

Chapter 3

The Image of Humans



What Follows Why?

The following chapter analyzes human behavior in the economy. What motivates people, what goals do they pursue and what makes them happy? We need the insights gained to explain unethical behavior and to move people to ethical behavior.

Learning Goals

You should be able to describe the fundamentals of human behavior in your own words.

3.1 The Classical View of Man: Homo Economicus

Economics uses a simplified model of humanity to represent economic actors, namely homo economicus, an egoistic creature.¹ According to F. A. Hayek the term homo economicus goes back to John Stuart Mill² and Utilitarianism.³ Homo economicus is like a computer, or a being that only acts rationally (principle of rationality) as a machine would. This ideal actor is attributed preferences, and thus a constant utility function. Such assumptions have the advantage that human behavior would change only if the basic parameters for a decision changed.⁴ Assuming a

¹Weber explains the reduction to rational goal-oriented action as simplified behavioral assumptions by giving examples of exceptions to rational behavior, such as stock market panic. See Weber, Max (1922), p. 16.

²“It is concerned with him solely as a being who desires to possess wealth, and who is capable of judging of the comparative efficacy of means for obtaining that end. It predicts only such of the phenomena of the social state as take place in consequence of the pursuit of wealth. It makes entire abstraction of every other human passion or motive;” Mill, John Stuart (1844), See p. 38.

³See Hayek, F. A. (1971), p. 77.

⁴See Franz, Stephan (2004) and Göbel, Elisabeth (2010), p. 52.

given degree of information, they would always choose the option that maximizes their gain (principle of the individual), making their decisions mathematically predictable.⁵ On the other hand, it means that homo economicus not only leaves the benefit to others out of the equation but that he would even commit amoral acts to achieve his goal of maximizing his own advantage, including lying, betraying and other immoral acts.⁶

The theoretical homo economicus is a shallow image. When societal influences are not part of the equation, such an actor is represented as being purely psychological, not sociological. Mill considered people sociological, however.⁷ If we take societal mores for human behavior into consideration, the resulting decisions change. These mores are societal norms that dictate to the members of a society how they should act in order to benefit the society and not harm it. Societal norms and values can be chosen consciously by the individuals or inculcated socially. Societal sanctions in the case of norm infractions can make certain decision alternatives seem to be more utility maximizing even if they bring fewer individuals more advantage than others.⁸ The term gain is to be understood as net individual advantage, in other words profitable gain reduced by losses from social sanctions. On the flip side, sanctions prevent decision alternatives that would maximize the individual's gain at the cost of society. Sociology refers to motive/norm conflicts in this context, because an individual's need conflicts with the norm. Societal norms have rarely been taken into consideration by economic science, if at all.

The same is true for ethical values, although the term "gain" applies even less. The need that many people feel to do good for other people only indirectly provides a gain, by satisfying an existing subjective need. Everything that a person wants and gets could be described as a gain,⁹ but additional benefit must also be objectively comprehensible to a third party. The fairy tale "Hans in Luck" by the Grimm Brothers¹⁰ illustrated how a person can feel better subjectively, even though their objective gain has diminished. The term "gain" in this context is really too restrictive,

⁵ See Erlei, Mathias/Leschke, Martin/Sauerland, Dirk (1999), pp. 2. Current economic thinking handles market failure as a human failure only marginally, if it means rejecting the Rationality Theory of homo-oeconomicus. But even then human behavior is deterministic based on the assumptions of how they behave irrationally.

⁶ See Milgrom, Roberts (1992).

⁷ "The deeply rooted conception which every individual even now has of himself as a social being, tends to make him feel it one of his natural wants that there should be harmony between his feelings and aims and those of his fellow creatures. If differences of opinion and of mental culture make it impossible for him to share many of their actual feelings- perhaps make him denounce and defy those feelings- he still needs to be conscious that his real aim and theirs do not conflict; that he is not opposing himself to what they really wish for, namely their own good, but is, on the contrary, promoting it. This feeling in most individuals is much inferior in strength to their selfish feelings, and is often wanting altogether. But to those who have it, it possesses all the characters of a natural feeling." Mill, John Stuart (1863), pp. 267.

⁸ See Föhr, Silvia/Lenz, Hansrudi (1992), p. 153.

⁹ See Hausmann, Daniel M./McPherson, Michael (2006), pp. 79.

¹⁰ See <http://www.authorama.com/grimms-fairy-tales-2.html>

as one can really only speak of fulfilling a need. Economic decision-making theory needs to be expanded to include this concept. To sacrifice something for others may be rare, but it is a very well-known human phenomenon. To sacrifice would then indicate following the dictates of a need to help others, even if it reduces one's own objective advantage. This is exactly what earns our admiration and what many religions, including Christianity, demand of people; "It is better to give than to receive." The moral of the fairy tale is that Hans minimizes his objective gain and maximizes his subjective benefit, or better his happiness. We need to speak more generally of happiness maximization when examining human motivations. The idea that having goods from the economy alone does not bring happiness is clear once goods have been acquired. That happy feeling does not usually last very long, and in the end the goods only fulfill material needs.

Jeremy Bentham, James Mill and his son John Stuart Mill, the main founders of Utilitarianism, grew apart over time. Utility maximization is now understood exclusively in relation to material gain. Happiness is closer to Bentham's thinking, as he considered pain and pleasure.¹¹ For Bentham, happiness could arise from things such as sensory pleasure, a good reputation, wealth, power, or charitableness, but also negatively connoted traits such as malevolence. Pain might result from privation, a bad reputation, enemies, but potentially also from charitableness, piety or malevolence. John Stuart Mill includes not only desire in the pursuit of happiness but also the pursuit of honor, duty, and morality. Whoever rejects Utilitarianism because they reject the pursuit of happiness underestimates humanity. People search for happiness through their desires, but also through dignity.¹² A person's self interest, thus the basis for being happy, can be found in the pleasure derived from understanding and morality. According to Mill, there are moral and immoral pleasures or perceptions of happiness, which is why people must question their interests and adjust their motives to their ethical views.¹³ Utility maximization must therefore be understood as pleasure maximization and not solely as the maximization of material gain.

