

# Order Ethics: Bridging the Gap Between Contractarianism and Business Ethics

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**Abstract** Contract-based approaches have been a focus of attention in business ethics. As one of the grand traditions in political philosophy, contractarianism is founded on the notion that we will never resolve deep moral disagreement. Classical philosophers like Hobbes and Locke, or recent ones like Rawls and Gaus, seek to solve ethical conflicts on the level of social rules and procedures. Recent authors in business ethics have sought to utilize contract-based approaches for their field and to apply it to concrete business dilemmas. However, the application of contractarianism to management contexts can cause difficulties. Our article discusses this conceptual problem of contractarian business ethics and presents the idea of order ethics as an alternative. Order ethics, as we argue, can make a difference by conceptually bridging the gap between contractarianism and business ethics.

**Keywords** Business ethics · Constitutional economics · Contractarian business ethics (CBE) · Contractualism · Liberalism · Political philosophy

## Business ethics and contractarianism

The relation between business ethics and political philosophy has in recent years been continuously under scrutiny: For example, Heath et al. (2010) called for the professions of business ethics and political philosophy to work out a more unified theory of markets, firms, and business practices. They echoed Moriarty (2005) and Byrne (2002), who had previously noted that business ethics is often weak in political philosophy and that it would considerably benefit from a closer link to that field. Both follow Hodgson (2000, 2001), who argued that closer cooperation between political philosophy and business ethics would not only be fruitful but also even be necessary, because people—whether in the role of a business person or consumer—expect business ethics to answer the question of what they *ought* to do. For instance, which rules should be implemented in a certain business context, or which products should be bought and which should be boycotted? These questions cannot be answered without reference to the wider context of political philosophy (Heath et al. 2010: 441). We seek to provide this by outlining the conception of *order ethics* as a link between political philosophy and corporations' behavior in unregulated markets.

The idea of embedding business ethics in a social contract context seems to be a natural solution to the problem Heath et al. highlight. Indeed, over the past 20 years, several authors have explored this path (Donaldson and Dunfee 1995, 1999, 2000, 2002; Keeley 1988; Norman 2011; Rowan 1997, 2001; Wempe 2004, 2008a, b, 2009; Werhane 1985). Connecting social contract philosophy and business ethics seems *prima facie* a viable path for inquiry. However, a significant conceptual problem arises: All social contract philosophy starts from the predicament of moral disagreements.

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For example, the owner of company X thinks that by generating returns and paying taxes for returns and assets, he fulfills all moral requirements. Some stakeholder group, however, may feel that the owner of X also needs to pay for a local day care to enable mothers to return to work and thus advance the value of gender equality. Social contract philosophers from Hobbes to Kant and from Locke to Rawls thought that such cases of moral disagreement are not directly solvable among the persons concerned. They believe that people are bad judges in cases where their own interest or individual morality is at stake (Gaus 2011: 10–11). Because people disagree so much about actual cases, social contract philosophers focus on abstract social rules, or as Rawls (1971, 2001) has put it, on the basic structure of society. They are motivated by the hope that while we cannot reach agreement on actual cases, we can reach agreement on general principles.

Abstract rules are in general more easily agreed upon, if people do not know in advance how they will be affected by those rules—as long as the procedures are fair and impartial and do not systematically discriminate.

However, there remains a tension between a political philosophy that tries to solve problems by means of abstraction, as social contract philosophy does, and the field of business ethics, which is concerned with concrete cases of what one ought to do. We shall discuss this tension in greater detail in the first section. In the second section, we provide an overview of this gap in the recent business ethics literature. We conclude that although contract-oriented business ethics is aware of that gap, it still has not found a satisfying solution to overcome it. In the third section, we introduce order ethics, which we consider a contractarian approach constructed to help close this gap.

## The Tension Between Contractarianism and Business Ethics

Modern societies benefit enormously from pluralism. People can love whom they want, dress how they see fit, or pray to flying spaghetti monsters. Pluralism has taken root, and new moral problems have opened up: How should we deal with moral disagreement? To what principles need the state adhere?

