

Updating Adam Smith on Business Ethics: Institutional Economics and Ethical Capitalism

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Abstract The paper analyses Adam Smith's stance on 'business ethics', specifically asking whether morality can be realigned with Smith's economic writings, and if so, how and in what respect this can be applied, especially in relation to the *Wealth of Nations* (WN). The paper argues that there are at least three different perspectives, in terms of (1) societal welfare ('public good') as an outcome of economic, 'business' activity, (2) the systemic codification of morality in institutional frameworks (e.g. business laws), and (3) the generation of ethical capital in market transactions, that enable a concept of 'business ethics' to be set out and attributed to Smithsonian economics. Not all of these ethical dimensions were clearly seen – not even by Smith or by his critics. Starting from these base points, the paper 'updates' the Adam Smith scholarship on business ethics. The paper connects with and draws from institutional economics to develop arguments. It also questions the idea that business ethics could somehow be attributed to Smithsonian economics (i.e. the WN) by projecting Smith's virtue and sympathy-based moral philosophy (his *Theory of Moral Sentiments*, TMS) onto the WN, a project keenly indulged in by a considerable number of authors of business ethics and moral philosophy. The paper projects these arguments to a debate of corporate social responsibility and corporate social performance.

Keywords Moral dimensions of Smithsonian economics; economics as ethics; ethical capitalism; (institutional) economics & corporate social responsibility / corporate social performance

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To expect, indeed, that the freedom of trade should ever be entirely restored to Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the publick, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it. (Smith 1776/1976, p. 471)

Introduction

The paper disputes the thesis, favoured by a very considerable number of critics of Adam Smith, that Smith's economic writings (the WN) reflected an amoral and possibly even immoral stance. The frequent target of such accusations is Smith's model of self-interest as a key conceptual element of the WN.

I outline that at least in three respects 'business ethics' can be defined, or even better, can be conceptualised *in economic terms* with respect to the WN. First, Smith grounds the concept of economic exchange in the model of merely self-interested choice. Still, in Smith's model of individualism there arises – as a side effect of economic exchange – societal welfare. This happens as an unintended outcome, as a mere by-product of self-interested interactions. In this regard, even self-interested and solely profit-driven management counts as 'business ethics' since such management contributes – albeit unintentionally – to societal welfare.

Second, although market exchanges in themselves occur in the classical view of Smith within a moral-free zone, they are institutionally bound and framed by constitutional and derivative legal and quasi-legal structures. 'Business ethics' is in this respect 'transferred into' and codified in laws. In this way, a baseline level of moral standards above a zero-level and likewise 'business ethics' are institutionally enforced on market participants. Business ethics and market morality in this way are located in the institutional framework of the market economy. These institutional structures can be viewed as the conventional, standard location of morality in a market economy system, leaving market interactions as such in a moral-free zone.

Third, more recent developments, especially since the 1980s, but even more so since the 1990s and after 2000, have led to the rise of business ethics in market interactions themselves. Practical examples are 'green', environmentally friendly consumption, or ethical investment funds, and in this regard, the classical economic stance of Smith on business ethics can be critically revised. This viewpoint of Smith was still upheld by Friedman (1962, 1970) in the 1970s, when he put forward his well-known theorem that the 'only social responsibility [i.e. business ethics activity] of firms is to maximize profits within legal constraints' (Wagner-Tsukamoto 2007). Mele (2008, pp. 58-59) projects Friedman in this manner to shareholder value theories of corporate social responsibility. Revisions to Smith's and similarly to Friedman's positions (as well as its modern interpretation, such as shareholder value theory) can certainly be undertaken *in economic terms*; by proposing an instrumentally oriented, strategic economic framework for stakeholder management that is grounded in utilitarian moral philosophy. The goal of business ethics activities of firms is then to cater for and even develop further ethical demand from morally

aware stakeholders. Such stakeholders (green consumers, ethical investors, etc.) need to be prepared to pay a premium price for a product or service which is considered to be 'more' ethical than a comparable, standard product (which only meets the ethical minimum requirements laid down in laws).

In these three respects, 'business ethics' can be set out in relation to Smithsonian economics. As noted, businesspersons and firms contribute through these three business angles to doing good in society, to exercising, in a sense, 'corporate social responsibility', and to getting engaged in 'corporate social performance', as the present paper comments on in its final section.

The paper develops these lines of argument on the grounds of (institutional) *economic* analysis and critique. Therefore, the paper disassociates from attempts to define or reconstruct a 'business ethics' or 'corporate social responsibility' stance of Adam Smith in non-economic terms, by somehow projecting Smith's moral philosophy (the TMS) or other traditional, moral behavioural philosophy onto the WN. I argue that the WN reflects a conceptual and methodological rupture as compared with the TMS and other behavioural ethics. Accordingly, Smith's TMS and WN develop radically different stances on ethics, one being grounded in virtue-based and sympathy-based moral philosophy, the other in a 'new' moral philosophy, which we later came to call 'economics'. This thesis that economics reflects a new moral philosophy is already implied by my outline of the three economic dimensions of 'business ethics', which I introduced above regarding a critique of Smithsonian economics.

Subsequently, the paper assesses Smithsonian economics in these three respects in order to set out Smith's stance on 'business ethics', how businesspersons

and firms can contribute to the moral good in society: In the first part, I comment on societal welfare goals of the WN. In the second part, I outline that the WN envisioned institutionally, systemically constraining (in moral terms) market participants through laws. In the third part, I analyse how a classical economic stance of business ethics, as derived from the WN, can be revised through stakeholder theory, demonstrating that an economic, strategic approach to stakeholder management does not necessarily mean 'business without ethics', as suggested by Goodpaster (1991, p. 53). In the fourth part, the paper questions whether business ethics could somehow be projected onto the WN, by trying to reconcile the WN with the TMS. The final part offers conclusions.