As opposed to the economic theory of homo economicus the information processor, social psychology considers people to be decision-making problem simplifiers.

¹¹ "Nature has placed mankind under the governance of two sovereign masters, pain and pleasure. It is for them alone to point out what we ought to do, as well as to determine what we shall do. On the one hand the standard of right and wrong, on the other the chain of causes and effects, are fastened to their throne. They govern us in all we do, in all we say, in all we think: every effort we can make to throw off our subjection, will serve but to demonstrate and confirm it. In words a man may pretend to abjure their empire: but in reality he will remain subject to it all the while. The principle of utility recognizes this subjection, and assumes it for the foundation of that system, the object of which is to rear the fabric of felicity by the hands of reason and of law." Bentham, Jeremy (1789), first chapter.

¹² "... but its most appropriate appellation is a sense of dignity, which all human beings possess in one form or other, and in some, though by no means in exact, proportion to their higher faculties, and which is so essential a part of the happiness of those in whom it is strong..." Mill, John Stuart (1863), p. 10. See Mill, John Stuart (1992), pp. 86.

¹³ See Mill, John Stuart (1992), pp. 86 and 90.

To this end people use patterns, created from their impressions and experiences. Social psychology has used several interesting experiments to show the influence of patterns. Pre-determined thought structures and ways to solve problems (behaviors) help to call up patterns and information quickly. Over-confidence can also be an issue with thinking. It has been shown that people do not have the abilities of a *homo economicus*.¹⁴ New Behavioral Finance agrees.¹⁵

According to social psychology, cultural/societal influences form human behavior, which deviates from the *homo economicus* stereotype. Examples include various gestures and the strongly self-centered Western cultures as opposed to Asian cultures. It is also important to know how people adapt to cognitive dissonance, which might be created by an immoral environment. The Ash Conformity Experiment proved that individuals even adopt a false group opinion if the group presents its view with self-confidence. We humans therefore tend to over evaluate the way something is being presented. This also explains why managers who are so self-confident that they do not question themselves and never admit mistakes are more successful than those that correct themselves. However, this also results in more mistakes.

People take on roles within groups that influence their behavior. Individuals adapt to the group in order to gain social recognition (social comparison process or aspiring to conformity). It is assumed on the other hand, that only the individual influences the behavior of *homo economicus*. Norms create moral behavior, as has been shown in experiments.¹⁶

The simplified human model of *homo economicus* is legitimate. Rational, informed and balanced action generally does bring advantages. The assumptions behind *homo economicus* become problematic when economic science forgets that they are dealing with a model¹⁷ and treat it as reality.¹⁸

¹⁴ See Jonas K./Stroebe, W./Hewstone M. (2007), pp. 374; Fehr, Ernst/Fischbacher, Urs (2003), p. 786 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001); Frank, Robert H. (2004); Frank, Robert H. (1988) and Güreker, Özgür/Irlenbusch, Bernd/Rockenbach, Bettina (2006).

¹⁵ See Conrad, Christian A. (2005), pp. 391.

¹⁶ See Jonas K./Stroebe, W./Hewstone M. (2007), pp. 374; Fehr, Ernst/Fischbacher, Urs (2003), p. 786 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001); Frank, Robert H. (2004); Frank, Robert H. (1988) and Güreker, Özgür/Irlenbusch, Bernd/Rockenbach, Bettina (2006).

¹⁷ "Not that any political economist was ever so absurd as to suppose that mankind are really thus constituted, but because this is the mode in which science must necessarily proceed." Mill, John Stuart (1844), V 38.

¹⁸ An interesting neurological experiment was conducted in 2003 that showed *homo-economicus* to be a fiction, and the press gave its conclusions much attention. The ultimatum game was conducted in the laboratory of Princeton University by Alan Sanfey. See Sanfey, Alan et al. (2002) and Handelsblatt vom 03/23/06, p. 11.

3.2 Falsely Understood Egoism

Perhaps the lack of ethics and morals of many managers comes from a false understanding of the economic bible “Wealth of Nations,” by Adam Smith, or at least a very abbreviated and thus misleading representation of his ideas as presented in economic education. The brilliant idea of Adam Smith was how human self-interest is directed toward the common good through the “invisible hand” of the market. Even bad people thus serve the common good, as Hume commented. The law of the market functions as an ethical guideline thus¹⁹:

...it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.²⁰

By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.²¹

It almost seems as though many managers take this as a free pass to limitless pursuit of their own interest, as though they understood it as egoism at the cost of others. The second central work of the Scottish moral philosopher Adam Smith, “Theory of Moral Sentiments” is almost never mentioned. Here we find quite different quotes:

How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.²²

According to Smith, people have a highly developed conscience that functions as an internal moral judge. Like Schopenhauer and Hume,²³ he accords people the capacity of compassion and sympathy with other people. They can empathize with the interests and needs of their fellow humans, and must therefore weigh them in their conscience against their own self-interest. They are helped in this by an imaginary, objective third-person opinion derived from the question of how an impartial third party would decide. The principle of rational thinking is the basis for weighing the various interests. This capacity of a human conscience is generally credited to God or generally to human rationality. The individual is part of the natural whole and responsible for his or her own decisions. Responsibility and freedom are natural

¹⁹ See Starbatty, Joachim (1999), pp. 17.

²⁰ Smith, Adam (1776), Paragraph I, p. 82. The idea of an invisible hand can be traced back to Mandeville's bee fable. “The worst of all the Multitude Did something for the Common Good.” Mandeville, Bernard de (1732) p. 9. Mandeville had already seen the danger than self-interest can pose to society: “So vice is beneficial found, when it's by justice lopt, and bound; Nay the people would be great; as necessary to the state; As hunger is to make them eat; Bare virtue can't make nations live; In Splendor; they, that would revive A Golden Age must be as free For Acorns, as for Honesty.” Mandeville, Bernard de (1732) p. 24

²¹ Smith, Adam (1776), Book IV, Chapter II, p. 489.

