

Cognitive Theory and Moral Behavior: The Contribution of F. A. Hayek to Business Ethics

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ABSTRACT. This paper shows how business ethics as a concept may be approached from a cognitive viewpoint. Following F. A. Hayek's cognitive theory, I argue that moral behavior evolves and changes because of individual perception and action. Individual moral behavior becomes a moral rule when prominently displayed by members of a certain society in a specific situation. A set of moral rules eventually forms the ethical code of a society, of which business ethics codes are only a part. By focusing on the concept of "limited" or "dispersed knowledge" that underlies the cognitive approach, I show that universal ethical norms that should lead to defined outcomes cannot exist. This approach moreover shows the limits of deliberate rule-setting. Attempts to deliberately impose universal ethical rules on societies may turn out to be harmful for societal development and lead to an abuse of governmental power.

KEY WORDS: business ethics codes, cognitive theory, cultural evolution, developing countries, knowledge problem, selection processes, universal ethical rules

1. Introduction

The approach that I am advocating here may be an unusual one. To contribute to the field of business ethics from a Hayekian perspective is not straightforward at first glance. Moral philosophers and practitioners may believe that Hayek, although contributing to more than the narrow field of economics, cannot tell us much about moral behavior. Well known as a classical liberal thinker, Hayek's contribution to business ethics may appear either nonexistent or insufficiently developed, compared to the elaborate and well-established theories following Kantian philosophy.

Hayek is known as an ardent fighter for a free society and market order in which government is restricted in the use of its coercive powers by a legal framework. His attempt is to show how this state of affairs is a result of human actions that are guided by moral rules developed in a spontaneous order. What is less known is that Hayek's cognitive writings have contributed much more to an explanation of the development of morality in small groups than a crude liberal perspective would suggest.

In his writings, Hayek develops a consistent theory of the evolution of morality. He underlines his thoughts by explicitly referring to the works of David Hume and Adam Smith. The works of these moral philosophers have significantly influenced Hayek's own view that individuals are driven by moral sentiments that can never be explained following a fully rational concept. Economists that reject the mainstream approach of rational behavior may find one tool to fill the gap between theory and reality, namely Hayek's concept of individual morality.

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However, Hayek's most intriguing work is his cognitive theory, as described in his oeuvre "The Sensory Order." Being an unusual contribution to the field of economics, Hayek's partly sketchy cognitive approach earned widespread rejection and was never offered sufficient valuation, explanation, or further development. Consequently, a full explanation of his theory is still lacking. Only most recent approaches (Rizzello, 1999) support Hayek's contribution by theories of neurobiology and lead to a consistent theory that explains Hayek's argument favoring capitalism, free markets and private property.

My approach is to derive a Hayekian view of business ethics by connecting Hayek's cognitive theory with the moral issues to which business ethics contributes. I argue that we cannot successfully define what the human perspective of future ethics can be without focusing on human cognition. Terms such as "humanity" and "dignity" are related to a cognitive dimension. I will try to show how Hayek is able to contribute his classical liberal perspective to topics as ethical business codes and developing countries.

The paper is structured as follows. Section 2 introduces Hayek's theory of cognition, followed by the most important section about the knowledge problem. With a proper understanding of these ideas, we may be able to follow Hayek's emphasis on spontaneous orders such as a free market. The fourth and fifth sections refer to his theory of moral and societal evolution, followed by a section on ethical codes using a Hayekian viewpoint of the development of moral rules. The question of whether or not business codes can be compared with societal codes will be discussed in depth. As we will see, this comparison is feasible since societal codes and business codes can be traced back to an individual level as referred to in cognitive theories. Section 7 deals with the role of government in the development of moral rules. The last section exemplifies strategies that aim to help developing countries. Contributions of Lord Peter Bauer and Patricia Werhane will be discussed. I show how developing countries may evolve, without imposing rigid rules by developed countries and corporations.

2. Hayek's theory of cognition

Hayek's cognitive writings build the platform for his statements on politics and economics. It is therefore worthwhile to give a closer look at how he developed his ideas about the superiority of free markets, based on competition and individual actions. We will see that the concept of knowledge is fundamental to explain these topics. The concept of limited knowledge, in particular, is shown to be a key factor in fully understanding the social world and forms Hayek's central argument on the significance of rule following behavior and the importance of limiting the power of government.

In Hayek's seminal work, "The Sensory Order" (1952) as well as in his essays "Rules, Perception and Intelligibility" (1967, pp. 43–65), "The Primacy of the Abstract" (1978, pp. 35–49), and "The Theory of Complex Phenomena" (1967, pp. 22–42), his aim is to explain perception as well as human action as a purely individual or subjective phenomenon. Hayek combines metaphysical issues with neurobiological ones in showing how neurons and neuronal connections play a specific role in the human brain. Although these arguments were largely rejected during his lifetime, current research in cognitive psychology reveals that Hayek's approach is correct in most aspects (Rizzello, 1999).

The starting point of Hayek's cognitive theory is the relationship between stimulus and response on an individual plane.¹ Hayek thoroughly reflects on a simple stimulus-response mechanism and links processes that occur on a neural plane with philosophical reasoning. The argument that connects Hayek with the cognitive approach called "Gestaltpsychologie" is that stimuli cannot be perceived by an individual in their original and pure shape. Stimuli are only perceived when connected with other stimuli. Every perceived stimulus or bunch of stimuli must fit into so-called categories. These categories work as a filter in that only categorized or classified stimuli may lead to an action.

After stimuli have passed the process of classification, the human mind is able to perceive them because they belong to a certain set of categories

the brain possesses. One may find parallels to Kant's concept of "categories." While Kant's categories of mind are unchangeable and permanent, Hayek's concept allows for a semi-permanent nature of these patterns. Hayek agrees with Kant that categories are genetically transmitted, but goes further to say that they are also highly influenced by individual experience and, hence, can be changed. This fact marks the starting point of Hayek's individualism.