In the face of moral disagreement, there are basically two strategies to resolve conflict. The classical solution is to find the one justified morality. This one morality can in turn be used to adjudicate every moral disagreement. Act utilitarianism, for instance, advances a seemingly universally applicable morality. Faced with the moral dispute about the local day care, act utilitarianism will pick out the claim that maximizes utility over all. The problem, of course, is that if two persons with their own moral beliefs

quarrel about something, it is utterly unclear why anyone on either side should suddenly accept a third moral concept like act utilitarianism as superior to their own moral convictions (let alone the problem that utility cannot be measured and thus remains a matter of dispute between the two parties). Social contract philosophy, in contrast, takes deep pluralism seriously and accepts that individuals tend to be orthodox in their own moral convictions, as Locke pointed out in his “Letter Concerning Toleration.” Faced with deep pluralism, social contract philosophers basically give up the project of finding *one* justified social morality. Rather, they focus on a subject of morality that is both less contested and in a sense more important. They turn their attention to abstract ethical rules and the basic institutional framework or, as Rawls phrases it, the basic structure of society.

Social contract philosophers are thus motivated by the hope that even if we cannot reach agreement on actual cases, we could reach agreement on general principles. This idea has an initial plausibility. Although we disagree about what the obligations of X are in situation Y under conditions  $x_1$ – $x_n$ , we usually agree on very general principles. For instance, we generally agree that murder is bad, that you should help people if they are in great danger and you would lose almost nothing by saving them, or that theft is bad. These kinds of general moral principles are shared by most people in almost all cultures. The core question at the heart of contractarianism is which set of rules is in the interest of everybody? Instead of building on particular religious doctrines or moral theories for justifying rules, contractarianism thus regards mutual self-interest as central. The basic structure of the society is justified only if it is in the long-term interest of everybody. In this way, contractarians hope to reconcile the authority of social morality with our status as “free and equal persons in a world characterized by deep and pervasive yet reasonable disagreement [...]” (Gaus 2011: xv).

The criterion of consent—even when it is qualified because of a “veil of ignorance” or similar devices—tends to generate a rather small set of rules in general. To give a simple example, suppose we have agreed on some kind of night watchman state, because a state that protects our most basic negative rights is better than no state. We now think about adding further rules to our society. Let us say X brings up a rule that would outlaw organ trade. Let us further imagine that we would argue about it, but in the end X could not convince others. This impasse would, of course, mean that the others retain their rights to sell your organs. If we cannot agree on a new rule, then the default option is to fall back on what we already agreed on, which in our case would be a night watchman state. Because in modern societies pluralism is pervasive, social contract philosophers often tend toward less-regulated rule

frameworks, but not necessarily. Sometimes, in order to make markets work in mutually beneficial ways, rather more than less rules might be necessary.

Another important point is that in a sense, contractarianism wants to relieve citizens from moral judgments—at least to some extent. If an individual adheres to the rules of the basic structure, she has already fulfilled her contractual obligations. Everything beyond that is optional and within the scope of personal morality or personal commitments. Social contract philosophy thus offers no answer to the classical Aristotelian question of what entails a good and successful life. It also remains silent in the face of moral dilemmas, which managers may confront on a daily basis. As Wempe (2008a, b) points out, contract models are usually “self-disciplined” and “task-directed,” which means they are thought experiments that try to fulfill a clear-cut function. They generally try to answer the question about which rules we all can agree on.

What does that entail for business ethics? Business ethics can be viewed as discussing two distinct sets of problems. First, there are problems that entail adjusting or proposing new rules. Second, there are problems that concern social morality. These latter instances entail, for example, questions of how stakeholders and shareholders should interact in the absence of legal obligations. Hence, the second question is *prima facie* out of the scope of contractarianism. In addition, the consent criterion is rather restrictive when it comes to new rules. This leaves us with the question of how contractarianism can be employed by and for business ethics when it remains silent half of the time (*the problem of limited scope*) and is rather restrictive when it comes to new rules.

### Contractarian Business Ethics and the Problem of Restrictiveness

The problem of how to overcome the apparent restrictiveness of contractarianism without stretching the concept too much is a serious one. The most influential contract-based business ethics is the integrative social contracts theory (ISCT) by Donaldson and Dunfee (1999, 2000). The three central building blocks of their theory are the macrosocial contract, the microsocal contract, and the diverse hypernorms. The macrosocial contract can be understood as one that regulates the basic structure of society. It is amended by a host of microsocal contracts, which can be understood as local norms or local social rules, rules that are more or less strictly followed by a group within or a subset of the whole society. These microsocal rules can be nested and, taken together, should be embedded in a macrosocial contract. Donaldson and Dunfee explain that “In this sense, all particular or ‘micro’