Systemic Morality and Smithsonian Economics: Profit Generating Management as Business Ethics

Smith's WN comes with normative, ethical goals. Already its title reveals this: the *wealth of nations* is at stake in universal perspective, but not the wealth of a singular nation, and even less so the wealth of a few individuals within a nation. This is the overriding moral dictum of the WN, that even merely self-interested choice behaviour, both of firms (especially their managers and other employees) and of the stakeholders a firm interacts with (consumers, investors, etc.), contributes to 'public good'. Already Mandeville, prior Smith, clearly realized this in his *Fable of the Bees: Private Vice, Public Good*.

The 'greatest good of the greatest number' and not of a few individuals became Smith's aim, as he hinted in different passages, some quite explicitly so, for example Smith (1776/1976, p. 455). Smith's other references to this principle, namely his normative goal of the 'wealth of nations', or 'public happiness', or 'happiness of mankind', or 'society' capture this utilitarian perspective too.

Both Mandeville and Smith (in the WN) clearly believed in this respect that societal good arose as an *unintended* outcome or mere 'by-product' of potentially self-interested choice: 'A revolution of the greatest importance to the public happiness, was in this manner brought about by two different orders of people, who had not the least intention to serve the public.' (Smith 1776/1976, p. 418) Smith's famous 'invisible hand' quotations can also be referred to at this point (Smith 1776/1976, pp. 456, 687). In this interpretation, the 'invisible hand' refers to self-organizing market interactions that unintentionally yield public good (Blaug 2008, p. 564-565), but not to a deistic component of the WN (as proposed, in my view incorrectly, for instance, by Oslington 2011, pp. 5-8; Macfie 1967, pp. 6-8).

In this connection, Smith explicitly stated that human nature in any traditional, moral behavioural sense (i.e. by invoking virtue ethics, duty ethics, religious ethics, Confucian ethics, etc.) was not at stake and was not to be conceptually drawn upon to discuss a moral dimension of the market economy, and thus to conceptualize 'business ethics':

Whether this propensity [in human nature] be one of those original principles, of which no further account can be given; or whether, as seems more probable, it be the necessary consequence of the faculties of reason and

speech, it belongs not to our present subject to enquire. (Smith 1776/1976, p. 25)

Some modern interpreters of business ethics positioning of the market economy clearly sense this non-behavioural position of Smith, Friedman (1962, 1970) and Homann being the most explicit about this (1997, 1999). Profit-making of the firm as such is viewed as an ethical stance since this contributes unintentionally – Goodpaster and Matthews (1982, p. 136) call this ‘independently’ – to societal welfare (such as the innovation of more and better products and services; tax income for the state, which can be spent on the provision of public goods; employment; rising living standards; etc.). For instance, Goodpaster and Matthews (1982) speak of ‘systemic morality’ of the market economy, or Vogel (1991, p. 108, 114) of a ‘socially useful function’ of the market. It is apparent though that neither Vogel or Goodpaster and Matthews (1991, p. 53, 57-58, 60-61) comprehend fully the implications in this context that even strategic, self-interested stakeholder management of the firm can be reconceptualised as ‘business ethics’ – not only by aligning it with but also by differentiating it from ‘business ethics as systemic morality’. In part three of this paper I return to this point when discussing the market interaction level of morality.

Smith, in the WN, made the transition from a behavioural moral philosophy, as he still had favoured it in his earlier publication of the TMS, to a non-behavioural ‘systemic’ moral philosophy, otherwise known nowadays as ‘economics’. Clearly, for Smith the WN was the continuation of ethics (Homann 1997, 1999) but a radically different kind of ethics as compared with the TMS. This change in ethics resulted from a change in research questions and research problems as addressed by the TMS

and the WN, and by a change in research methods for addressing the different research questions and problems as raised by the WN and the TMS.

Smith outlined that the research problem within the TMS is a study in human nature, his aim being to shed light on the nature of moral motivation. In complete contrast to this, the research problem of the WN deals with the question of how to organize economic activity in society. This methodologically requires abstraction from a behavioural analysis of human nature, as Smith so strongly emphasised (See the exemplary quotation above). Therefore, it can be seen that Smith's model of self-interest, as it drives theory-building in the WN, cannot be viewed as an empirically valid or even normatively prescriptive model of human nature. Rather, it is a 'mere' research heuristic which methodologically undergirds theory-building of the WN (Buchanan 1975, 1987a, 1987b; Becker 1976, 1993; Homann 1997, 1999). Popper's and Lakatos's philosophies of science discussed this issue in terms of problem-dependent research heuristics in scientific research (Lakatos 1970, 1976; Popper 1985; Wagner-Tsukamoto 2003). I return to this issue in part four of the paper when discussing the relationship between the TMS and the WN.

Essentially it is this shift in method, which relegated a model of human nature to the heuristic sphere, that enabled Smith and similarly Mandeville to pioneer a 'new' ethics: The key feature of this new brand of ethics, which enquired how societal welfare could be raised by changing the systemic set-up of economic activity, was that it did not conceptually or practically rely upon 'good' moral human nature to create socially desirable outcomes for society. Smith (1776/1976, p. 456) clearly defined his thoughts on this with this explicit statement: 'I have never known much

good to be done by those who affected to trade for the publick good.’ Buchanan’s arguments expressed similar views (1987b, p. 62).

Many modern interpreters of Smith (e.g. Young 1992, pp. 80-81; Werhane 2000, p. 192; Khalil 2002, pp. 666-670), and of economics in general, still struggle to fully comprehend the fundamental nature of this issue, that economics is a systemic ethics, and that this necessitates the abstraction from human nature in any holistic, empirical, behavioural sense, or as Williamson put it in terms of ‘human nature as we know it’ (Williamson 1996: 6; 1985: 44–6, 387, 391, 402–3; similarly Simon 1956, pp. 130–1, 1976, pp. xxvi–xxvii, 1993, pp. 159–60, 1997, pp. 38–9, 42–5, 52; Macfie 1967, p. 4; Sen 1990, pp. 25, 30, 35, 37; Coase 1994, p. 111).