In other words, categories lead to the perception of data from outside the mind. Since these categories are individually unique – inherited and formed by experience – every individual has his own framework by which he is able to perceive the world. In Hayek's (1952) description, the mind itself can be described as a framework that organizes the perceptions received from the outside world. However, perceiving is not a passive act; it entails an act of interpretation (Rizzello, 1999, p. 25): "the placing of something into one or several classes of objects" (Hayek, 1952, p. 142).

Furthermore, individual perception is, as Hayek claims, necessarily reduced to parts of any physical event, which refers to those parts that can be related to already classify stimuli (Hayek, 1952, p. 143). Hence, experience plays a crucial role in bundling the results into a group of stimuli. What we perceive is what we have already compared with other classes of events on a neural plane. In other words, mind is a framework attributing classifications to groups of stimuli. In approaching Hayek's individualism, that will explain his thoughts about knowledge we shall become familiar with the central concept of the cognitive writings – "dispositions."

With the introduction of the concept of dispositions, Hayek is able to explain why an individual uses certain categories and not others, and why he is likely to respond to stimuli in a certain way. Dispositions are "the most convenient starting point . . . which makes an organism inclined to respond to stimuli of a certain class, not by a particular response, but by a response of a certain kind" (Hayek, 1978, p. 40). Dispositions can be found on two levels: either on the level of perception or on the level of action. Categories follow dispositions. The inter-

pretation of the perceptions or the classifications by which a received stimulus has a specific significance is based on inclination, a disposition of an individual to perceive this stimulus in this way.² Because dispositions have formed categories, they share some similarities. Dispositions are genetically inherited but are also the result of the society's experiences. Hence they may be regarded as the result of the socialization process in a broader sense, encompassing both education and living conditions, as well as individual experience. A disposition to act is abstract as is the classified perception, which was the starting point for the disposition to act. Therefore, the disposition to act is only a very vague and abstract pattern. It is called a "general rule" or "pattern of action," and is usually superimposed by other dispositions (see Figure 1). These additional dispositions refer to the current situation of the individual and evoke the individual's response.

It is important for our purposes to highlight the abstract quality of the primary dispositions. These predispose an action in a very general sense. It explains why Hayek underlines the possibility only to *predict* a general disposition but the impossibility to predict an individual action. This means that valuable prognosis can be done regarding the pattern of events since knowledge of only a few situational circumstances, which concern the connection between the characteristics of the event, are necessary. In the following section, we will see how the concept of pattern prediction is related to the concept of limited knowledge in a world of complex phenomena.

3. The knowledge problem

As we have seen, the concept of the human dispositions underlines Hayek's emphasis on individualism. Although members of a society will tend to act in a specific way because of the social quality of their dispositions, the final individual action cannot be predicted because of the individual quality of the dispositions. Dispositions are therefore responsible for what is perceived by the individual, and perception and action have a subjective character.

It is easy to show how this approach links to

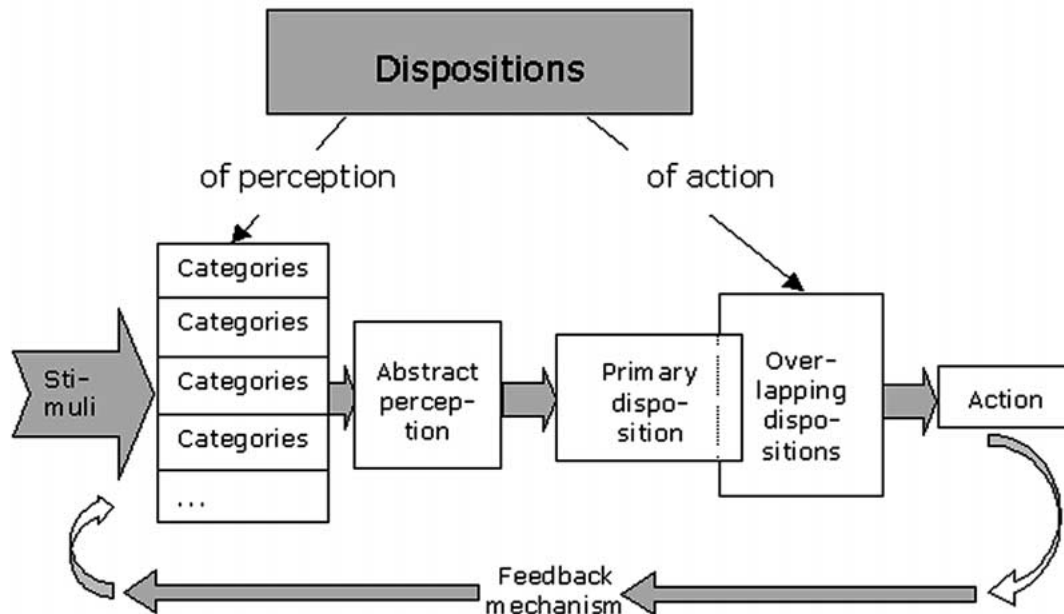


Figure 1.

the concept of knowledge. The key element of Hayek's theory is that human knowledge is limited. Why individuals have only limited knowledge about their environment and are able to act only by referring to a small part of it lies in the fact that the social system, the marketplace in economic systems, and the nervous system are complex phenomena. There are so many variables or circumstances that bring forth a result that one cannot take them all into account (Weimer and Palermo, 1982).

It is not just the limited capacity of the brain to perceive and process new knowledge, but also that knowledge is necessarily tied to individual perceptions and interpretations of how to act: knowledge is memorized in rules of perception and in rules of conduct. In other words, knowledge will always have a subjective quality since all information that reaches the mind depends on individual categories and individual dispositions. Knowledge is also largely dispersed in a society. Every individual will acquire only so much knowledge as he needs for his own interpretation of the world and for his own actions. Again, the individualism of Hayek's theory is made plausible.