²² Smith Adam (1759), Part I, Chapter I.

²³ “We are certain, that sympathy is a very powerful principal in human nature.” Hume, David (1739), p. 667. See Schopenhauer, Arthur (1840), § 15–18.

and God-given. Smith believes a truly uninvolved and objective third party's opinion is necessary to determine whether an action is morally and ethically acceptable. This impartial observer takes on the task of social corrective, which is comparable to Immanuel Kant's categorical imperative. Always act in such a way, that the basis for decisions could be the principle behind a general rule, the behavior could always be acted upon by all people and for the good of society.²⁴

Adam Smith was aware that the invisible hand is not sufficient to protect the common good from damage done by an individual. He stressed the need for an economic and structural system that included protection for the common good. Enrichment of the individual at the expense of the common good cannot be tolerated by a society for various reasons. Besides the damage sustained by the national economy, such behavior supplants the system. According to Smith, trade can develop via markets to the benefit of all people, thus creating wealth, only when the legal system is functional and there is trust in the supremacy of the state.²⁵

3.3 Individualism Versus Collectivism

3.3.1 *Rolegame Individualism Versus Collectivism*

Each participant gets 7 clothespins. The goal is to attach as many clothespins as possible to the other participants. After 30 s play stops and clothespins are counted. Round 2 follows with the aim of removing as many clothespins as possible from the others. The participants fight for the clothespins. After 30 s again play is stopped and clothespins counted. The game host now asks the participants why they fought against each other. He never said anything about competition. Through cooperation, they would have progressed much further (The game was explained in a talk by Dirk von Vopelius at the IHK in Nuremberg on June 10th 2015).

Social morality, or better ethos, as moral behavior in practice, is a public good in economic terms. The benefits of cooperative, considerate, and polite behavior of a society benefit all who are a part of it. The benefit is arbitrarily divisible, so not rival, and no one can be excluded. This also applies to teamwork. There is a free-rider problem, however. There is an incentive not to participate in the group performance because one cannot be excluded from the group's success.

Rational utility maximization, however, does not necessarily mean harm to third parties. For example, in game theory multi-round games show that decision-makers learn from their decisions and take into account the other's harmful counter-reaction, which is why they no longer maximize their usefulness in the short term. From a game theory point of view, games over several rounds have shown behavior to be profit-maximizing if one behaves first cooperatively and only if the other does not

²⁴ See Nass, Elmar (2003), p. 47.

²⁵ See Smith, Adam (1776), chapter III, first paragraph.

cooperate, to counter this with a likewise uncooperative behavior (trigger or tit-for-tat strategy).

The trigger or tit-for-tat games describe the underlying conflict between individual and collective rationality. In the prisoner's dilemma, maximizing individual utility at the cost of third parties is in direct opposition to collective benefit through social gains, e.g. access to collective goods such as a clean environment. In the Sixties, Anatol Rapoport and Albert Chammah used experiments to show that cooperation begins if games such as the prisoner's dilemma are played repeatedly. Based on computer simulations, Robert Axelrod later analyzed the conditions under which cooperation comes into being. In this context the tit-for-tat strategy suggested by Rapoport maximized results. This strategy has its strengths and weaknesses. The strategy says to play fair and never fleece or injure your opponent. Only if your opponent behaves uncooperatively, should you do the same. This strategy maintains the possibility for opponents to gain more only as long as they behave cooperatively, and to gain less if they are uncooperative. The motivation is thus to be cooperative and receive sanctions if you are not. The regulated sanctions would be the norms of the game. Exploitative strategies harm one's self and the other, because the gains from cooperation disappear. In the end, maximizing individual gain at the cost of another party means less net utility. Rapoport calls the principle behind this strategy "in weakness is strength," and recommends it as a leitmotif in his studies on arms races and conflict avoidance.²⁶ But this is only true for smaller groups. The more players are in the game the less they can see the connection between their (un-)cooperative behaviour and the reaction of the others.

The issue of cooperation benefits from public goods can also be illustrated with a game. A **public goods game** consists of say 5 people who must each pay 10\$ into a pot. If everyone pays in, the money in the pot doubles, which is meant to represent the added value of public goods. If not everyone pays in, the public good is not created and the sum is divided by five and paid back out. In the worst case scenario a player could pay in 10\$ and get back 2\$.

Game 1 Public Goods Game

Play the public goods game with chewing gum.

Give at least three people 2 pieces of chewing gum each. Tell them if they all put the chewing gum in a pot or in a cap below the table then you will give them an additional chewing gum each. If there are not two from each person in the pot all the chewing gum is distributed equally between the players.

The experiment shows that in the case of public goods made available, the initial trust decreases over several rounds of play because of the free-rider issue.²⁷ The player does not know how the others behave. Best case: he does not pay but he gets 1.3 pieces of chewing gum (3 players) and does not risk anything. Worst case: he gives 2 pieces and all others do not, then he gets 0.30 pieces back.

²⁶ See Rapoport, Anatol /Chammah, Albert M. (1970); Axelrod, Robert (1987) and Schwaninger, Markus (2008).

²⁷ See Holzmann, Robert (2015), p. 131.