Smith’s own understanding of this fundamental issue took some time to fully mature, indeed initially he also struggled with this insight, particularly when he attacked Mandeville in the TMS (Smith 1759/1966, pp. 451–6). To some extent, this attack can be justified since in the context of the TMS Smith developed a behavioural study of virtue and sympathy-based moral motivation, which differs from his research problems in the WN. Smith’s ‘attack’ was also provoked by Mandeville: Mandeville put forward his arguments on self-interest in a comparatively empirical, behavioural, non-heuristic manner. Smith, unlike some of his interpreters (e.g. Macfie 1967, p. 5), later saw through this methodological self-made misunderstanding of Mandeville’s, that a model of self-interest was indeed not an empirical, behavioural concept of economics (see also Homann 1997, pp. 18-19). This methodological insight helped Smith to advance Mandeville’s initial contributions (see also Goldsmith 1988, pp. 604–5; Buchanan 1975, pp. 36, 170-171) and to pioneer an approach, which we now know as ‘economics.’

The Constitutional-Institutional Level of Market Morality: Business Ethics as Law-abiding Behaviour

Smith's WN is to a very considerable degree not merely a treatise that advocates free market order (and as such would only link to what was discussed above as 'systemic' business ethics). Rather, the WN grounds advocacy of free market order in institutional critique of the then prevailing economic system of Britain – the institutional structures of the mercantilist society. Critical questions in this respect are, first, whether Smith not only rejected mercantilist institutions but also advocated constitutional and institutional structures that were to replace the ones of the mercantilist society; *and* second, if so, whether he clearly described a business ethics dimension in respect of these new institutions, i.e. that law-abiding behaviour of firms in relation to new constitutional and institutional structures of the market economy reflected business ethics behaviour (inasmuch as laws codified and enforced standards of business ethics on firms).

Unquestionably, Smith was an outspoken critic of mercantilist government and the way such government established institutional regulation through severe export-import restrictions, heavy taxes and duties of all sorts, monopoly powers that were granted to few producers, etc. (Smith 1776/1976, Books IV and V; Skinner 1976; 1979, chap. 9). In this regard, Smith linked the sluggish and lacking economic progress of the mercantilist society to the specific institutional order this society had erected (See also North and Weingast 1989). This resulted in his argument to abolish

this order, and argue for 'free trade'. In Smith's (1776/1976, p. 530) assessment of the situation mercantilist institutions were 'unjust' and ill-advised. He viewed them as 'violations of natural liberty' because they restricted economic progress (Smith 1776/1976, p. 530).

Nevertheless, it has to be critically asked as to whether Smith called for the advocacy of laissez faire economics instead, or whether he proposed to build a new constitutional and institutional framework for a free trade economy which, to a considerable degree, would cushion, regulate and indeed constrain 'free' trade. Reisman's (1998) or Viner's (1927) reviews are exemplary and very comprehensive in this respect, revealing that Smith cannot be considered to be a laissez faire economist but indeed proposed state intervention and the institutional regulation of 'free' trade. This is completely contrary to Nitsch (1999, p. 1316).

In respect of analysing and arguing for new institutional order, Smith clearly sets out the role institutions should play in shaping economic progress in a free trade society. No institutional-legal vacuum is left in this regard in the WN, where he clearly states that a new legal-institutional order should replace the structures of the mercantilist society. Smith argued for state intervention explicitly in relation to national defence tasks, the administration of justice in society, and the undertaking of public works, i.e. the provision of public goods (Smith 1776/1976, pp. 687-688).

In particular with regard to justice tasks, Smith advocated various ethical principles which explicitly limited 'natural liberty' and free trade in a number of passages in a contextualized manner with regard to a specific industry sector; for instance, at one point, when criticizing the Catholic Church: 'The liberty, reason and happiness of mankind ... can flourish only where civil government is able to protect

them.’ (Smith 1776/1976, p. 803; see also Reisman 1998, p. 367) Similarly, the topic of market failures is raised by Smith (1776/1976, p. 324), specifically so for the banking sector: ‘Those exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments.’ (Similarly, Smith 1776/1976, p. 112; see also Wilson 1989, pp. 63, 68-69; Jones 2010, p. 95) Or with regard to a specific country, Smith (1776/1976, p. 111-112, emphasis added) elaborated:

China seems to have been long stationary, and probably had long ago acquired that full complement of riches which is consistent with the nature of its *laws and institutions*. But this complement may be much inferior to what, with *other laws and institutions*, the nature of its soil, climate, and situation might admit. (See also Buchanan 1976, p. 274)

This institutional critique of China, which argues for institutional change, compares to the one which Smith even more extensively developed for mercantilist Britain.

Of course one could argue that Smith’s contextual approach to making qualifications regarding free trade implies a general stance on limiting free trade because of the long list of context-specific constraints seen by him (See also Buchanan 1976, p. 271).

Furthermore, Smith put forward constraints for free trade in a *non-contextualized, concluding* manner in his critique of mercantilism, and these statements are even more revealing regarding his generalizing (institutional economic) theory building strategy. For example: ‘Every man, *as long as he does not violate the laws of justice*, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any

other man, or order of men.’ (Smith 1776/1976, p. 687, emphasis added; see also Werhane 2000, p. 195, 1991) A comparable, general qualification regarding laissez faire economics was made by Smith when discussing human capital deployment:

The property which every man has in his own labour, as it is the original foundation of all property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper *without injury to his neighbour*, is a plain violation of this most sacred property. (Smith 1776/1976, p. 138, emphasis added)

The quotation at the beginning of this paper, which implies that ‘pure’ free trade is detrimental to society (Smith 1776/1976, p. 471), is equally general in tone.

These statements, both contextualized ones and non-contextualized ones, have strong institutional, legal connotations and they constrain free trade. These few quotations and references should suffice to illustrate the considerable number of conditional qualifications Smith introduced in constitutional and institutional terms for restricting the free market. Buchanan (1976, p. 273) confirms:

Adam Smith was far too realistic to argue that markets would emerge and would function effectively in the absence of a legal framework. ... Smith ... avoid[ed] the mistake of assuming that property rights and contracts are secure in nature and that they could be preserved through the emergence of voluntary association.