social contracts, whether they exist at the national, industrial, or corporate level, must conform to a hypothetical ‘macro’ social contract that lays down moral boundaries for any social contracting” (Donaldson and Dunfee 2002: 1854). At the same time, this conception allows for “moral discretion” for communities to live according to their own standards. In addition, it leaves enough room for experimentation and moral adaptation processes. These nested microsocal rules are particularly important for our question because they allow Donaldson and Dunfee to apply the criterion of consent to real-world cases, which extends the range of contract-based philosophy. While the consent criterion of classical social contract philosophy could be applied only to the basic structure, it can now also be applied to social networks that share norms. This extension allows Donaldson and Dunfee to partially solve the *problem of limited scope*.

Another important cornerstone of ISCT is the three types of hypernorms. As Wempe (2008a, b) analyzes, Donaldson and Dunfee distinguish among procedural, structural, and substantive hypernorms. The first two are derived from the initial contract, but the substantive hypernorms have a status akin to natural rights, the first moral principles that can be recognized by introspection. These norms do a lot of work in the conception of *ties that bind* (civic commitments); however, in that they directly resolve conflicts between sets of microsocal norms.

What we now face is the problem that the substantive hypernorms are in itself not justified by consent, but introduced ad hoc. This situation leaves us (and other critics like Boatright 2000) unsatisfied. How can a moral dispute between two people (or two communities), with their own moral commitments, be solved with reference to a third moral standard? How could such a third standard motivate people to leave their own convictions behind? Although ISCT provided progress and contributed immensely to a sound conception of business ethics and contractarianism, it still falls short of bridging the gap between them. In the following section, we introduce order ethics, a contractarian business ethics approach that is similar to ISCT in that it emphasizes that the project of justice must have macrosocial and microsocal components. Where it differs is in the general outlook on how to adjudicate moral disputes.

Finally, another contract-based approach has been introduced by Sacconi (2000, 2006, 2007; see also the discussion by Francé-Gómez 2003 and Vanberg 2007). Sacconi develops a social contract theory of the firm inspired by Buchanan’s constitutional and post-constitutional contract ideas. This theory is in several ways similar to the order ethics approach in that it relies heavily on economics and economic methodology, though some of its conclusions differ. In particular, Sacconi envisages a

constitutional contract that encompasses stakeholders in a much more broader sense of the term than order ethics. However, this point would require a much longer discussion (Vanberg 2007).

## Order Ethics: A Short Introduction

### Order Ethics and Contractarianism

Order ethics is based on the social contract tradition that includes authors like Hobbes (1651/1991), Locke, Spinoza, and Kant. Here, many authors (such as Wempe 2004; van Oosterhout et al. 2004, Heugens et al. 2004 or Heugens et al. 2006) distinguish between contractarianism and contractualism: Contractualism presupposes an internal morality of contracting: It assumes that contracting parties must have certain moral capabilities in order for the contracts to work. Moreover, contractualism usually regards actors not as predominantly self-interested, but rather as being embedded in a more general frame of commitments. In this sense, contractualism is at least in some regards closer to discourse theory and discourse ethics.

Order ethics as a systematic approach was mostly developed in the German-speaking community of business ethics by Homann and Blome-Drees (1992). Initially, it was mostly termed institutional ethics (“Institutionenethik”), while the term “Ordnungsethik” was first used in the mid-1990s by Homann and Kirchner (1995). During the following years, the designation of the approach varied. The English term “order ethics” was occasionally employed (Luetge 2008), but not thoroughly. Recently, the term is being made more popular in the English-speaking community by systematic presentations in Luetge (2012b, 2015, 2016) and Luetge and Mukerji (2016). The term “ordonomics” (Pies et al. 2009) is closely related, but places more emphasis on the economic rather than the philosophical aspects of order ethics.

Order ethics draws on the contractarianism of Buchanan (1985, 2000, 2009, 2010, 2011). Buchanan’s approach differs from others like Locke’s in that rights themselves must be granted to each other via a constitutional contract. In contrast, Nozick (1974) and his predecessor Locke take rights as something given. Locke takes them as something fixed by God and Nozick as something so essential that he does not even bother to ground them. Buchanan’s approach differs not only from Locke’s and Nozick’s, but also from many economists’, which may portray the effect of rules and the law in a simplistic way. Buchanan explains: “Contrary to orthodox economic methodology, the rights of persons to property, the rights to do things privately and individually with physical resources, cannot be treated in isolation

from those rights which are indirectly represented by membership in a collectivity that is constitutionally empowered to make decisions under predetermined rules” (Buchanan 2000: 94). It is a priori not clear on which set of rights, both positive and negative, a certain community would agree on for its constitution. It should be also pointed out that such a “specific constitutional mix” is not necessarily efficient in an economic sense (Buchanan 2000: 94).