In a public goods game, 40–60% of players are cooperative at the beginning. This behavior decreases when they notice that they are hurting themselves and the cooperative good is not being created. They then play up to ten rounds of anonymous play cooperatively and then become uncooperative.²⁸ There is always a base group of players who insist on being uncooperative and try to maximize their gain to the detriment of the other players. These free riders make up about one third of players. Altruistic rewards and punishments, which are also at the cost of the participants, can discipline the free riders into more cooperative behavior, which can allow the public good to be created to everyone's benefit.²⁹

Fehr, Fischbacher, Güerker et al. emphasize the role of so-called “strong reciprocators,” meaning players that punish uncooperative free riders even though it is to their detriment.³⁰ Emotions motivate the strong reciprocators to set the norms despite the loss they may suffer. Altruistic sanctioning of uncooperative behavior can be motivated by gratefulness, or a desire for retaliation. Without emotions no one would punish another to their own detriment. Getting upset over uncooperative behavior creates a sense of gratification and thus a net benefit for inflicting the punishment, which makes altruistic punishments possible.³¹ Fehr and Fischbacher showed that over 60% of neutral third parties will intervene in the case of game behavior perceived as unfair and uncooperative to impose fairness and cooperation even if it puts them at a disadvantage.³² We are talking about the sense of justice that makes us human. The sense of justice is why cooperative behavior in a group gets enforced. There are sanctions meted out, even though doing so requires effort and the sense of justice unites the group in its behavior.

These games also show the importance of societal sanctions (norms) and learning/socialization. The great majority of players enter the game in a spirit of cooperation, but they are willing to change that behavior if the advantages of cooperating turn to disadvantages. Such an experience is also part of the learning process, such as the role that reputation plays. If there is an option to switch to a game where sanctions are possible, it will be taken in order to enjoy public goods. With time the players are able to establish norms, allowing punishments to diminish greatly.³³ The tit-for-tat strategy was observed during these games as well. Thus most players saw their cooperative contribution increase along with that of the other players.³⁴

²⁸ See Fehr, Ernst/Fischbacher, Urs (2003), p. 786.

²⁹ See Fehr, Ernst/Fischbacher, Urs (2003), p. 786 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001).

³⁰ “Strong reciprocators bear the cost of rewarding or punishing even if they gain no individual economic benefit whatsoever from their acts.” Fehr, Ernst/Fischbacher, Urs (2003), p. 785. See Güerker, Özgür/Irlenbusch, Bernd/Rockenbach, Bettina (2006).

³¹ See Föhr, Silvia/Lenz, Hansrudi (1992), pp. 153 and Frank, Robert H. (1988) and Frank, Robert H. (2004).

³² See Fehr, Ernst/Fischbacher, Urs (2003).

³³ See Fehr, Ernst/Fischbacher, Urs (2003).

³⁴ See Falk, Armin (2003), p. 147 and Fehr, Ernst/Gächter, Simon/Fischbacher, Urs (2001).

It maximizes one's advantage to be uncooperative when playing just one round of the game, yet cooperative if playing several rounds. In other words, if the other players can neither defend themselves nor retaliate it is advantageous to fleece one's opponents, behaving unethically to the detriment of others, but not if they are able to defend their interests.

It is therefore not surprising that many ethical misdeeds have taken place within the finance sector within the last few years, since the games are generally played with just one round. No one even knows their business partner on the stock market. The bad subprime credits were mostly sold through the stock markets. If the buyer could have prosecuted the seller, the worthless sales would never have reached such a level because it would not have maximized utility to do so. Anywhere there is a long-term business relationship, or legal damage compensation is easy to obtain, it is not utility maximizing to injure a business partner.

We can observe however, that business is sometimes conducted such that this utility-maximizing strategy is contradicted. There are fields of u-pick flowers, and self-serve newspaper kiosks in the city, where one can cut flowers or take a paper without paying for it. Not paying would be the rational utility maximization strategy, since the "buyer" would not fear any reprisal. These offers exist nonetheless, which means that many people behave ethically and socially, instead of rationally utility-maximizing.

There have been several studies on human behavior using errant pieces of mail. Letters with postage were tossed into a mailbox at a rate of almost 80%. If the letter contained money, still more than 50% were forwarded.³⁵ In an experiment in which a wallet was placed in the letter, passersby in New York forwarded untouched wallets at a rate of almost 50%.³⁶ Gneezy's sender-receiver game experiment using students showed³⁷ that many people tend towards the truth, even if they do worse because of it. Asymmetrical information is thus not always used to one's advantage.

The results of these experiments can be explained by altruism, honesty as a human character trait or by corresponding social norms. That the addressees of the letter were unknown, and thus the finder could not identify with them, speaks for the explanation that moral behavior derives from norms.³⁸ On the other hand, there are no sanctions in this example that would create the norms, since the behavior was believed to be unobserved.

³⁵ See Lück, Helmut E./Manz, Wolfgang (1973).

³⁶ See Hornstein, Harvey A./Fisch, Elisha/Holmes, Michael (1968).

³⁷ See Gneezy, Uri (2005), pp. 387.

³⁸ See Hausmann, Daniel M./McPherson, Michael (2006), p. 86.

3.4 Fairness As Motivation

Alan Sanfeys conducted the “ultimatum game” in the laboratory at Princeton University. Two subjects are told to divide \$10 amongst themselves. The first (proposer) get the whole amount and can decide how much he gives the other. The second (responder) can then decide whether he accepts or rejects the portion he is offered. If he rejects the offer, neither gets anything.

Game 2 Ultimatum Game

Two students are to split 10 pieces of chewing gum. The first one receives everything and can determine how much he gives to the second. The second can then decide whether to accept or reject the gift. If he does not accept the money, they both get nothing.