Quite a number of other analysts of the WN attest to this too, even critical ones.

They agree that Smith’s WN put forward a surprisingly long list of arguments for institutional ordering and state activity/state intervention in a free market economy

(e.g. Macfie 1967; Musgrave 1976; Rothbard 1995; Reisman 1998; Werhane 2000; early on, Viner 1927). Therefore, it is clearly an incorrect statement to suggest that ‘unlike Adam Smith, Bentham did not expect maximum happiness to occur without government intervention.’ (Wärneryd 1999, p. 89) It becomes readily apparent at this stage that the WN is philosophically close to Bentham’s utilitarianism both regarding a principle such as the ‘greatest good of the greatest number’, which I discussed in the first part of the paper as ‘systemic morality’, and regarding the institutional constraining of free trade, which is discussed in this section of the paper. Viner’s (1927, pp. 228-229) discussion of passages from the WN surpassed even Bentham’s proposals on institutional regulation.

Having affirmed that Smith’s WN can indeed be read as an *institutional* economic treatise, a subsequent question then arises as to whether Smith clearly realized a ‘business ethics’ dimension of the new institutional order which he proposed for the organization and constraining of free trade. In contrast to previous institutional analysis of the WN, this latter question is in this connection central to the present paper: It does not focus on the question of whether Smith was an economic institutionalist as such but whether he was an institutional economic *ethicist* – who explicitly attributed to institutional structures of the market economy a business ethics dimension: Did he believe that law-abiding behaviour of firms reflected ethical behaviour – firms paying attention to ethical precepts that had been laid down in laws by society? For what purposes did he expect free trade to be constrained? Did he understand that ‘constraining’ raised ethical standards in the market economy?

Later economic analysts of Smith's position, for instance Friedman (1962, 1970), clearly comprehended this issue that Smith's economic stance on ethics could be projected and be made explicit in different ways (Wagner-Tsukamoto 2007): First, Friedman's economic analysis of a business ethics stance or 'corporate social responsibility' stance of firms, captured the level of systemic morality of the market economy – Friedman referred to this as 'the social responsibility of firms is to maximize profits.' Secondly, Friedman also explicitly discussed an institutional, ethical dimension of corporate social responsibility. He was outspoken about his belief that firms should 'only' maximize profits *within legal constraints* as they were imposed by governments, which is not attested to Friedman by Goodpaster (1982, p. 137).

Smith had already touched upon such a constructive ethical role of the institutional framework of the market economy in enforcing ethical standards on market agents. For example, he spoke of the systemic role of governments regarding people's earthly 'subsistence in this life' and their religious 'happiness in a life to come' (Smith 1776/1976, p. 539). Or with regard to religious sects, he recommended that government intervention should 'correct whatever was unsocial or disagreeably rigorous.' (Smith 1776/1976, p. 796) A similar statement can be found regarding 'consumer protection' when Smith argues for quality seals for products (Smith 1776/1976, pp. 138-139; see also Reisman 1998, p. 374) Smith's (1776/1976, p. 324, see above) statement on the legal prevention of market failures in the banking sector belong in this category too. Such contextual statements move in the right direction in proposing an ethics stance in law but they need to be generalized and projected to all kinds of economic activity.

Market failures and externalities loom *everywhere*, and it has to be made clear that laws exist to fulfil an ethical, institutional function in this regard. In the WN, this argument is present, although it is often presented in a sporadic and mostly, albeit not exclusively circumstantial, contextualized manner, with regard to a specific industry or group of society (See also Macfie 1967, p. 9; Viner 1927, pp. 218, 228-229, 232). In this respect, an over-arching, integrating institutional economic perspective is required, which explicitly spells out and promotes institutional regulation *in order* to enforce ethical standards on market participants and to protect ‘systemic morality.’ An explicit, coherent but not contextual, circumstantial and piecemeal theory of institutional regulation needs to be put forward. Such a coherent, design-oriented institutional economic theory, which brought the concept of ‘justice’ under a comprehensive economic framework, emerged only much later from the works of Buchanan (1975, 1976, 1987a, 1987b), and to a considerable extent from North (1973, 1990), North and Weingast (1989), and Williamson (1985, 2000) too.

The present paper is more critical of Smith in this respect than Reisman (1998): It is undeniable that a long list of examples for institutional change/regulation and state intervention were given by Smith. Nevertheless, an institutional *economic* framework has to be pieced together from the WN, as it is not explicitly and coherently developed therein. Furthermore, such an outline is needed to explicate the *ethical* nature and purpose of government intervention and state regulation, especially so with regard to an ethical dimension laws take on in a market economy. In this respect, Adam Smith’s stance on business ethics can be more clearly explained. Therefore, clarification and updates on Smith’s institutional, legal

stance on business ethics become feasible, already at the constitutional-institutional level of codified market morality.

The Market Interaction Level of Morality: Business Ethics as Exchange of Ethical Capital

The previously mentioned example of quality seals for cloth (Smith 1776/1976, pp. 138-139) is relevant for beginning a debate on how the market process itself can take on an ethical dimension, which in the classical view of Smith came as the moral-free zone (albeit constrained by institutional structures, such as laws). The example of quality seals for cloth implies that it is not solely a law which enforces a regulatory standard in market interactions but also consumer choice is required in this instance: Consumers can choose a qualitatively superior cloth product by selecting one which has a legally approved quality seal. Choice is involved since consumers can opt to buy a product without a quality seal; such latter products can be expected to trade at a lower price. Apparently, the institutional level of regulation and the occurrence of free choice 'inside' the market process interrelate. However, Smith's discussion of quality seals only refers to product quality issues in general but not to specific moral choices that consumers, investors, and other stakeholders could exert through their decision-making inside the market process when purchasing a product or service.