Buchanan’s approach thus differs from Chicago School economics and thinkers in the tradition of Locke and Nozick, but also from Rawls’s contractualism. In general, Buchanan’s objective is to “explain how ‘law,’ ‘the rights of property,’ ‘rules for behavior,’ might emerge from the non-idealistic, self-interested behavior of men, without any presumption of equality in some original position—equality either actually or expectationally” (Buchanan 2000: 71). Rawls’s project draws importantly on the veil of ignorance in both “A Theory of Justice” and “Justice as Fairness,” whereas Buchanan describes his efforts in “The Limits of Liberty: Between Anarchy and Leviathan” (Buchanan 2000) as simultaneously more and less ambitious than those of Rawls. Buchanan’s approach is more ambitious in that he does discuss the critically important bridge between an idealized setting and reality, in which any discussion of basic structural rearrangement might, in fact, take place. He also tries to examine the prospects for genuine contractual renegotiation among persons who are not equals at the stage of deliberation and who are not artificially made to behave as if they were, either through general adherence to internal ethical norms or through the introduction of uncertainty about post-contract positions. This point is critically important for the application of order ethics because it gives order ethics distinct tools for problem solving.

In another respect, Buchanan’s efforts are less ambitious than Rawls’s. Rawls identifies the principles of justice that he predicts to emerge from his idealized contractual setting, but Buchanan takes no such step. He does not “try to identify either the ‘limits of liberty’ or the set of principles that might be used to define such limits” (Buchanan 2000: 221). The order ethics approach highlights the relevance of Buchanan’s normative economics to ethical questions. It does not separate between normative political philosophy or normative economics on the one hand and ethics on the other, but makes normative economics applicable to issues that business ethicists have previously considered as outside the realm of political philosophy.

Other authors that order ethics refers to are Wagner-Tsukamoto (2005, 2008), who develops an economic approach to business ethics, and Binmore (1994, 1998), who develops a contractarian theory of the evolution of social norms using methods of game theory. While we do

not depend on the evolutionary accounts Binmore gives, his way of introducing morality based on self-interest is clearly in line with the order ethics approach (Luetge 2015, 2016). Binmore's morality provides us with a way of choosing between multiple equilibria in social or economic life.

One remark should be added here, concerning the relation of philosophical disciplines: We understand this paper chiefly as a contribution to a contractarian business *ethics*, not to *political philosophy*. The line between political contractarianism and what might be termed "moral contractarianism" (Herzog 2013) is, however, blurry. Political and ethical considerations go hand in hand, as we have argued here several times. Rules that order ethics aims at can be found both at the level of laws and on informal levels of social norms (cf. Luetge 2012a, 2013).

### Order Ethics and Individualist Ethics

Order ethics is essentially designed to cope with the problem of social order. In this regard, it distinguishes itself from an "individualist" ethics which focuses exclusively on the *individual actors* in a particular situation, on their ethos, their moral actions and their individual wrongdoings. When presented with a social problem, a defunct financial system, or a case of corruption, an individualist ethics approaches will usually start to look for defunct moral motives and actions of actors. As a solution, such ethics usually points to moral betterment in some form or another by, for instance, demanding more business ethics courses in business schools. Under the same circumstance, order ethics, in contrast, will look for defunct rules and suggest seeking solutions at the level of rules. Because there are different levels on which rules work, order ethics proposes rule changes on different levels relative to the problem.

Order ethics—in the research tradition of Buchanan and Tullock (1962)—assumes that most social problems can be framed as genuine prisoners' dilemmas. If problems can be reasonably framed as such, it becomes more obvious why the precepts of an individualist ethics are so often fruitless in modern society. A central point of order ethics is that in zero-sum games, it is necessary to moralize, for instance by calling for temperance, moderate profits, or a condemnation of lending money at interest. In positive-sum games, however, there is systematically another possibility for morality: the search for win–win solutions.

This also implies that order ethics has its limits: It is not designed for zero-sum game situations, but for modern economies with positive-sum games. If there are no positive sums in sight, then sharing and sacrificing will need to be called for (whether this works is another matter).