The ultimatum game is normally played with 10\$ instead of chewing gum. Rational behavior would dictate that the second subject agree to any amount offered. Regardless of how much he is given, he would still be better off than if he were to reject it and both get nothing.³⁹ People apparently behave quite differently, however. If the offer is seen as too low, many subjects rejected the offer completely and preferred to have nothing.⁴⁰ Brain activity values (MRT) showed that the lower the offer was, the more the prefrontal cortex (PFC), responsible for rational thinking, was overshadowed by the Insula, responsible for emotions. The interpretation of this experiment indicates that the positive decision to gain money was increasingly superimposed by the negative feeling of being treated badly by the other subject.⁴¹

This interesting neurological experiment from 2003 was lauded by the press for the realization that homo economicus is a fiction, yet the experiment can be interpreted differently if we take into account that humans are social animals, as Aristotle suggested.⁴² We can interpret the second subject’s rejection of an offer felt to be too low as an expression of the sense of fairness. It seems obvious that \$10 should be split evenly among equals with \$5 each. If we assume that humans are social animals descended from apes, we can call the behavior of rejecting a low offer irrational, yet goal-oriented and effective. How would such a group experiment play out in real life? By rejecting the offer, the second subject signals that he rejects the

³⁹It was interesting to see that in the ultimatum games students who had the course microeconomic before and therefore knew the experiment for showing not rational behavior gave only one of the ten chewing gums to the second person. Their argument was that they wanted to behave rational and the other person should be grateful to receive anything.

⁴⁰The ultimatum game was adapted and executed under competitive conditions with a proposer and several responders. Only the first responder to accept the proposer’s offer received a payout. The responders accepted even very low offers in this situation. See Holzmann, Robert (2015), p. 130 and Roth, A. E./Prasnikar, V./Okuno-Fujiwara, M./Zamir, p. (1991). Such a something or nothing situation is not comparable to the competition based on performance as per the do-ut-des principle of the markets.

⁴¹See Sanfey, Alan et al. (2002). The ultimatum game has existed since the 1980s. See Güth, W./Schmittberger R./Schwarze, B. (1982).

⁴²See Aristoteles (1944), 1253a.

social behavior of the first subject as unfair. He is also showing the proposer that his behavior can have negative consequences for him in the group if the other members agree that he has violated a norm, namely how sustenance is divided within a group. This behavior is programmed into us as humans and could not be denied in another experiment with different parameters. The refusal to accept the amount could alternatively mean that the second subject wishes to signal the first that he is not willing to be disparaged in the group with a lesser share of sustenance, and that the first subject has maneuvered himself into a conflict situation with his offer and the second subject will get him back at the next opportunity regardless of the experiment.⁴³ A variant of the ultimatum game is the dictator game.

Game 3: Dictator Game

Two students are to split 10 pieces of chewing gum. The first one receives everything and can determine how much he gives to the second. The second has to accept the offer.

In this game the second subject has no influence on the final distribution, rather he must accept what the first subject gives him. Here it would rationally maximize one's utility for the first subject to keep everything. The dictator game is normally played with 10\$ instead of chewing gum. The experiment shows however, that on average about 30% is given to the second subject, again showing an altruistic sense of justice.⁴⁴

Research on primates has also concluded that fairness is a central principle for creating cooperation in a group. Frans de Waal and Sarah Brosnan at Emory University in Atlanta conducted experiments with capuchin monkeys, in which different rewards – a grape or a cucumber – were given for the same effort. The monkeys refused the cucumber as a lesser reward for the same effort, leading De Waal and Brosnan to conclude that primates have an innate sense of fairness that has evolved to develop cooperation. Susan Perry from the Max Planck Institute for Evolutionary Anthropology in Leipzig also did experiments with capuchin monkeys and arrived at similar conclusions.⁴⁵

The experiment also shows the influence of group behavior on economic decisions, which has been heretofore neglected in economic science. Fairness as an ethical value has concerned people as long as they have existed. Fairness, or justice, is the objective of the basic normative principle of human co-habitation (principle of social behavior).⁴⁶ This is the prerequisite for an individual to participate in the division of labor of a group. The individual will only adapt to group's demands and work cooperatively if his share from the labor distribution is felt to be fair. Without fairness there is no added value from labor distribution for our society and civilization (emergence). That means for a company as the group with which he earns his

⁴³ See Conrad, Christian A. (2010), pp. 125 and Fehr, Ernst/Fischbacher, Urs (2003), pp. 785.

⁴⁴ See Holzmann, Robert (2015), p. 129.

⁴⁵ See Brosnan, Sarah F./de Waal, Frans B. M. (2003); Perry, Susan (2003) and Brosnan, Sarah F./de Waal, Frans B. M. (2014).

⁴⁶ See Höffe, Otfried (1992), pp. 91.

livings the employee will adapt to supervisors demands and work cooperatively if his share from the labor distribution is felt to be fair. If not he will stop cooperation, which is important information for leadership theory. To be successful the leader has to explain this distribution share to each individual in order to create motivation to work in a group.

Subjectively, fairness is understood as an ethical value. The classical world considered it a fundamental virtue as well as a guiding principle for action, which prevented any overreaching one's fellow humans. Even though there are no sanctioned norms, a righteous person behaves ethically by not taking advantage of others even when he has the opportunity; he in fact gives others their share.

3.5 Human Intelligence

What abilities are decisive in life? What makes it possible for people to cope with the challenges from their environment? What makes people successful? These are questions about human intelligence. Today intelligence is mainly defined as the correctness and speed with which unknown tasks are solved.⁴⁷ There used to be three forms of intelligence identified. The ones necessary here are the mathematical, spatial and linguistic intelligence, whereby the mathematical is the most well-known. Mathematics is understood here to be the pure form of abstract and logical thought. People gifted with this intelligence are able to use chains of proof and rules that can be recorded with figures. Mathematics is considered nature's blueprint because many laws of nature can be represented mathematically. The most famous of those with this feature of intelligence was Albert Einstein, the founder of the Theory of Relativity. The second, spatial intelligence, allows three-dimensional comprehension and processing of the environment as forms, spaces or objects. The embodiment of this form of intelligence is considered to be Michelangelo Buonarroti with his statue of David and the images in the Sistine Chapel with perfect perspective. The third traditional form of intelligence is a gift with languages. This allows hearing through words, written and verbal expression and independent reflection through writing. An example here would be Johann Wolfgang von Goethe with a vocabulary of around 90,000 words. The average person has between 2000 and 5000 words. These three traditional forms of intelligence have determined the way human capabilities are perceived and perhaps their valuation for decades. The explanatory power of these gifts for success in solving tasks in life is quite limited, however. According to the Harvard Professor for Psychology Howard Gardner, in the best case these three traditional forms of intelligence could only predict scholastic success to a certain extent. According to Gardner there are some careers whose demands are concentrated in these forms of intelligence, such as lawyers through formulations and verbal arguments, physicists who work with mathematical formulas or pilots who must think spatially. For most other careers however, such as managers,