We can think about two ways to solve the problem of dispersed knowledge. On a mental

level, we find the solution in the dispositions. These solve the problem of dispersed knowledge since they contain more knowledge than an individual is able to collect during his lifetime. In addition, Hayek connects dispositions with the concept of tacit knowledge. Individuals act not only according to their own genetic background and individual experience, but also according to primary dispositions that developed over time in society and contain societal experience. Dispositions contain the knowledge that previous generations have accumulated. An individual is enabled to use all knowledge that is stored in the traditions of a society without knowing that he is using it. For this, tradition does not only store the knowledge of a society but it helps an individual refer to more knowledge than he could acquire on his own. The other way out proposed by Hayek plays on a political plane. Government can ensure that the members of society are able to use the traditional knowledge stored in the societal pattern of actions (the primary dispositions). If only the members of a society were allowed to act in conformity with their tradition, the use of such knowledge in a society would be enormous. The request that government should ensure tradition is a very difficult one. Because of its tacit nature, traditional knowledge

does not seem rational. Tacit knowledge is not open to processes of criticism. Rules that bear this knowledge cannot be entirely explained since it is connected to specific cognitive mechanisms, as classification is. Hayek mentions this problem in the “Sensory Order” by stating that the mind cannot explain complex phenomena allocated on the same level on which it is operating.³

4. Hayek’s theory of cultural evolution

Hayek’s theory of cognition leads directly to his theory of cultural evolution. Hayek connects the individual invisible mental processes with the visible results on a societal level. As shown in the preceding section, individuals act by referring to abstract rules of actions, the dispositions. It is not sufficient to speak about dispositions only in the sense of rules of perception and action. Hayek stresses particularly dispositions

that endow moral rules because they are the most important building blocks of societal order. Moral rules are abstract rules or dispositions that an individual follows when acting “morally”. We may only speak about a societal order if a predominant number of individuals submit to specific dispositions, that is, submit to a certain moral rule. We will refer to this fact below. Hayek understands morality as a guideline for individual acting made up of moral rules, certain legal rules, and customs.⁴ Only the combination of these rules can bring forth beneficial outcomes for the whole society.

Hayek, in following Popper (Popper, 1966), distinguishes the “small” from the “large” society, and refers both to historic and to current processes of development. Both methods of observation allow for two different kinds of morality: the morality of the small group and the morality of the large society, respectively.

Hayek’s theory of cultural evolution starts with the concept of a “face-to-face society” in which

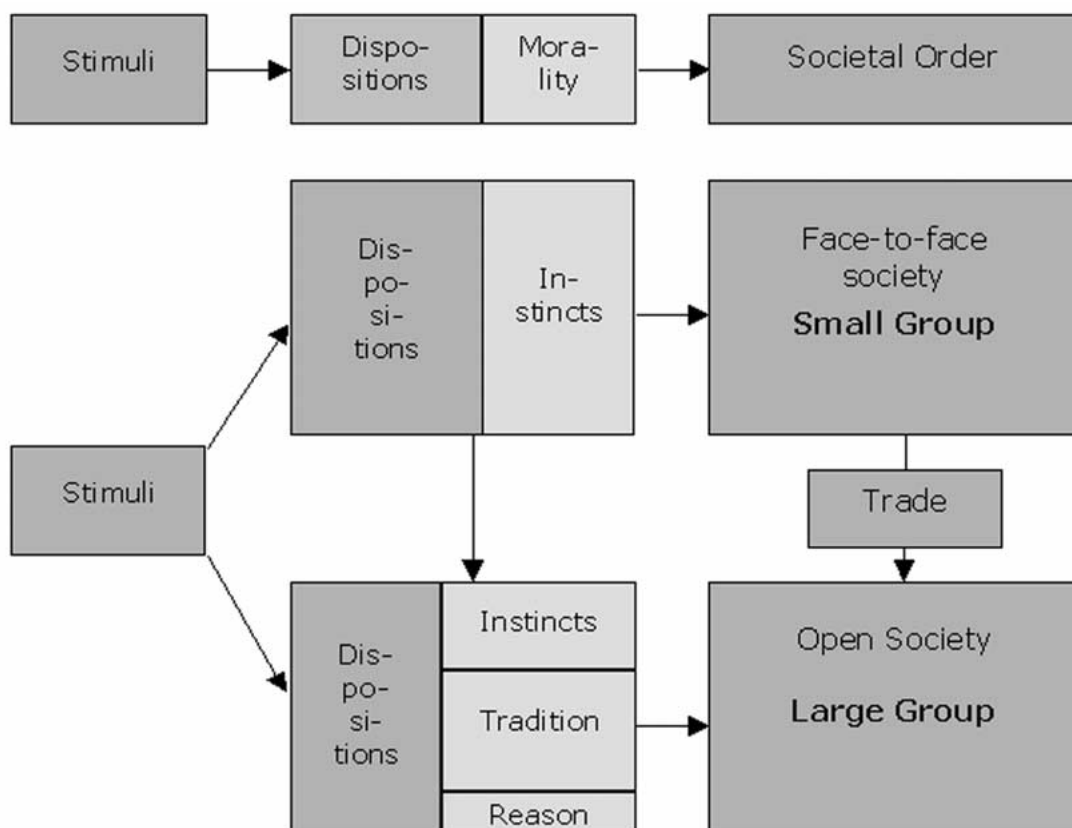


Figure 2.

genetic instincts are prevalent; this, in turn determines the development of the mind. Small groups with 10–15 members – usually groups of relatives, such as gatherers and hunters – emerge together with strong links between one another. Instincts play the decisive role in ensuring the best available adaptation to the prevailing environment. They are the best response to the stimuli that reach the individual. Instincts are Hayek's moral rules of small groups or his "natural morality" (Hayek, 1979, pp. 153–176 and Hayek, 1988, p. 12). They help control and ensure cooperation among group members. This form of cooperation has been established by trust; the behavior among the members is ensured by altruism, solidarity, sympathy and group decisions and is considered the morality of the small group. Seen from a historic perspective, members during this stage share the same perception of the environment, aims, risks, and threats since they developed similar dispositions.

The crucial step forward occurs during a stage in which trade becomes a common pattern of action. The possibility to trade with humans outside the group leads to the "division of labor" and specialization and thus, to the division of knowledge. Trade cannot be based on collective knowledge but needs the establishment of conditions that permit these activities to flourish. Without a doubt, there is a need for a new mechanism. Private property rights emerge as a substitution for common ownership. Hayek, following Hume and Smith, points out that private property is the fundamental principle of cultural evolution (Hayek, 1988, chapters 2 and 3). These new phenomena make it possible for the group to grow richer and faster, but one of the consequences of this process is the separation of goals for different members. Knowledge, varying from person to person, leads to a different perception and to different individual cognitive frameworks.