### Order Ethics and Pluralism

This absence of a shared normative foundation in modern times has another important implication, insofar as we can no longer count on common values as criteria for judging rules. In the age of globalization, the pre-modern consensus on values is gone forever. In traditional societies, reference to shared moral beliefs could affect the desired change in actions, but this has systematically become more difficult through the lack of shared moral beliefs and convictions. Although this pluralism has many enjoyable effects, it has also a huge drawback from a functional point of view, because reference to moral standards or hypernorms will now usually fail to resolve prisoners' dilemmas (Buchanan 2000: 85–86; Ostrom 2005: 131–132). Sanctioned rules are necessary, in which Buchanan's (and our) view does not mean resorting to a higher, external authority, but to one created by "us" out of (long-term) self-interest, an authority which we can all agree to, or at least to a much greater extent than to individual rules.

The only criterion left which does not rely on prior normativity in the form of common values is the criterion of mutual advantages and benefits. This has been the core of social contract theory from Hobbes and Spinoza to Rawls and Gauthier. Interests and advantages are seen as prior to morality; ethical norms are established to fulfill the citizens' interests—indeed, the interests of each single citizen. This is the idea of Kantian autonomy under modern conditions: People constrain themselves—autonomously, but collectively—by rules, for the sake of greater collective benefit. The condition for this is the consent of all others (Luetge 2005).

### Cornerstones of Order Ethics

#### Rules

In modern societies, the rules governing individual actions have increasingly come under our control—certainly not fully, as for normal citizens the influence on legislation remains limited to elections. Nevertheless, such regularized elections along with public outrage and debate, the right of demonstrations, and a free press allow for much greater influence on legislation than in pre-modern societies. In addition, our understanding of rules themselves and the interconnection between rules and actions has become more and more evident through the intensive research in these fields in the last 40 years.

The order ethics approach to business ethics is based on three aspects which in turn rest on the distinction between actions and rules, as outlined by Brennan and Buchanan (1985):

1. Only changes in rules can change the situation for all participants involved at the same time.
2. Only rules can be enforced by sanctions—which alone can change the incentives in a lasting way.
3. Only by incorporating ethical ideas in (incentive-compatible) rules can competition be made productive, making individuals' moves morally autonomous in principle. With the aid of rules, of adequate conditions of actions, competition can realize advantages for all people involved.

To the order ethics approach, it is important that rules and actions do not conflict with one another. Ethical behavior on the level of actions can be expected only if there are no counteracting incentives on the level of rules. In the classic model of the prisoners' dilemma, the prisoners cannot be expected to cooperate because the conditions of the situation (the "rules of the game") are such that cooperation is punished by defection on the part of the other player. Morality thus gets crowded out—and moralizing conceptions will not work.

This is one of—at least—the two major differences between the ISCT approach and order ethics: ISCT tries to solve genuine moral conflict between two parties with reference to a third norm (hypernorms). Order ethics, in contrast, will look for a (formal or informal) rule change, which benefits both parties (Luetge 2013). Its basic assumptions are therefore weaker, requiring only the idea of win-win or mutual advantages (Luetge 2005). This extends the range of application of order ethics without introducing norms that are not compatible with the consent criterion. The second major difference, as we see it, is that ISCT is less interested in the general moral benefits produced by the entire system of the market economy. ISCT focuses on *deficiencies* of the market economy. Order ethics, by contrast, stresses that market economies with competition have moral benefits over less competitive systems—provided that the rules are set adequately.

### *Level of Rules*

It is much easier to come to a consensus on rules than on actions, i.e., on rules of distribution rather than on an actual distribution of goods. Nobody knows in advance what effects a certain rule will have in each individual case. It is principally easier to consent to rules that aim to achieve mutual benefits. The more abstract a rule is, the less it says about concrete results, and the more plausible it is that rational individuals will consent to it. Hence, Buchanan distinguishes between constitutional and post-constitutional rules (Buchanan 1990, 2000 also calls the latter "subconstitutional" rules): The former are rules which prescribe the mechanisms of how the latter are established, by defining

voting procedures or majority rules, among others (examples of such rules regarding tax laws, for instance, those involving wealth redistribution, can be found in Brennan and Buchanan 1980, and Holmes and Sunstein 2000).