⁴⁷ See <http://wirtschaftneudenken.blogspot.de/2010/09/abschied-vom-iq.html>

politicians, musicians etc., these criteria are not suited to determining potential. This fact caused the Gardner to investigate other forms of intelligence. In the 1980s he developed his radical concept of multiple types of intelligence, in which he included four additional gifts. In the meanwhile research has identified a total of ten forms of intelligence.

First there are the special forms of intelligence, such as the naturalist, musical and kinesthetic intelligence. Naturalist intelligence refers to a particular comprehension of nature and its products. Foresters, biologists, veterinarians and top chefs would be careers for this group. Alexander von Humbolt, who discovered and explained many interconnections with his field research would a prime example of naturalist intelligence. The first example to come to mind for musical intelligence is the genius Wolfgang Amadeus Mozart. Kinesthetic intelligence is relatively unknown. Science considers it to be the ability to use one's body to complete tasks. A famous kinesthetic genius would be the silent film actor Charlie Chaplin.

The four most important forms of intelligence to have been recently identified are the existential, interpersonal, intrapersonal and emotional intelligence. Relationships between people, social competence or soft-facts had been completely neglected by the traditional forms of intelligence. Interpersonal intelligence allows one to recognize and understand the motives and desires of other people. In particular teachers, politicians and sales people need this kind of empathic ability. Only someone who can put him or herself in the shoes of others can motivate and recognize both strengths and weaknesses to then best apply, encourage and demand them, developing them optimally, as an ideal manager does. Another example is politicians who must recognize the desires of their voters in order to be successful.

The transitions between the abilities are fluid however, and there are many overlaps depending on the type of demands made. Thus rhetorical abilities belong to linguistic abilities as well as to interpersonal intelligence, since a good speaker must gauge what the listeners are receiving and react rhetorically to their reactions. Overlaps are particularly numerous for interpersonal relationships. This is how the American Daniel Goleman developed the concept of emotional intelligence in the mid-90s. He considers this to be not only recognizing and dealing with the feelings of others, but applies this to one's own feelings as well. Emotional intelligence is thus located between the interpersonal and intrapersonal intelligence as the capacity to deal with human emotions. Mahatma Gandhi represents an excellent example of emotional intelligence. He was able to judge the feeling of his compatriots, influence them and channel them into passive resistance as well as to control his own feelings in an exemplary manner, making him an excellent leader. He was a model for his compatriots in suffering. The nickname Gandhi translates as "large spirit." The intrapersonal capacity to understand one's self makes it possible to differentiate between realistic goals and personal dreams, an ability not to underestimated, as it is then possible to achieve an inner balance at live with inner harmony. In 1896 Sigmund Freud described scientifically for the first time how self-knowledge is the basis for human existence on earth, and inner peace. Internal balance and finding the right relationship between reality and a person's capacities and desires is the basis for internal force and perseverance, and thus for a person's long-term success.

The last three forms of intelligence for social competence are not only determining factors for managers, but also for the successful integration in a team. Only he who knows himself and understands others can offer his strengths and weaknesses to the team in a way that increases the team's ability to perform. The last of the new forms of intelligence is the existential intelligence. It is attributed mostly to philosophers, priests and authors, because they are capable of addressing the fundamental questions about the world and humanity. Immanuel Kant is our example here, who significantly contributed to modern thinking with his work "Critique of pure reason" (1781) and his categorical imperative,⁴⁸ as well as his thoughts on enlightenment. This intelligence can generally be characterized as the capacity to get to the source the past and future of things, or to put social or environmental observations into a larger perspective. This form of intelligence is therefore important when addressing that big picture of human structures. This also applies for economic science as the science of people in economic interconnections.⁴⁹

For the question of the extent to which man behaves ethically, compassion, that is, sympathy with other people, plays an outstanding role. This is an emotion. In principle, it is therefore necessary to distinguish between a rational impact assessment and emotion-driven compassion. This also occurs in two separate brain areas, as the case of the railway worker Phineas Gage showed. In an accident, an iron rod, 1 m long and 3 cm wide, had been shot through his head. He survived this and, surprisingly, the basic cognitive basic functions were unaffected as perception (except for the loss of an eye), intelligence, memory and speech. Only his social intelligence seemed to be impaired. Before, he was a popular, prudent and successful personality, after the accident he had problems, long-term decisions and social contacts. It turned out in a later investigation that especially brain regions had been damaged, which are added to the processing of emotions.⁵⁰ As in experiments where the brain activity was measured by means of functional magnetic resonance tomographs (fMRI), emotional inhibitions occurred in subjects especially when: (1). a personal responsibility (ME) was (2). for direct physical damage (HURT) (3). A physically present or alive person (YOU) was present (MeHurtYou).⁵¹

Haidt et al. succeeded in demonstrating the influence of emotions caused by norms, in particular, on moral decisions by placing people before decision – making alternatives which did not result in objective harm but were morally problematic, such as the eating of the deceased dog before the Background that dog meat should taste good or use a bust American flag to wipe the toilet.⁵²

Where do we place the character of morality with the background described above? Morality, like all characteristics, is partially inherent and can be helpful in

⁴⁸ People need to select maxims to guide their actions, which can simultaneously function as general laws.

⁴⁹ See Gardner, Howard (1983); Gardner, Howard/Kornhaber, Mindy L. (1996); Gardner, Howard (1999) and Schlesinger, Christian (2007).