At this point, the group and its behavior changes and a new social order arises. The gradual replacement of innate responses by new rules, perceived and learned from outside the group, accounts largely for human evolution. The instincts themselves do not lead to a more beneficial life. Their gradual suppression,

together with their replacement by new rules of conduct may lead to a new order.

Only at this point does Hayek's approach of overlapping dispositions come into action. Human behavior in small groups generally shows a high degree of similarity because of common perception of the environment; it can be easily controlled by other group members. The character of rules now changes. Different dispositions overlap with new rules. Regulations, often consciously, leave certain areas open for individual action while prohibiting other activities completely – a fact that permits individuals to share their knowledge. Hayek calls these new sets of rules the "morality of the large group" or of the open society. They include frugality, fairness, property rights, trade and competition. Hayek's writing follows David Hume's thoughts about the morality of property and honesty, which, in the extended order, ensures cooperation. Over time, these rules have become increasingly established inside societal tradition and transmitted through the cultural process of socialization. Tradition, as mentioned before, stores knowledge that turns out to be mainly tacit knowledge for individuals. Rules of morality form a part of culture and are constantly in change. In addition to tradition, reason also plays a role in determining current societal evolution. However, its impact is a limited one since reason is a "thin layer of rules, deliberately adopted or modified to serve known purposes" (Hayek, 1979, p. 160). The rules of morality as a whole, bearing in mind the above mentioned problem of explanation of complex phenomena, cannot be understood as long as tradition operates on a different plane than reason.⁵ Nevertheless, individual action, by finding out inconsistencies in certain rules, eventually alters these rules and, according to Hayek, contributes to the development of society. This central point constitutes Hayek's concept of "immanent criticism" (Hayek, 1988, p. 69) that leads the individual to solve the inconsistency between general patterns of action and the requirements that are predisposed by his environment. Insofar as the individual is able to deviate from his actions, deviation is necessarily limited to what he perceives. The individual obviously needs to perceive a negative feedback

between an existing rule of action and its unsatisfactory outcome.

5. The development of a society: changing dispositions and moral behavior

The important contribution of Hayek, as already sketched in the historical perspective, is that the individual predisposition to perceive rules from outside the group (society or subgroups) allows for a process of individual selection as well as group selection.

Let me give a deeper insight in the selection processes discussed by Hayek. The development of society starts on an individual level. The first evolutionary process is individual selection, referring to the perception of rules that are slightly different from those already existing and leading to the creation of new rules. It is, in Hayek's cognitive framework, a process that operates on an individual plane. The decision to act according to a certain disposition is the result of an individual process of trial and error; it is a process in which the individual responds to an outside stimulus referring (or not) to the dispositions that reflect group behavior. If the individual deviates from the "common" rules of action because of his awareness of a better rule or his increased subjective knowledge and he is shown to be more successful than when he acted in common, he will be imitated by other members of the society or his group. The more individuals follow this process of problem solving, the faster the rule becomes a part of the group's dispositions: a new tradition emerges. Vromen (1995) calls this kind of behavior "within-group imitation." Likewise, moral rules may also be accepted directly from other groups. If an individual cannot change his behavior inside his group, he may still migrate to a group that either already practices the new rule in question or offers more tolerance toward deviators.⁶ This process, according to Vromen (1995), is called "between-group migration." Hayek is able to show that the development of dispositions is a continuous process. This depends largely on the qualities of dispositions, which are not permanent as Kant suggests.

A second step in the historical interpretation of cultural development is the working of a group selection mechanism. The group selection process rates the new social order; it shows if the new result is more beneficial for the group as a whole compared to the situation before the individual selection took place. Hence, the key criterion in the process of individual selection is individual fitness; in the case of group selection it is the fitness and thus the growth and survival of the group.⁷ Hayek stresses the importance of group selection in overcoming the problem of limited knowledge. Again, the government should enable group selection, as we will learn later.

6. Ethical codes

Given all of this, we may now be able to shift our focus from a more theoretical view to a practical one. We can apply Hayek's theory of cognition and all its implications regarding the knowledge problem to the field of business ethics. As we have learned, a social order is formed by a collection of behavioral rules – rules of action – stored in individual dispositions. We may interpret the set of abstract behavioral rules governing a society as a code of conduct, valid in a specific time in a specific society.

Nevertheless, societies are not homogeneously structured. Large societies as modern societies in particular are, are characterized by many subgroups. Families, clubs, church communities, firms, and so forth can each be considered a subgroup. In every group, we can find specific behaviors shared by its members. One subgroup in which the morality of the small group is strongest is the family. As a whole society develops through time, so do the subgroups. In the 1950s, the family was characterized by a more authoritarian behavior of parents regarding their children and the predominance of the husband in family decisions. We now see that the rules governing a typical family have changed.

The same development of rules of conduct happens with the ethical codes of firms. Firms

always operate by submitting themselves to specific codes. We know that even medieval small enterprises submitted themselves to the ethical codes of their guilds. When trade in Renaissance times expanded, internationally operating firms struggled to be seen as reliable traders in foreign countries. An important institution was the commercial court, which had not only the duty to settle conflicts, but was a signal to foreigners that traders were reliable men who submitted themselves to extra governmental judgments. In modern societies, firms and international corporations have the same incentive, to be seen as reliable and trustworthy for the gain of good reputations. For that, businessmen have to show that they operate in accordance with ethical principles.