As pointed out, order ethics traditionally distinguishes between the constitutional and the post-constitutional levels. But order ethics can be—and indeed, has been—expanded to social problems and issues that cannot readily be solved on the constitutional or post-constitutional level. These issues concern, for instance, global trade where international law is still insufficient and sometimes completely missing and where the concomitant rules within companies are often incomplete. In the following section, we provide a short overview of how order ethics has conceptually expanded its theoretical means to tackle the problem of insufficient legal orders and incomplete contracts (for another important and in many ways compatible approach, see Ostrom et al. 1994).

Where do new rules come from? With regard to the problem of restrictiveness, order ethics is more open than Buchanan's original contractarianism: New rules can originate from a number of different sources, broadly termed *heuristics*. New rules do not necessarily stem from new economic or political ideas, but may arise in contexts like philosophy, arts, literature, and others. Whether they can be actually implemented needs to be determined by careful contractarian and economic analysis, however.

## **Two Challenges to Order Ethics**

### **Incomplete Contracts Within Firms**

A problem for order ethics is the fact that the law is in many instances not refined enough. As Regan (1998: 305) puts it, "Law cannot anticipate every instance in which corporate actions may have broad social impacts. The cultivation of managerial judgment often may be the only assurance that corporations will take account of the externalities they impose."

From an order ethics perspective, the question is then how social control beyond rules of law can be conceptualized in a nonmoralizing framework. From the same viewpoint, ethically motivated actions going beyond the law—required by the individual or by the individual corporation—must be in the companies' individual interest,<sup>1</sup> at least in the long run. If their actions are not in their own interest, we cannot reasonably expect them to stick to these actions in a competitive environment.

<sup>1</sup> This is, for instance, the case if consumers reward a company for conforming to the consumers' ethical standards.

The theoretical basis for dealing with this problem (which was not sufficiently discussed by other approaches like Gauthier's (1986) or Binmore's) is provided by the theory of incomplete contracts. In reality, contracts cannot be completely fixed in terms of quality, date, or content, for any possible circumstances in the future, and despite any difficulties in enforcing these contracts. Incomplete contracts are those in which the obligations of each party resulting from the contract are not specified exactly or in which it is difficult and/or expensive to determine whether the contracts have been fulfilled (Hart 1987; Hart and Holmström 1987). Lawyers have to be employed, and contract enforcement is difficult and expensive. The modern world is riddled with and even characterized by incomplete contracts: employment contracts, long-run cooperation contracts, insurance contracts, and many others. In dealing with these contracts, there is a major problem of interdependence of the partners' actions. An honest partner who fulfills his part of the contract cannot automatically be sure that the other partner does the same. The other one might capitalize on gaps in the contract or interpret contested sections to his advantage, or it may be too expensive to enforce a claim.

A rational actor faced with these kinds of contracts would rather not sign them, especially if they are risk-averse. But if these contracts promise high benefits, the actor has an incentive to try to rationally deal with the incompleteness. To collect the benefits of incomplete contracts, trust, fairness, integrity, and good will are needed; in short, ethics are needed. If contracts are becoming increasingly incomplete, we need both an ethics for internal relations of the company (employees and management) and an ethics for external relations to customers, banks, suppliers, and the public. Under certain circumstances, it is rational for a company to invest in these ethical categories because it contributes to the company's success.

If rules are incomplete or if there are no rules for a specific situation, institutional economic theory suggests relying on substitutes. Corporate responsibility rankings and CSR blogs, which have become increasingly visible in the past few years, are examples. Corporations, as partners in interactions, have the opportunity to commit themselves to certain policies and to mechanisms of trust and fairness, for instance. The willingness to trust each other is strongly influenced by the institutional framework and the social conditions of the situation. These commitments to building up trust and social capital must be made credible through organizational measures and be signaled to others. Actors create a reputation by implementing rules—a reputation that is a necessary prerequisite for long-term success. Reputation is a mechanism for solving certain problems of implementation that consist in uncertainties and unforeseen situations that cannot be eliminated by contracts (cf. Kreps 1990).

It should be emphasized that both in situations with well-established and in situations with incomplete rules, incentives and sanctions are key issues. Corporate responsibility rankings and blogs are not necessarily based on activism, but can also be institutionalized by the state. From another perspective, CSR measures can also be regarded as making ethics another production factor. Ethics is, in this way, complementing the classic production factors of labor and capital.<sup>2</sup> It is not an external restriction placed on corporations from the outside, but is in their own immediate interest. From an order ethics point of view, an organizational ethics (Phillips and Margolis 1999: 620) should thus be built around the idea of ethics as a factor of production. However, this does not entail that ethics (in the form of reputation, etc.) can be reduced to just an instrumental tool for companies. That would be a misunderstanding of order ethics. Measures taken by companies must have more than narrow instrumental value in order to be called ethical. They must be in the interest of others, of other groups or stakeholders, i.e., they must create win-win situations.

