeted 241 enterprises (in which service import/export firms accounted for 17.8 % and goods import/export enterprises 82.2 %) have provided the information. This number is reliable enough for analysis. As the firms provided, the ratios of net profit to total revenue were 21.04 %, 22.20 % (2008); 23.68 % (2009); 23.01 % (first half 2010). Similarly, the proportion of international trade revenue in total average revenue were 49.64 % (2007); 49.71 % (2008); 49.60 % (2009) and 50.75 % (first half 2010); ratios of international trade in total average net profit were 45.99 % (2007); 45.28 % (2008); 45.13 % (2009) and 47.00 % (first half 2010). Nevertheless, analyzing by SPSS software is not sufficient enough to prove that goods import/export firms were affected by global crisis more than service import/export firms.

Regarding negative hit of crisis on labor average wage, research shows that average (monthly) labor wage in private firms and FDI firms decreased significantly in comparison with that of state-owned ones. Particularly, when other factors are fixed, then the proportion of revenue from international trade in total revenue of private firms went up by 15.32 % in comparison with that of state-owned firms, with significance level of 1 %; and that of FDI firms also surged up by 15.17 % with significance level of 5 %. Hence, even though average monthly wages and labors shrunk much in non-state firms, compared with those of state-owned firms, our research shows that in international trade activities, non-state firms succeeded more than state-owned firms.

**Table 4** Firms' assessment of the impacts of global economic crisis

| | N | Least | Largest | Average | Deviation |
|---|---|---|---|---|---|
| 1. How economic crisis affects the firm's business activities | 237 | 1 | 5 | 3.35 | 0.96 |
| 2. How the reduction of imports/exports affects the firm's business activities | 235 | 1 | 5 | 3.35 | 0.97 |
| 3. The increase of costs of production of the firm in the crisis | 234 | 1 | 5 | 3.25 | 0.98 |
| 4. The decrease of investment in the firm in the crisis | 233 | 1 | 5 | 2.95 | 1.06 |
| 5. The impacts of fluctuation in the USD/VND on the firm's business activities | 233 | 1 | 5 | 3.72 | 0.96 |
| 6. Benefits from stimulus policy from the Government | 231 | 1 | 5 | 2.52 | 0.93 |

Source: Calculated from research results by the author

*Fifth hypothesis: Macroeconomic stimulus measurements have positive effects on import/export firms in Hanoi.*

In 2009 and 2010, the government launched two stimulus packages to help firms overcome the crisis. Still, the effects of these packages were not clear yet. So, in the questionnaire for import/export firms in Hanoi, the author asked about their assessment of the impacts of global economic crisis on their business activities with scale 1-Very little; 2-Little; 3-Normal; 4-Large; 5-Very large. Results are shown in Table 4 above.

Therefore, from the surveyed firms' points of view, the economic crisis and reduction in import/export activities had great impacts on the firm's business activities (3.35 points) and costs of production raised as a result of the global crisis (3.25 points). According to the firms' assessment, fluctuation in the VND/USD exchange rate most affected their business activities with 3.72/5 points but the Government stimulus packages did not work (2.52 points). Only one good thing is that during the global crisis, investment did not go down (2.95 points).

Research results show that well-established firms were less affected by the global economic crisis than new-born firms. There is a trend in reducing wages in office labors including management and indirect ones; non-state firms cut off labors more than state-owned firms but that is not enough to prove that goods import/export firms were more affected by the economic crisis than service import/export firms. Most firms agree that the economic crisis had a great impact on their business activities by reducing import/export activities and increasing costs of production. Among Government policies, fluctuation of the USD/VND exchange rate had the most negative effects on the firms' business while most of them did not benefit from the stimulus packages. Until 2010, the only positive point is that investment did not decrease much. We hope these results can help both the Central and Hanoi management agencies have proper policies for firms to overcome the present post-crisis.

**Biography** Associate Professor Nguyen Hoang Anh is from Foreign Trade University (FTU), Hanoi, Vietnam. Her research and expertise is in business culture and cross-cultural management. She is currently the Director of FTU's Asian-Pacific Cooperation Center whose task is to foster understanding and promote cooperation between Vietnam and other countries in the Asia-Pacific region. She has contributed chapters in 4 textbooks and published several research papers. She is also a regular contributor for several prestigious Vietnamese magazines such as Trade Review Magazine, Saigon Economic Times, International economic magazine, Scientific Activities magazine, European Studies Review Magazine, Communist magazine, and so on.

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# Author Index



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# Subject Index




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