Through morally aware choice behaviour of stakeholders, the market process itself can take on an ethical dimension. Empirically, such 'green' choice behaviour began to affect many economies since the 1980s, but the more so from the 1990s

and after 2000. Such phenomena were still not encountered by Friedman (1962, 1970) in the 1960s and 1970s, and even less so by Smith, and not by many later interpreters either (e.g. Wilson 1989; Bassiry and Jones 1993; Werhane 2000; Jones 2010). Key examples of such modern ethical stakeholder behaviour relate to environmentally friendly, fair trade, organic and animal friendly products and services (Wagner-Tsukamoto 1997, 2007; also Smith 2008). These types of products and services exist in many niche markets and have even entered the mainstream in various categories.

From an institutional economic, ethical perspective, such morally aware stakeholder behaviour is so fascinating because it yields ethical standards inside the market process, and specifically on the side of corporations, which are *higher* than the ethical minimum standards enacted on all firms through business laws of the market economy.

Seen from the point of view of the firm, this phenomenon can be approached as the creation and exchange of *ethical capital*: A product or service is created which exceeds the ethical minimum standards laid down by laws, and the firm's costs for pioneering such a product or service are recouped from the market – from ethically aware stakeholders who are willing to pay a price premium for such products and services (Wagner-Tsukamoto 2005, 2007). The idea of 'ethical capital' is drawn upon in this respect. The concept of ethical capital reflects that a firm needs to charge a price premium for a product or service which exceeds legal standards, in order to cover higher production costs and also to protect a profit margin for the firm.

In general, corporate behaviour which caters for ethical demand of stakeholders can be expected to be more costly than 'conventional' corporate

behaviour (which 'only' played by the legal standards of the market economy).

Otherwise, the market process would automatically default to a more moral level of corporate behaviour, and in this case the need to debate and develop 'business ethics' and corporate social responsibilities would not exist.

Ethical capital can be actively created by a firm, i.e. a company developing a market segment of ethically aware consumption, investment, employment, etc. Historically, the Body Shop is a key international example in this respect. The creation of ethical capital can also be driven by the market, the firm then taking on a more reactive responsive role, for example, in relation to rising green consumer demand over time (e.g. Wagner 1997; Smith 2008).

The business ethics theory we are arriving at in relation to stakeholder management is a strictly conditional and hypothetical one: Only if a firm can profitably satisfy sufficient demand for ethical products and services (which exceed legal standards), can the firm be expected to offer ethical capital through the market process. This implies an instrumental, strategic framework for stakeholder management, which philosophically can probably only be morally grounded in utilitarianism. It is difficult to see that such a stakeholder approach could be linked, on the side of the firm, to Kantianism, virtue ethics, religious ethics etc. because of the pure, motivational and ends-oriented nature of these latter types of ethics. With regard to these types of ethics, and these types only, we have to uphold Goodpaster's (1991, pp. 53, 63-65) criticism that traditional (behavioural, motivational and conscience-oriented) ethics when being projected on the firm, yields paradoxical incompatibility, either 'business without ethics' or 'ethics without business'. Macfie (1967, pp. 5-6, 10) developed a similar conscience-based critique

of the WN, and Vogel (1991, p. 114, 117), speaks in a similar vein of 'paradoxical indifference' of Smithsonian agents. Parker (1998, p. S35) also referred to paradoxes within business ethics, critiquing them from a postmodern perspective.

However, this paradox which Goodpaster so vehemently raised does not occur universally throughout all kinds of ethics: Utilitarianism is the key exception. A coherent theory of business ethics, which is also compatible with economics in general, and with the conception of ethical capital in market processes in particular, can be arrived at by embedding a theory of corporate stakeholder management in utilitarianism. The key reason for this is that utilitarian ethics is means-oriented and therefore motivations for ethical behaviour do not matter for assessing, in a solely outcome-oriented manner, the ethical nature of an act.

This leads on to a fundamental qualification and updating of Smithsonian economics, as it was still largely promoted by economists in the 1970s. The market process itself takes on a moral dimension and market interactions no longer need to remain in the 'classical' moral-free zone, which was ethically only constrained by laws. These updates on business ethics become feasible on Smith's own economic grounds, as set out in the WN. The heuristic, conceptual mechanism of self-interested choice is not dispensed with especially not so on the side of the firm.

Updating Smith on Business Ethics by Reconciling TMS and WN?

Both among Adam Smith scholarship and among (business) ethics research widespread attempts have been made to read an ethical stance into the WN by

drawing on moral behavioural ethical theory, i.e. Smith's TMS (For references, see below). My argument is that such attempts are myopic and flawed in numerous respects. Three points of discussion follow to explain my opinion.

First, the attempt to project the TMS and its concepts of sympathy-based and virtue-based moral philosophy onto the WN frequently ignores the ethical dimensions which this paper explained for the WN in its own (economic) terms. I discussed three economic, ethical dimensions in this regard, connecting to (a) the ideal of public good as an outcome of self-interested market exchange; (b) the codification of moral-minimum standards in (business) laws; and (c) the creation and exchange of ethical capital through instrumental stakeholder management, which is conceptually grounded in utilitarianism.

Second, Smith himself did not refer even once in the WN to his earlier, moral behavioural publication of the TMS (Berry 2003, p. 185). This should alert moral behavioural and other analysts of Smith, who critique the WN through unrestrained and unquestioned references to the TMS (e.g. Macfie 1967; Wilson 1989, pp. 69-70; Young 1992, p. 72-73, 77-78; Reisman 1998, p. 358-370; Werhane 2000, pp. 192-194; Khalil 2002, p. 675-692; Jones 2010, pp. 94-95), to ask as to why this is the case? Obviously, Smith could not have forgotten the TMS by the time he wrote the WN, especially so since he published new editions of the TMS after the first publication of the WN in 1776. This leads me to a related, further argument which explains why the TMS and the WN cannot be conceptually reconciled.