The economic logic behind this kind of ethics for organizations can also be built on the concept of risk, in the following way: In the globalized world, multinational corporations face a number of risks: traditional business risks like financial risks (loans), risks concerning primary products, risks due to intensified competition, or in some industries weather risks. Next are political risks, such as the introduction of new tariffs, a breakdown of trade relations or a fundamental change in a country's political structure. Moral risks, which can be increasingly found alongside the classic economic ones, have an economic dimension, too: corruption in business relations, discrimination, child labor, or questions of job safety, to name just a few. These factors have always been ethically problematic, but in the era of globalization, they develop into serious economic issues for two reasons. First, there are important changes in regulatory laws, such as the US Sarbanes–Oxley or the Dodd–Frank Acts. The ongoing financial crisis will probably lead to further regulation. Second, corporations are increasingly being watched over by nongovernmental organizations (NGOs). NGOs can be seen as a new element of control—even a balance-of-power component in business—which adds to legal control. The important point to learn from this is that because of these risk structures, it will become much more important for corporations to invest in their ethical capital. From an order ethics standpoint, therefore, refinement of the legal framework takes priority, but does not suffice alone. The legal framework can never be refined enough to cover all possible situations and outcomes as it

<sup>2</sup> Interestingly, Buchanan already applied simple capital and investment theory to morals (Buchanan 2000: 159).

leaves corporations with not just one, but a number of possibilities to pursue their own interest. Institutions should be built that encourage ethical behavior, and to invest in such institutions is in the interest of companies, whether they already know it or not, as outlined below.

### Globalization and Incomplete Laws

Order ethics places emphasis on rules. But on an international level, a legal framework that would be able to govern the interactions within the global society in an ethical and efficient way is simply not in place (Homann 2007: 3). At the same time, it is obvious that competition between international companies is fierce. Because we have no established legal framework and companies from different cultural backgrounds are competing, order ethics would predict that the moral standards with which companies might stick at first erode very quickly under competitive pressure (as long as consumers do not reward the companies for their ethical behavior).

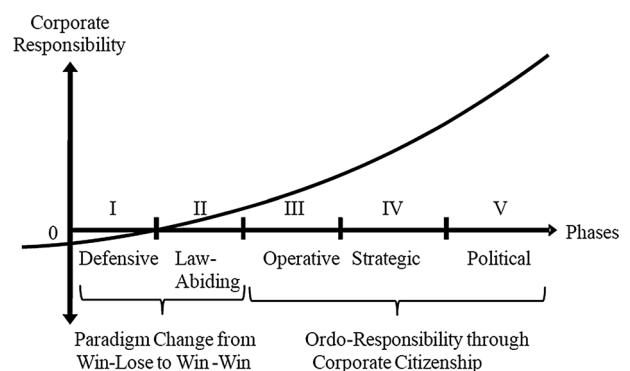
In one sense, the global marketplace is in a state of anarchy because of the lacking legal framework. But as Buchanan has shown, anarchic situations can—under real situations and without a veil of ignorance reasoning—be transformed into social order. That brings us to the question of why companies might be interested in establishing a social order for a global society. First, order ethics, as an ethics approach informed by economics, recognizes that the industrialized countries do not profit from poor or failing states. Some individual firms might, but neither do societies nor their corporations in general. The opposite is evidently true, as corporations will greatly profit when poor countries start to prosper. Developing countries can be rightfully viewed as assets, as factors that can bring about more wealth and prosperity if the conditions are set adequately (Homann 2007: 7). Using adequate mechanisms is essential from an order ethics point of view because, *prima facie*, building up well-ordered institutions can pose a prisoners' dilemma for multinational companies. If some companies suggest a better legal framework in country X, other companies could free ride on these institutions, which in the worst case will disincentivize companies to invest in legal or extralegal institutions as assets. The business strategy for a multinational corporation should be to form associations with other companies so that they can mutually implement legal or branch-specific structures and, at the same time, minimize free riding potentials. Companies' behavior thus consists in a social contract between corporations and the country in which they operate, to build rules—mutually between companies and to their long-run benefit. It may qualify as “a second unified theory of ethics, markets, firms and business practices” (Heath et al. 2010).