It seems obvious that entrepreneurs who socialized in a specific environment act and do business in accordance with ethical rules that are valid in that time and that place. They apply them unconsciously and follow traditional rules of acting. Like any rule that is followed implicitly, ethical rules are difficult to make explicit. The act of writing down the rules a business should be governed by is a complicated one. Written business codes are very vague. Since they are confronted with the knowledge problem, business rules need to be abstract; their application differs from case to case, which makes any strict definition impossible. No one knows what a specific action will require and what will influence a future action. Business codes tell us nothing more than the actions we expect of a business firm. Hence, business codes must be widely acceptable in a society. This acceptance not only derives, as often supposed, from an underlying mutual gain, but also from following or applying traditional rules.⁸

Business codes first evolve, as does every moral rule, in the minds of the members of a society; they reflect traditional business practices. The way societal codes change is the same way business codes may change. They evolve through an adjustment to environmental necessities. Referring back to Hayek's theory of social evolution, this is not the only method of development but is the most important method for moral rules. Business codes, a demonstration of social

responsibility, are subject to public discussion of obligations, taking place in legislatures, lecture halls, business journals and other public forums (Arrow, 1973).

In the last decade, we see a development of the business ethics codes insofar as the shareholder concept was widely discussed against the newer stakeholder concept. The older concept, with Friedman as its prominent advocate, sees the goal of the firm as maximizing profits for shareholders.⁹ The stakeholder concept – an adjustment to a changing environment in which the firm is operating – developed due to the increasing significance of environmental issues (pollution, ozone concentration etc.) and the influence of consumers, suppliers and communities. Companies are not only requested to be socially responsible to their shareholders as owners or capital providers, but also to the environment, suppliers, employees, and the community.¹⁰

Until now, we have referred to changing rules in a certain society and its subgroups like families and business firms. The question arises whether we can apply the concept of development of moral rules not only to one society but also to every existing society. Is it plausible to think that we may find in every society of the world the same or at least very similar human dispositions in order to act according to universal moral rules? We may find, as Werhane (2000) suggests, at least a widespread agreement in every culture that human suffering, poverty, preventable disease, high mortality and violence are social bads. Can there be a legal and moral framework that aims to reduce these bads that is accepted by the inhabitants of every country? In accordance with the concept of division of knowledge, Hayek clearly points out that

not only do we not possess such an all-inclusive scale of values: it would be impossible for any mind to comprehend the infinite variety of different needs of different people which compete for the available resources and to attach a definite weight to each. . . . The point which is so important is the basic fact that it is impossible for any man to survey more than a limited field, to be aware of the urgency of more than a limited number of needs (Hayek, 1944/1994, p. 65).

It follows that there exist only a few very abstract universal moral rules that will be accepted by every member of the world. There have been attempts to record such universal rules. One of the most prominent examples is the Bills of Rights. We find these in every democratic, Western-oriented constitution. These rules are fundamental rights, intended to protect individual liberty by excluding arbitrary governmental coercion. The rights expressed in the various Bills of Rights are not the only ones that protect individual liberty. As society develops, so will new individual rights or other individual rights gain significance. As Hayek points out: "Those which are commonly explicitly named are those which at particular times were specially threatened . . ." (Hayek, 1979, p. 110).

We should be aware that when speaking about ethical codes, codified principles only form one part of the plethora of uncoded and unconsciously accepted principles we adhere to.¹¹ The majority of moral rules is followed tacitly insofar as these kind of rules are traditional rules, developed in a slow societal evolutionary process. A complete ethical code can never exist because of the impossibility of knowing all the rules underlying individual action worldwide. The attempt to make at least a part of the rules mankind is acting upon explicit is of course helpful in societies with a similar traditional background. The Bills of Rights, however, have evolved in a Western tradition and cannot be presumed to be accepted as guidelines in every part of the world. We cannot conclude that every society has built up the same dispositions. Recalling the qualities that underlie Hayekian dispositions, we can be sure that this state of affairs is subject to change. If we take into account that societies may be able to contact each other, then a learning process may begin that will lead to an adaptation or replacement of dispositions. Nevertheless, all of these processes are individual, only partly conscious, and not necessarily imposed by government or supranational organizations. To refer to consciously accepted universal principles in terms of values of mankind, as Bowie (2001) does in mentioning the principles found in the UN Universal Declaration of Human Rights, the European Convention on Human Rights, the

Helsinki Final Act, and the OECD Guidelines for Multinational Enterprises and Social Policy, is a misleading concept. Although the UN Universal Declaration of Human Rights contains the individual rights of the Bills of Rights, it adds also "social and economic" rights that stand in contrast to the general and abstract meaning of the former. Whereas the older rights aim to subject every individual (and government) to the same right, the newer rights aim for a specific outcome: the entitlement to holidays with pay or the claim to just and favorable conditions of employment and of work. These are not equivalent to the abstract rules of conduct valid for everyone at anytime.

To sum up, universal ethical codes need first common agreement in order for people to act by reference to them. Such an agreement on an international basis is only to be expected if the rules of the code become fewer and more general in character, not more specific and outcome-oriented.¹² An approach describing rules as universal would lead to governmental rule setting and oversees that moral rules are usually followed implicitly and thus not accessible to reason. The misunderstanding lies in the circumvention of group selection processes – and partly of processes of individual selection. These processes in the end will show which ethical code may emerge and foster the survival and growth of the world population.

7. The role of government

Until now, we have stressed the importance of individual acting with respect to the development of rules of behavior. We have described societal evolution as a result of individual selection as well as group selection. We have so far largely neglected the importance of governmental action and collective acting regarding the evolutionary processes. In order to understand the role of government from a classical liberal standpoint, we must again refer to the knowledge problem. As we have seen, knowledge is widely dispersed in societies. Every individual, though being able to use more knowledge than he knows by adhering to traditional rules, utilizes only so

much knowledge as he needs for achieving his plans.

This state of affairs raises the question of whether there can be a mechanism that collects all the dispersed information in a society. There are two answers: the government or the market process. Hayek strongly rejects the first choice and clearly prefers the latter. A market is a spontaneous order that, through prices (under competition), delivers to individuals all the information they need; it helps “to utilize the knowledge of many people without the need of first collecting it in single body” (Hayek, 1952/1979, p. 177). A market is therefore a dispersed knowledge transmitting system – “an instrument for communicating to all those interested in a particular commodity the relevant information in an abridged and condensed form” (Hayek, 1952/1979, p. 177).