Third, the answer I want to suggest to the puzzle of why Smith ignored the TMS in the WN is that Smith was clearly aware that the two books did not conceptually connect to each other, that they (a) addressed fundamentally different

research questions and research problems; (b) they applied different theory-building strategies and different methods in order to analyse different research questions and research problems; and (c) they developed, as a result, different types of ethical theories.

Smith (1759/1966) clearly defined the research questions and research problems of the TMS as a study in human moral motivation, targeting the sympathy-based and virtue-based analysis of human character – its subtitle already reveals this: What are the principles by which humans naturally judge conduct and character of neighbours and themselves? (Smith 1759/1966, p. iii) He further specified the research questions of the TMS as: How do features of personal, virtuous character and the human mind stir moral motivation and human character? (See also Skinner 1979, pp. 13, 16) The key research objective of the TMS is, as its title states, to set out a *theory of moral sentiments*, which Smith arrives at in the final part (VII) of the TMS. Smith (1759/1966, pp. 391–2) then explicitly specified the research questions, and thus the research problem of the TMS:

First, wherein does virtue consist – or what is the tone of temper, and tenor of conduct, which constitutes the excellent and praiseworthy character, the character which is the natural object of esteem, honour, and approbation? And secondly, by what power or faculty in the mind is it that this character, whatever it be, is recommended to us? ... [H]ow [does the mind] ... denominate the one right and the other wrong?

He questioned in this connection (Smith 1759/1966, pp. 391-392, 472-480; also pp. 451-460) the idea that 'self-love' (i.e. self-interest) is to be conceptually drawn upon to examine ethical problems (of human character and human moral motivation). In this regard, as noted by Khalil (2002), Smith is indeed a non-modern thinker – but Khalil incorrectly used this conclusion by projecting this argument from the TMS directly onto the WN. This was an inappropriate action by Khalil as it was only in the TMS that Smith set out a comparatively traditional, moral behavioural philosophy which was grounded in the empirical method of character study, in the Greek, virtue theory-based tradition.

In stark contrast, the WN reflects, so my key argument demonstrates, a deep conceptual and methodological rupture as compared with the TMS. Viner (1927, p. 201) early on touched on this issue too. The WN's research questions and research problems focus on the study and organisation of economic activity in society in macro perspective, particularly, to paraphrase Smith, as to how a society's revenue may be explained that provides the annual consumption ('wealth') for a people in different ages and nations? (Smith 1776/1976, p. 11).

Methodologically, the WN is grounded in the non-empiricist Newtonian method rather than the empiricist Greek method. Smith (1762-62/1963, p. 140) was quite explicit in this regard (Wagner-Tsukamoto forthcoming). This was overlooked by Young (1992, p. 77). Specifically, Smith applied in this connection the model of self-interest (model of economic man, homo economicus) to consistently analyse any human behaviour in terms of societal effects on mutual gains and the public good as interaction outcomes (the ideal of the 'wealth of nations' in most inclusive, universal, macro perspective). The normative goal of this approach is also ethical,

but it sets out a distinctively different and new ethics as compared with the TMS: Economics in Smith's conception in the WN, as earlier already strongly hinted at by Mandeville's *Fable of the Bees*, represents modern ethics. I outlined various dimensions of this ethics above, and further derivative ones could be added (See Wagner-Tsukamoto 2003, chap. 8).

For these reasons, the paper promoted the view that it is conceptually and methodologically naïve to critique and analyse the WN and the TMS by somehow trying to reconcile these two books. Clearly, the TMS and the WN can be compared with each other but the purpose of such analysis would be to understand their differences, in theoretical, methodological, and normative terms, rather than somehow aiming to equate their conceptions of morality and human behaviour and to uncritically merge one book into the other.

Conclusions: Business Ethics and Economic Ethics

The paper critiqued Smith's stance on business ethics in multiple economic perspectives. The first three sections of the paper explicitly concentrated on Smith's stance on business ethics, and how morality could be aligned in different ways with Smith's economic thinking.

Assessments regarding the unintended societal goal of the 'wealth of nations' and regarding business laws as systematic places of morality in a market economy reflect a view on business ethics which was largely known to Smith and his economic interpreters, for instance most famously so Friedman and Buchanan. In this regard,

the paper's claim to updates is largely based upon clarifications and explicit re-statements of Smith's position on economics and ethics. Still, already in these respects, stronger and 'real' claims to updates can be made, especially so regarding critics of Smith who either overlooked or misinterpreted business ethics qualities of Smith's conception of systemic morality, and of an ethical dimension of the institutional framework of the market economy. The business ethics research tradition which tries to establish a link between corporate social performance (including the fulfilment of corporate social responsibilities) and corporate financial performance ('profitability') is a key example. I return to this proposition further down.

In addition to these 'clarifications' of Smith's position on business ethics, in other respects, Smithsonian economics can be more radically updated *in economic terms* and therefore on its own ground: The paper outlined that modern empirical phenomena, such as green consumption or ethical investment, as they emerged in force from the 1980s onwards in many economies around the world, were not anticipated by Smith, and they were not yet seen by supporters of Smith (such as Friedman) as recently as the 1970s. In this regard, Smithsonian economics can be fundamentally updated and revised regarding business ethics, demonstrating that market interactions themselves, which in the classical view are treated as moral-free zones, can indeed take on a moral dimension. The prime example of this is Ethical stakeholder management, which caters for ethically aware consumers, investors, employees, etc.

The paper argued that through a utilitarian moral philosophy, a theory of instrumental stakeholder management could be cohesively developed and be

smoothly aligned as a 'business ethics' concept, in economic terms, with Smithsonian economics. I further illuminated this thesis, as developed throughout this paper, when I projected below the economic business ethics arguments of the paper to a theory of corporate social responsibilities and corporate social performance.