The particular measures that evolve as a consequence of companies' actions range, for example, from CSR standards, self-imposed international codes of ethics to agreements with NGOs, governments, and international institutions. Examples for all these can be found in a case study which we now discuss.

The challenge of order ethics is to identify how self-interested companies under market pressure influence rule-making that incentivizes ethical behavior on an individual level. Pies et al. (2010), whose work is based again on the order ethics approach, have identified such cases in their study *Sustainability in the Petroleum Industry: Theory and Practice of Voluntary Self-Commitments*, in which firms undergo five stages of order-ethical learning. In the past, most companies had viewed engagement in ethical conduct only as costs. According to Pies et al., it is an important task of business ethics to incentivize companies for leaving their often conservative and somewhat defensive attitude toward ethics and to support them in changing their perspective. If companies manage to view ethical problems as potential win-win solutions, there can be a steep learning curve (Fig. 1).

Pies et al. (2010) report that in the case of the petroleum industry, after the oil companies left behind phases I and II, they quickly moved through learning phases III, IV, and V. “[T]hey put individual commitments into practice in their management system for their operating activities, e.g., by voluntary commitments to meet environmental or social standards. They also provide commitment services for their interaction partners, e.g., by contributions to Capacity Development of civil society organizations or by the transparency initiative EITI, which helps to improve state governance in developing countries” (Pies et al. 2010: vi).

This example shows how it is possible for companies in cooperation with other important international players to steadily work toward an international rule framework—and thus to create social order from anarchy through a better understanding of rules. Certainly, rules suggested by



**Fig. 1** Ordo-responsibility and corporate responsibility (Pies et al. 2010)



companies may in fact weaken global institutions rather than strengthening them, as they may discourage countries to conduct necessary structural and institutional reforms. However, in situations in which the legal framework cannot be strengthened, order ethics has not reached its end, but argues that the mechanisms of incomplete contracts or incomplete laws provide secondary solutions that are better than none at all. This does not necessarily mean that companies explicitly agree on international rules. It can also mean that they enter into extended discussions with NGOs or set up systems of corporate social responsibility and similar that prevent ethical problems from arising or at least from worsening.

## Conclusion

In their comments on contractualism and economics, Hausman and McPherson (2006) state that they hope that the influence of social contract theory on normative economics will grow (p. 213). We, in turn, hope that the interest in contractarian business ethics will further increase. Here, we have argued that the apparent gap between contractarianism and business ethics can be bridged by increasing the reach of the consent criterion through incentive-compatible rule changes on the level of both macrosocial and microsocial contracts. We further argued that in modern societies, incentive-compatible rules and institutions can fulfill those tasks that were, in pre-modern times, fulfilled by moral norms, which in turn were sanctioned by face-to-face control. The problem of restrictiveness toward new rules can, at least in principle, be overcome by allowing for heuristics from different sources, like philosophy, arts, literature, and others. The implementation of such norms in modern times can, however, only work by setting adequate incentives to prevent the erosion of moral norms, which we can expect if “moral” actors were systematically threatened with exploitation by other, less “moral” ones (this has been confirmed in experimental studies such as Gürer et al. 2006 or Andreoni 1988). In our view, business ethics (and ethics in general) should focus not only on how moral norms come into being in the first place, but on how they can be kept *stable*—which will be a much harder task, especially in competitive market scenarios. Companies and actors who systematically ignore their own interest will be singled out. In general, order ethics thus agrees with Heath et al. (2010) and Moriarty (2005) that questions of business ethics need to be discussed within a wider framework of political philosophy and economics, if we take the challenge of pluralism seriously.

Our paper does not only discuss order ethics or summarize its main tenets. This paper takes the debate around

this approach forward in—at least—three ways: First, it deepens and broadens its philosophical aspects; second, it puts it into perspective within the discussion of contractarian and contractualist approaches.

Third, our paper further exemplifies how order ethics can be successfully applied to social problems that cannot be readily solved by governments or international institutions alone. Given (at least some of) the problems associated with the recent crises of the global financial system, fueled by the rule-abnegating motivations of the Chicago School or shareholder-value approach, order ethics offers an enormous opportunity for those who are looking for an alternative: to avoid an exclusively abstract character of a contractarian business ethics and provide concrete advice for business ethics.

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