This statement has far reaching implications: if the market system is an instrument of knowledge transfer and, therefore, an instrument for achieving additional subjective knowledge, it should be protected from interferences which distort the price mechanism. Here exactly lays the main task of a government.

In order to fulfill this task properly, a government has to provide or to protect an already existing legal framework. Such a legal framework offers the “rules of the game” that are valid for every member of the society and are intended to last for long periods. The framework consists of the Rule of Law, general principles laid down beforehand enabling the members of society “to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one’s individual affairs on the basis of this knowledge” (Hayek, 1944/1994, p. 80). These rules determine the conditions under which the available resources may be used but they do not tell the individual for what ends they should be used. Examples of such rules are those governing private and criminal law, they also apply to constitutional codes and the Bills of Rights. Moreover, there are rules in a society that are not legally fixed. These are the moral rules and customs of a society. All these rules, together with the public law, form the framework for individual and governmental action. Hayek’s

focus on traditions implies that these Rules of Law can develop in different ways. Alternatively, they can develop spontaneously in the above – mentioned selection processes; very few of them are set deliberately. The important feature they share is their abstractness; they are guidelines for human action that leave the social (and of course economic) outcome open.

The proper task of government in a classical liberal society consists largely of helping individuals achieve their plans and goals based on individual knowledge. To this end, a government should seek to improve the legal framework wherever possible. However, it implies that government is not supposed to suppress the selection process that leads to a new framework. The danger behind is that governments are likely to be much more in favor of an intervention. The results of a selection process are largely unpredictable since neither a politician, nor a majority of voters, may act without cognitive limitations. Whenever government is not acting as a “government under the law,” its actions may turn out to be a means of coercion and of suppression of market processes. Interventionism as a political principle that pursues well-specified outcomes contradicts the mechanism of any spontaneous order and has therefore, been rejected by Hayek. Though Hayek speaks in favor of interventions for well-specified and exceptional cases, he fears that such policies will eventually lead to an expansion of governmental actions. Governmental interventions themselves bring forth new situations that need further intervention, leading to a vicious circle.

Following the Scottish philosophers, Hayek regards the government as a “government of law and not of men or of will”. Hence, the government needs to act as any other member in the society, in accordance with the legal framework that has largely developed in a spontaneous way. A government should be subject to the same legal restrictions as every individual in society. However, the position of government is a special one: government plays the role of a *primus inter pares* with the duty to protect the legal framework so that a spontaneous order may further develop.

At this point, it is important to explain Hayek’s

thoughts on the impossibility of collecting knowledge in a society. He sees no reason why government should not be subject to the same cognitive restrictions as every individual. As Hayek points out (Weimer and Palermo, 1982, p. 325):

The essential knowledge is possessed by literally millions of people, largely utilizing their capacity of acquiring knowledge that, in their temporary position, seems to be useful. Now the conveying to any kind of central authority all the knowledge an authority must use, including what people know they can find out if it becomes useful to them, is beyond human capacity (or at least in trying to compile, it takes so long that it is no longer useful).

He stresses again the same thought in his last work when claiming that “this dispersed knowledge is *essentially* dispersed, and cannot possibly be gathered together and conveyed to an authority charged with the task of deliberately creating order” (Hayek, 1988, p. 77).

To sum up, the proper task of government is to protect the legal framework in order to permit individuals to pursue their goals. Individuals in a competitive environment have incentives to bring forth new solutions and rules that are beneficial to them and eventually turn out to be beneficial to the whole society. As to the protection of the mainly spontaneously developed framework, government has a coercive role in the procurement of public services and activities that reduce transaction costs in economic processes.

8. The problem of developing countries: a short example

Bearing in mind Hayek’s explanations of cultural evolution, we are able to view the problems of developing countries in a different way than they are usually regarded. Hayek’s approach also offers a possible explanation of why the attempts at helping these countries are mainly unsuccessful.

The question is whether, seen from a classical liberal standpoint, it is possible to interfere in the societal evolution of developing countries and, if so, who should do this. In the past, there have been many attempts to help: monetary transfers

with or without conditions (in the last few decades the International Monetary Fund and the World Bank lent money only under the condition of economic reforms), technological and infrastructural programs, and political help (sustaining a specific government) were given. Despite foreign aid, many of these countries are lagging behind in terms of growth in per capita income.

An explanation of the unfruitful attempt to promote development processes can be found in the highly criticized writings of Lord Peter T. Bauer (1971).¹³ He tries to explain the failure of the development aid policy by reference to the traditions of the people of these countries, which Hayek calls the tradition of a small society. Recalling what Hayek says, we may see that this tradition does not support any “morality of an extended order”.

Bauer (1971, p. 84) puts it similarly:

Economic development requires modernization of the mind. It requires revision of the attitudes, modes of conduct, and institutions adverse to material progress. The attitudes, mores and institutions of large parts of the developing world differ radically from those that have promoted the material progress in the West over the last millennium, especially those that have prevailed in recent centuries. The mores and institutions of developing societies are often closer to those of much earlier stages of development in the west.

Both Bauer and Hayek refer clearly to the fact that individuals in developing countries have different dispositions than individuals in developed ones. In addition, Hayek (1988) mentions that people who live in suburbs of developing cities such as Mexico City, Jakarta and Bombay have not yet fully adapted to the traditions, morals and customs of a market economy. If we recall the Hayekian theory of societal evolution in Figure 2, we see that these people must struggle to leave behind the morality of the small group in order to survive in the extended order of the market economy.