The paper questioned attempts to set out or 'update' a business ethics stance of Smith by projecting the TMS onto the WN, possibly even by aiming to develop a virtue theory-based approach to stakeholder management (or similarly, a Kantian one, as advocated by Goodpaster 1991, pp. 67-68, 70; or Evan and Freeman 1995) that explicitly or implicitly attempted to bring the TMS and the WN together somehow. The paper suggested that the TMS and the WN address radically different research questions by using fundamentally different research concepts and methods (Wagner-Tsukamoto forthcoming). A deep conceptual and methodological rupture – Viner (1927, p. 201), speaks of a 'breach' – can be observed between these two studies of Smith. Attempts to evaluate and 'update' Smith on (business) ethics need to take account of this.

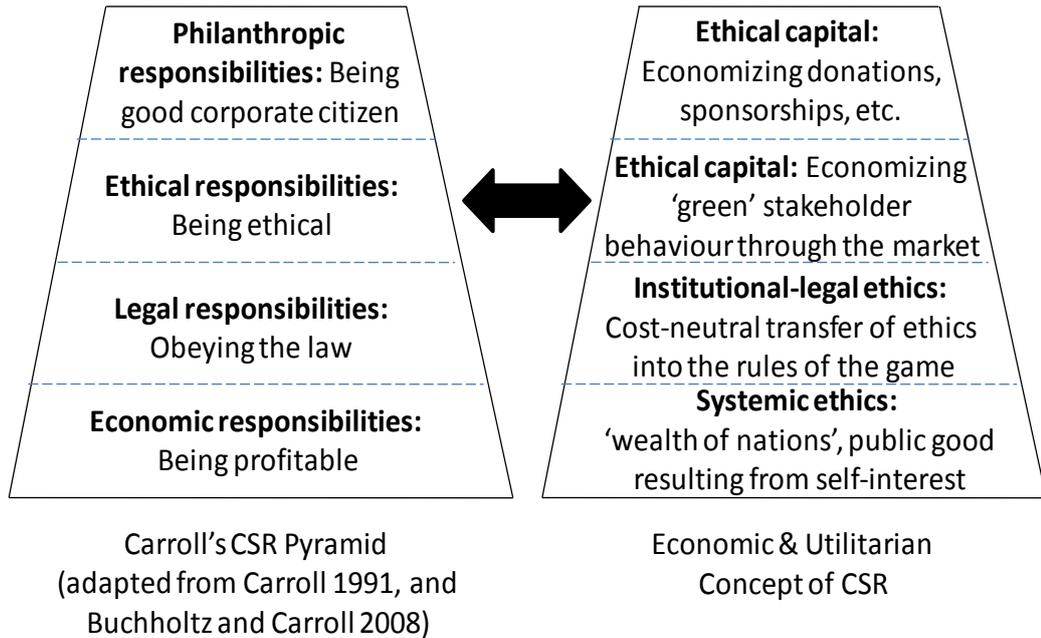
The explaining and 'defining' of three dimensions of business ethics for Smith's WN enables us to recast, in economic terms, a theory of corporate social responsibilities (CSR). To do so I decided to focus on possibly the most widely applied and accepted model of corporate social responsibilities: Carroll's pyramid concept of CSR (Carroll 1979, 1991; Buchholtz and Carroll 2008). This CSR model can be economically reconceptualised and ethically economized in a comprehensive manner (See Figure 1). An explanation of the three dimensions follows.

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Insert Figure 1 about here

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Figure 1: Two Models of Ethical Capitalism



First, the concept of systemic business ethics, as discussed in the first part of my paper, clarifies the idea of corporate 'economic responsibilities' in the Carroll model. In particular, the concept of systemic morality explicitly aligns both societal welfare goals and self-interested, profit-maximizing behaviour of the firm. It therefore specifies the ethical, societal quality of profit-generating management itself. This is not clearly set out by Carroll (1991, pp. 40-41) or Buchholtz and Carroll (2008, p. 40) when discussing economic responsibilities of the firm.

Second, the paper's concept of ethical standards being codified in laws, which enact morality through institutional-legal economic structures within firms,

explicates the ethical dimension of Carroll's 'legal responsibilities'. Legal responsibilities are taken on by the firm, because such responsibilities are enforced on all firms in a manner which is cost-neutral to competition, since all firms face the same costs caused by laws within national markets (but not necessarily in international perspectives). Profitability, in any discriminatory, comparative, and competition affecting manner is therefore not at stake (within a national market) unless institutional regulation tampered with key ideas and key mechanisms of the market economy, such as market interactions that self-organize 'even' in the face of self-interested choice; or as Buchanan (1987b, p. 62) put this:

If one wishes to examine the extent to which a particular institutional order transforms private interest into public interest, it becomes entirely appropriate to focus on a model of man in which private interest dominates. To model man as publicly motivated in making such a comparison would be to assume away the problem that institutional design involves – the problem that was central to Smith's purpose [in the WN].

Third, both of Carroll's top two levels of corporate social responsibilities – ethical responsibilities, and philanthropic responsibilities – can be economically reconstructed through the idea of strategic, utilitarian stakeholder management. Many writers on corporate social responsibility, including Carroll (1979, 1991), have not set out such an inclusive economic conceptualization. Carroll (1991, p. 43), or Buchholtz and Carroll (2008, p. 22, 43-44, 46), for instance, focus more on a sociological rather than economic tradition, on 'legitimacy' and 'power' concepts to interpret corporate social responsibility, especially ethical and philanthropic responsibilities with regard to stakeholder management. Mele (2008, p. 66) even

invokes, more idealistically, issues of human dignity and rights as such, and ultimately seems to link this to sociology too (Mele 2008, p. 76) rather than to economics.

Ethical responsibilities according to the Carroll model reflect the expectations of society in regard to good corporate behaviour. Such expectations have not (yet) been codified as laws according to the Carroll model. On the grounds of the economic reconstruction undertaken in the present paper, the ethical responsibilities of the Carroll model have been reconstructed through the idea of ethical capital. In this understanding, a firm profitably markets, at a price premium, a product or service which exceeds the moral minimum standards laid down by laws. Ethical responsibilities of the firm are in this way strictly linked to instrumental, strategic stakeholder management. This has a 'double' ethical effect, not only with regard to corporate moral standards being implemented that exceed laws but also with regard to profitability being maintained. Therefore a connection with Carroll's idea of economic responsibilities is also established.