⁵⁰ See Holzmann, Robert (2015), p. 117.

⁵¹ See Greene, Joshua D./Nystrom, Leigh E./Engell, Andrew D./Darley, John M. (2004).

⁵² See Haidt, J./Koller, S./Dias, M. (1993).

solving unknown tasks in life, just like the forms of intelligence. It belongs to the social abilities, or more exactly to interpersonal intelligence. As we have already shown, morality is the basis for trust and thus also for productive human social existence. Repeated moral behavior inspires others to do the same, to compromise in transactions, to invest for example, and to trust in the later reciprocal action of a business partner, which leads moral people to experience more interpersonal success than immoral people. There is a negative form of interpersonal intelligence, which we call cleverness. We understand cleverness to be the ability to enrich one's self immorally at the cost of others, to gain advantages, without being discovered. This ability is unfortunately often a key to success in life. From the perspective of the society, this success should be prevented because it damages individuals and the system as a whole.

The conclusions one can draw from these new findings are quite reassuring. When someone has not scored well in the traditional three forms of intelligence, it neither means that they will be unsuccessful, nor that they are dumb. Intelligence as the capacity to be successful in life is as complex and diverse as the challenges of life itself. Analysis and problem simplification can be trained with a study in an orchestra score. In order to be successful in a group, one needs both interpersonal and emotional intelligence. There are many overlapping abilities, so that it seems almost impossible to definitively classify a person's intelligence or to evaluate someone in relation to their chances in life. Everyone has strengths and weaknesses that are often balanced, even at extremes. All too often we find engineers who cannot use their ingenious inventions because they lack the ability to sell it. Intelligence can also be learned to a certain degree. The fundamental abilities are inherited, but they can be increased by around 15% through training.

From the various forms of intelligence one can conclude that people are able to understand the effect of their behavior on the welfare of third parties and to feel compassion. Furthermore, they show that human nature goes far beyond the homo oeconomicus.

On the whole, it may be doubted that all the intelligentsia worked out by Gardner can be proved empirically. Up to now, social intelligence has been isolated and empirical proof has been given of a connection with the success of personal influence on people. In addition, links between the academic degree as well as age and social intelligence were identified.⁵³

⁵³ See Eshghi, Parto/Arofzad, Shahram /Hosaini, Taghi Agha (2013). Zur Diskussion See Gardner, Howard /Moran, Seana (2006).

3.6 The Cultural Impact

Empirical studies confirm a familiar basic principle of raising children, or human socialization in general. Social, or more exactly, moral and ethical behavior can be taught and learned.⁵⁴ The reverse conclusion is that moral behavior weakens whenever it is no longer taught or demonstrated. For this reason there is a duty to educate children and socialize members of a society in all areas. If this does not take place, or only poorly, the effects will be felt in all areas, in companies and in national economies. The effects are gradual, noticeable only over the longer term, similar to the effects of pollution in the environment. It often pays off for individuals to violate social rules as long as others keep to them. There is also the fact that socialization as a practiced social behavior and moral values can be lost. Like a young cat dependent on the role model of its mother to catch mice despite its hunting instinct, humans need role models, guidelines and education, including punitive measures for moral transgressions. This allows them to become functional members of the human community in a positive sense. If values are not passed on and socialization does not occur, this human capital, the experiences of living together, is lost and cannot be given to the next generation.

Morality and customs of managers are also products of each respective society. Morality of the individual is partially inherent and partially trained through the social and familial socialization process.⁵⁵ According to David Hume, Stinchcombe and Friedrich A. von Hayek there is also a cultural development process. Sociology calls this the process of natural selection. The unsuitable behavioral patterns and rules (institutions) die out with the groups that have selected them. Cultural development is a process of trial and error, with uncertain results. Legal constructs (institutional rules) such as private property, money and credit, even the market economy itself, are discoveries that brought benefits to groups that initiated them. Forms of social life and societal organization are tried out and taken on if they provide economic success and social acceptance, and rejected if they do not. If a society does not behave in this manner, it risks going under in the competition with other societies with its poorer organization, which is the explanation for such a developmental process.⁵⁶ One could argue, for example, that when the Socialist and Communist systems collapsed, private property had instituted itself. The process of natural selection takes place through a very slow process of selection. The decisive factor is selection through human thought and learning from experience (trial and error). This applies especially for the creation of economic order and in general of social order.

⁵⁴ One study was conducted in Germany with craftsmen and one in the USA with students (lecture "business ethics"). See Steinmann, H./Löhr, A. (1994), pp. 174, 190 and Noll, Bernd (2002), p. 144.

⁵⁵ See Wiswede, Günther (1985), p. 195.

⁵⁶ See Wiswede, Günther (1985), p. 195, Hayek, Friedrich August von (1976), p. 39, 40 und 59; Hayek, Friedrich August von (1979), pp. 154 and 167 and Noll, Bernd (2002), p. 29.

The social evaluation of good and evil is also subjected to this principle of cultural selection. A society defines what is good and bad for itself, just as does every individual. Society develops norms for its protection and welfare. If it develops the wrong norms it can cause its destruction. This awareness is very broad and is not applicable only to moral norms, but to all behavioral guidelines.

People orient themselves by other people. If traditional values are rejected, in youth for example, or by influential social classes, first a trend is created as a new mainstream culture. We may refer to this as the *zeitgeist*, which represents the temporary nature of this trend. A regeneration is then already almost impossible, if the old values no longer reflect common sense in the society. If the moral values are no longer common sense, or dominant, there are no longer sanctions from the society for moral missteps. At some point the values are forgotten. The respective social culture is then lost forever, it dies out, like so many cultures of the native peoples in earlier colonies during the European socialization. We are not talking about the natural questioning of parental values during one's youth and the process of constant rejuvenation that results for social orientation and values, but of massive cultural ruptures. A rupture of this kind can be brought about by exceptional events, such as a war. Families are torn apart in war, which impedes the natural process of passing on values. Social values are particularly called into question when a war is lost and the dominant social and power structures collapse. Not only is an authority vacuum created, but there seems to be a tendency to take on the social norms and values of the superior, victorious society.