A slightly different approach is found in Werhane (2000), referring to different mental models between cultures. Although she claims no interference due to different translations of

perhaps equal underlying moral rules, she appeals directly to businessmen of developed countries by not bringing the mental models of their society into the developing world. If ideas of the extended order such as free enterprise and private ownership reach people of the Third World, these values will destroy their traditions and social networks that are common in small groups. She calls for modified versions of Western values in order “not to destroy the fabric of a particular set of social goods, or replace that fabric with a new ‘good’ that destroys, without replacing, all the elements of that culture” (Werhane, 2000, p. 359). On first glance Werhane’s, Bauer’s and Hayek’s results seem the same, but there is an important difference. Werhane is, like Hayek and Bauer, aware of the impossibility of a sudden shift from a small group to a large society due to attitudes that cannot change in a short amount of time. Social evolution is a long-term process. In order to quicken social development without destroying old values, Werhane argues that businessmen should try to comprehend what mental models or values are operating in the country where they plan to operate. The resulting questions are: can such a conscious modification of Western values really work? Are businessmen able to free themselves from their own values? We must take into account that Western values have evolved and are working properly in their own environment. Western companies will have difficulties perceiving and understanding the specific moral traditions of those countries that have undergone a different process of societal development and, conversely, will not be understood by individuals in developing countries. Therefore, it makes sense that companies cautiously approach new cultures. Werhane shows, in a few examples, where a rigid imposition of Western values did not work and where the traditions of the developing countries were destroyed. She mentions the failed transportation of the Anglo-Saxon law system into Indian law, or Western commercial law to Russia.

The problem behind these examples is not Western values *per se*, but the forced governmental imposition of foreign values not developed in their own society. Following Hayek, we learn that both the members of the society and

the government are affected by the limited knowledge problem that brings forth unwanted results or at least results that the members want to avoid. It follows that a severe control mechanism must be installed in order that members act according to the imposed rules. Finally, the government must be able to adjust all the unpredictable results since it can never know everything that will influence a specific action.

Let me return to a problem in developing countries that is often viewed as secondary. It refers to the role of government in developing countries. Many developing countries suffer from institutional problems that trace back to the traditions of the small group. The lack of separation of powers creates a potential for coercive government. Hayek refers to this problem when designing a constitution for countries that have adopted “the institution of democracy without the foundations of beliefs and convictions presupposed by those institutions.”¹⁴

It is not helpful here to explain in depth on what criteria such a constitution is built. The very fact is that a constitution primarily shows the rules of allocation and of limiting governmental power. The aim is to ensure, as I show above, the working of the abstract rules in the legal and traditional framework. Imposing a “model constitution” that favors the proper democratic behavior of political actors would give Third World countries a real chance to develop democratic dispositions. This aim does not stand in contrast to the aforementioned non-interference principle. A constitution does not give any advice on how to behave in specific situations. It is never an agglomeration of legislative guidelines for specific circumstances. The basic aim of such a constitution should indeed be not to define the functions of government but to define the limits of its coercive powers.¹⁵

The “model constitution” can be used in every country that is willing to become a democracy, whether developed or developing. Nevertheless, developing countries may not give the same importance to rules governing the extended order of Western countries such as private ownership and many others previously mentioned ethical values. In addition, a transfer

of a democratic political system to the developing world risks coercion through western institutions. In such a case, the dispositions to adopt this system would be absent and the control costs of Western countries would be too high. On the other hand, if desired by the people of developing countries, a democratic system based on the real division of powers is a great chance to change old, unfruitful behavior. This may be seen as a process of individual selection inducing imitation, in that members of the developing country realize other countries are better off when governed by a different political system.

The key argument of Hayek, Bauer and Werhane is the necessary development of mental models and dispositions in developing countries that submit to the values of the extended market order. Nevertheless, these values should be forced neither from Western institutions nor from Western corporations.

9. Conclusion and some critique

Hayek's contribution to business ethics is based on an individualistic approach. His explanation starts with individual choices that may build a moral and societal order. While focusing on the spontaneousness of the process, he does not limit his explanation to the outcome but highlights the role played by moral rules that themselves evolve spontaneously.

Hayek, in adopting an evolutionary approach to ethics, argues that rules develop historically responding to the environment the individuals are facing. Therefore, moral rules are not immutable. Moral rules are not the result of human or supernatural design. In rejecting a transcendent ground of ethical rules, Hayek assumes an ethical naturalist standpoint, seeing moral rules as naturally evolved ones. Walker (1986, pp. 36–37) comprehends Hayek as a representative of ethical objectivism: Moral rules do reflect “a solid, objective meaning, a meaning beyond the internal experience of the person holding or espousing them.” Now Walker (1986, p. 59) criticizes Hayek of lacking “any objectively valid, self-evident ‘good’ in which to anchor his system of ethics.” Granted, Hayek as an evolu-

tionist sees the “good” in individual behavior. This behavior, though, is able to promote cultural evolution and therefore the survival of societies that find themselves in an ongoing process of competition. The meanings of “right” and “wrong” are therefore only related to individual action that affects and changes the societal order itself. These moral rules have a definite purpose, even if the acting individual itself uses them in order to achieve other, individual goals. Hayek (1973, p. 113) differs at this point from Kant, arguing “Kant’s denial of purpose is justified only so far as the application of a rule to a particular instance is concerned, but certainly not for the system of rules as a whole.” He in particular disagrees with Kant’s “attempt to turn what in law is a test of justice to be applied to an existing body of rules into a premise from which the system of moral rules can be deductively derived” (Hayek, 1976, p. 167). The objective meaning of Hayek’s moral rules stands therefore in contrast to Kant, who sees morality derived from pure reason. Individuals, according to the latter, act morally when they do not act on inclinations or the desire to be known as good persons. Instead, virtuous people act consciously following a universalized moral law. Hayek, although accepting the test of universalizability for some rules that apparently conflict with their ends,¹⁶ emphasizes cultural rules as the bearers of tacit knowledge. Recall at this point that the majority of rules, and moral rules in particular, are not accessible to reason. These arguments exclude rational design of rules. They are however subject to rational critique and improvement. Hayek, in referring to Popper calls this procedure “immanent criticism”. Behind “immanent criticism” stands Kant’s test of universalizability that Hayek only accepts when applied to single rules.

He clearly refuses its application to rationally discuss the outcome of the individual actions, namely the order itself. The social order is a game. Whether it is “just” or not refers only to the rules of the game but not to its result.¹⁷ It is possible to correct the outcome of the game “only by assuring that the principles on which it rests are consistently applied” (Hayek, 1976, p. 143). In referring to the test of universaliz-

ability, he argues (Hayek, 1976, p. 143) that if government sees a need to “assist particular groups”, it needs to achieve this by acting “on the same principle in all similar instances.” These particular groups are composed of individuals that cannot adequately maintain themselves on the market. Note however that “corrections” of this kind do not correct the order itself but help certain individuals to e.g. live without income.