With regard to Carroll's idea of philanthropic responsibilities, a similar argument applies. In economic terms, such responsibilities do not carry a legal quality. A firm can approach such responsibilities with profit in mind, again through instrumental, strategic stakeholder management. For example, corporate donations to the local community for building a hospital, or for sponsoring a museum exhibition, are brought under an economic umbrella: Through communicating the corporate donor's name to stakeholder groups, the media and the party which received the donation, some economic 'pay-back' can be conceptualized for the firm.

In this way, philanthropy becomes compatible with Smithsonian economics, again linking back to 'economic responsibilities.' Further to this, ethical and philanthropic responsibilities are no longer mere 'constraints' on profitability, as implied by Carroll (1991, p. 45) or Buchholtz and Carroll (2008, P. 46), but are looked upon as sources of profit-generating management and representations of systemic morality and ethical capital generation. In this vein of economic theory generation on business ethics, we can also address Porter's (2003, p. 42) concern regarding a need for '... tools and sound, persuasive argumentation for why corporate philanthropy matters to corporate competitiveness.'

These initial suggestions on how to realign and reconstruct, in economic terms, Carroll's concept of corporate social responsibilities both with classical economics and modern, economically oriented stakeholder ethics grounded in utilitarian moral philosophy, open up many avenues for future research, especially business ethics research on CSR that can theoretically and practically bridge a gap to economics.

This economic translation of Carroll's pyramid of social responsibilities also enables us to critically comment on literature which has tried, albeit with mixed success and contradictory findings (e.g. Waddock and Graves 1997; Johnson and Greening 2001; Orlitzky et al. 2003; Marom 2006; Laan et al. 2007; Kurucz et al. 2008, p. 85; Makni et al. 2009), to establish a relationship between corporate social performance (CSP) and corporate financial performance (CFP). Research on a supposed relation between CSP and CFP can be fundamentally reconstructed in economics terms, as the present paper proposed, and specifically so with respect to

ethical capital creation – through instrumental, utilitarian stakeholder management that reflected on Carroll’s top two levels of the pyramid of social responsibilities.

However, what the CSP-CFP research tradition overlooks is that, already with regard to profit generating management and law abiding behaviour as such (which predominantly mirror Carroll’s bottom two levels of the CSR pyramid), ‘business ethics’ can be diagnosed and therefore a conceptual link between corporate social performance and profitability needs to be examined. This has largely gone unnoticed in the literature, especially in respect as to how Carroll’s CSR/CSP model could be economized – through the model of economic moral agency, as set out in this paper (See Figure 1 for a summary).

Furthermore, I would like to advance the thesis that in the first place, theoretical clarifications are necessary before any empirical link between CSP and CFP can be investigated. Conceptual clarifications have to focus, so the key conclusions and key arguments developed in this paper have explained, on the question as to whether, and if so, how CSP reflects successful economizing.

It has to be asked, first, *which* conceptual levels are targeted and *how* are conceptual levels of the Carroll pyramid targeted by empirical/normative research regarding a link between CSP-CFP; and second, it has to be inquired – especially for research that focused on the top two levels of the Carroll pyramid – whether such research theoretically addressed the question of successful economizing of the CSP *into the* CFP. The most critical (conceptual) issue and question, which would drive empirical and normative research on CSP-CFP, would be: Have ethical responsibilities and philanthropic responsibilities of the firm been theoretically approached as ethical capital, or can they be approached in this way? Wagner-Tsukamoto (2005,

2007) set out original ideas, and Marom (2006), Dentchev (2004, 2009) and Kurucz et al. (2008, pp. 88-89), all touch on this issue in various respects when asking whether stakeholder management and CSP are (or are not), or can (and should be) turned into a competitive, economic advantage. Porter (2003) seemed to argue for such an economically inspired research agenda too.

Depending upon how this question of conceptualization was approached, which subsequently was to drive management intervention, empirical and normative research could be expected to either uncover or fail to find a relationship between CSP and CFP.

To recapitulate, in the proposed economic conceptualization, ethical and philanthropic responsibilities are viewed as 'goals' and 'objectives' of profit-generating management rather than as constraints on profitability. A great deal of confusion over claimed existing or non-existing links between CSP and CFP can be reduced and cleared up on the grounds of such conceptual, economic reconstructions of business ethics. By integrating the three-level model of economically grounded, moral agencies within the firm with utilitarian, instrumental stakeholder management and Carroll's CSP/CSR model a new 'economized' version of the CSR can be developed that will help clarify this situation.

As an example, Makni et al.'s (2009) findings of a lower profitability of socially responsible firms (for certain CSP activities) can be reconstructed in this economic reading as the unsuccessful economizing of CSP into CFP. Nevertheless, one cannot generally dismiss CSP as a corporate activity simply on the grounds of empirical findings such as these. Rather, one has to conceptually inquire as to how CSP can be approached with profitability in mind. This comes as an ethical, conceptual debate

that links to pragmatic managerial skills or the 'bottom line', which Parker (1998, pp. S28, S31, S35) seems to question as an unfeasible bridging act, at least so for 'post-modern' business ethics.

Clearly, such clarifications which link CSP/CSR research and stakeholder theory back to the very roots of Smithsonian economics are important, since they touch upon the ethical legitimization not only of business activity but also of management studies. A claimed 'business ethics' oxymoron can be qualified and rejected on such grounds. Such clarifications would be decisively more economic than envisaged by Kurucz et al. (2008, pp. 1003-106), who ultimately move to a 'holistic' and 'societal value' argument in order to set out a 'business case' for CSR. As noted, this paper's economic approach is grounded in ethics, i.e. utilitarian stakeholder (management) ethics, which critics of such a project all too easily seem to overlook (e.g. Vogel 1991, p. 117; similarly Goodpaster 1991).

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