3.7 Conclusion and Summary

What motivation for ethical behavior do we have? There are many people who selflessly do good deeds and feel better for doing so, not worse. This gives us a selfless motivation that contradicts the theory of utility maximization, or the concept of *homo economicus*. The fact that selfless, or even self-sacrificing, acts exist shows that such an ethic is not unrealistic. Volunteer work and individuals like Mother Theresa are clear examples. This behavior can be explained by a more general theory of maximizing happiness, which is behind theories like the Happiness Theory from Bentham and Mill. Many people are generally good, which is to say they have an ethical disposition.

Selfless acts generally garner prestige in a society, presenting another motivation for ethical behavior. Both motivations are bases for behavior relevant to the satisfaction of a person's basic needs, according to Maslow's⁵⁷ hierarchy of needs. Beyond maximizing one's advantage, people need to feel a purpose in life. There are people who measure their benefit or value as a person by how beneficial they are to others. Behavioral theories have given too little consideration to intrinsic motivations until now. Here we are looking at an enlightened human ethos. People consciously behave

⁵⁷ See Maslow, A. H. (1943).

ethically because they understand the importance of such behavior to society, or because they empathize with other people. Normally these motivations only become meaningful after all of one's basic needs have been met, and they cannot be presupposed for every person. Nonetheless, such ethical motivations must not be disregarded. Our representative democracy in fact demands altruistic behavior from people as a prerequisite to allowing delegates to represent the voter's interests. This expanded theory allows us to explain altruism, helping others and sympathy.

The genetic predisposition to cooperative behavior we have described is not sufficient on its own, however. Hobbes recognized that cooperative behavior must be worthwhile for the individual, who must also be able to count on it from others, since we would otherwise have anarchy. Luhmann considers trust to be a tool used to reduce the complexity of social interactions.⁵⁸ Trust can only be ensured by a society rewarding cooperative behavior and punishing non-cooperative behavior. Without controls and sanctions there is no guarantee of fair, thus economically ethical, behavior.

Therefore moral hazards are extremely dangerous. The existing asymmetries of bonus compensation schemes have led to a divergence of interests between employees on the one hand and the health of financial institutions and other companies at large on the other hand. Remuneration and bonuses depend on short-term profitability, which increases share prices in the short-term, but not the long-term health of the company. In the financial system, investment managers increased the risks for their employer by buying highly profitable but risky assets and were rewarded with high bonuses, which led to the financial crisis in the long term. Without accountability variable compensation schemes become unilateral bonus maximization schemes with negative effects for the company and the principal. It means risking other people's money which will generally be abused unethically.⁵⁹

Moreover people are influenced in their behavior by their view of the world. Ideas and attitudes, or moral values, must be shown by example and included in education. This makes schools of economic science particularly important. There are those who blame management training for catastrophes such as Enron, the subprime crisis etc. Thomas Lindsay, once Dean of the University of Dallas, points to studies before Enron that prove managers rarely fail economically or morally because of a lack of professional knowledge. What they are generally missing is what Aristotle calls "wisdom," to be understood as interpersonal capabilities and practical knowledge. In Lindsay's opinion the education for managers was excessively subject-oriented, and the moral capabilities of the students are almost completely lost through unadulterated profit maximization. Aristotle said that true leadership is based on the ability to recognize and serve the good of the community. To train these abilities one needs much more than a professional education, one needs instruction in history, philosophy, literature, theology and logic.⁶⁰

⁵⁸ See Luhmann, Niklas (2000).

⁵⁹ See Conrad, Christian A. (2015).

⁶⁰ See Bennis, Warren G./O'Toole, James (2005), p. 95.

If households maximize their benefits and companies maximize their profits, it is economically efficient and economic science would consider this a goal for orientation. Good businessmen always act to maximize profit. Whoever wants to be a good businessman should act accordingly. Good households also act to maximize benefits. Thus private persons should also act to maximize benefits. This is the world being taught to young students of economic science in the Western industrial countries. Many would say that this is how the world is, and people ruthlessly maximize their benefits. What about the idea that people are neither wholly good nor wholly bad – as this paper has shown – but they were only told to behave badly? The world would be worse than it had to be.

In the company, management must consider the employees' strong sense of justice. The distribution of income in the company must be explained to the employees so that it is accepted and the employee remains motivated. In addition, a key task of management is to ensure that the company is also justified among the employees.

The economics, with their focus on a pure objective utility maximization, are far from human reality. Although an exclusively objective benefit allows for measurability and thus the use of deterministic decision-making models, they lead to the wrong results. There are three systematic errors:

1. Economic sciences are exclusively psychologically oriented. People decide in a social environment, which is why sociology is at least as important for behavior as psychology. Motives such as social rewards or sanctions are not taken into account. For instance is acceptance by others is a very important behavioral incentive.
2. Taking the objective as the basis for human decision-making, the influence of the group (the company) or society must also be taken into account. Norms that are sanctioned reduce payouts and are critical to decision-making.
3. Finally, the objective benefit is not decisive but the subjectively perceived. However, this is difficult to measure from the outside. However, decision models that build on only objective material utility are misrepresentative and cannot explain many human motives, such as emotions, envy, sense of justice, and compassion. Man is stunted with the homo oeconomicus. It would therefore be more realistic to base the explanation of human behavior on the maximization of happiness as on benefit maximization.

Comprehension Questions

1. Describe the characteristics of homo oeconomicus. Is that image of human beings realistic?
2. What role do the “strong reciprocators” fulfill? What importance do societal norms have for society?
3. Why have many ethical misdeeds taken place especially within the finance sector?
4. What importance does the justice of salary distribution for a company have?

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