One may furthermore criticize the concept of evolutionary stages in a society and the predominant rules in those as described in his theory of societal evolution. The moral rules developed at the earliest stage of evolution, show Hayek’s affinity to Hume since both reduce ethics to individual feelings like altruism and solidarity. We should however take into account that Hayek regards these feelings as deeply ingrained in individuals, he refers to them as “instincts” rather than as “morality” (Hayek, 1988, p. 12). This does not imply that altruism and solidarity have no moral value. It shows that Hayek sees individuals endowed with these values, “fixed” in the neuronal map of their brains and linked to their dispositions. Insofar, Hayek distances himself from a Hobbesian world. In a next stage of societal evolution, the role of ethics could be seen as reduced to culture. True is that Hayek emphasizes culture and tradition. Nevertheless, he has shown that individuals rely on evolved cultural norms in much the same way as they rely on the small group values. Since these values need to be learned they are subject to more criticism than the inherited ones. Outer doubt, the rules learnt in early childhood – an impressive example which does not refer to moral rules is the learning of the language by a child – “become as much part of our personalities as what governed us already when we began to learn” (Hayek, 1988, p. 17). This however does not mean Hayek would reduce small group morality to feelings and large group morality to culture. Instead, he stresses the importance of the different values in each stage of development. Recalling the cognitive model, we observe that Hayek’s dispositions are not only a matter of feeling but also a matter of the environment in which the individual is living, the experience of the species and his own experience and reason.

Stimuli, as well as information about his environment are responded in different ways. The response does not only follow individual dispositions but also the evolutionary historical stage in which the individual is living. Insofar, an individual is not a “tabula rasa” at the beginning of his life but already endowed with the morality of the small group. During his lifetime, he has to learn to apply also the rules of the societal stage he is living in. This will happen mainly in a socialization process induced by parents, teachers and other important figures of his life. The rules that form both kind of moralities are not given by god or any authority, nor are they mainly the result of a conscious design but the best spontaneous adaptation to social environments which may promote the social order.¹⁸

Hayek has argued throughout his works that adhering to societal rules does not only reduce transaction costs but brings forth a spontaneous order, which may be the most efficient order. However, neither the individual nor the society can judge the results by measuring the efficiency of the rules or the spontaneous order. Only group selection, the “slow test of time” according to David Hume, can measure efficiency in terms of societal development. This utilitarian perspective of morality is immanent to any evolutionary theory. Hayek (1988, p. 62), although rejecting crude utilitarianism, which stresses that it is “unreasonable to do anything unless its effects are not only fully known in advance but also fully observable and seen to be beneficial”, favors rule utilitarianism, which emphasizes the efficiency of rules established in a given society. Rule utilitarianism recommends the adherence to moral rules in order to form expectations and coordinate actions. If and only if people follow these rules, society as a whole may reach a faster growth.

In emphasizing spontaneously developed rules and rejecting transcendent moral rules, Hayek may be blamed to support ethical relativism. In fact, he rejects a “good” *per se* and he underlines that a rule (either moral or legal rule) can only be considered as “good” in its relation to the whole system of rules that form the social order. This problem appears in the context of ethical codes and the impossibility of a whole system of

universal ethical rules. The question behind is whether ethical norms developed in specific societies are always “right” or “good” or if they and the actions following thereof may be judged following objective supra-cultural standards. Hayek considers “right” or “good” as related to the traditions of a society. Thus, if we cannot or do not want to refer to transcendent ethical norms we may apply cognitive theories to explain why societies have developed certain practices. Cognitive theories explain how individuals perceive their environment and how they respond to it. Cognitive approaches can tell us how rules are translated into behavior. Insofar, individuals in the society under consideration translate rules into their own meaning. They do so in referring to abstract rules that enable individuals to “move successfully in a world very imperfectly known” to them (Hayek, 1973, p. 30). Among other social scientists, Hayek may be considered as the most prominent economist that developed such a theory in order to explain moral behavior in societies.

However, arguing in favor of universal rules would imply that we can explicitly define them and impose them on every society.¹⁹ This constructivist view advocates for a strong government, which should be able to make implicitly followed rules explicit. Note that no explicit rule, especially if legally enforced, can have further evolution.

I therefore conclude that, if societal and business ethic codes are made explicit, they should be kept very abstract in order to be adaptable to unknown future circumstances. If codes of this kind have been made explicit by government or by supranational institutions, they cannot merely act as guidelines for members of society any longer, but will instead dictate directly individual behavior. Individual is rendered impossible, and by undermining individual choice, society deprives itself from further development.

Hayek’s main concern about interference in developing countries is that individuals are imposed upon by foreign values in order to accelerate societal development toward Western standards of life. A problem will arise when explicit rules do not reflect implicit ones, illustrated in the way that developing countries struggle with

western ethical rules. Hayek and Lord Bauer support “immanent criticism” in order that individuals may choose new values through imitation that are in accordance with their traditional rules. Human reason, the third component of individual dispositions will be able to apply the test of universalizability to proof the consistency of a new rule with the already existing framework of rules. In order for development of Third World countries to proceed without outside pressure, developing governments should be restricted in their coercive power. Only a slow development will bring forth a new social order that will be accepted by its members. The result, of course, is not necessarily a society that is based on the same values as ours.

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Notes

¹ The model is clearly not one of behaviourism insofar as the individual responds actively to stimuli in classifying them.

² Hayek (1952, p. 97) The organism is not only prepared to react because of certain combinations of stimuli but the organism has “also a special receptivity for certain classes of stimuli.”

³ Hayek (1952, p. 185): “The capacity of any explaining agent must be limited to objects with a structure possessing a degree of complexity lower than its own. If this is correct, it means that . . . the human brain can never fully explain its own operations.” See also Hayek (1967, p. 61). In his article “The Sensory Order after 25 Years” (Hayek, 1982), admits that the proof he had given was inadequate; nevertheless, the conclusions about the limited possibilities of explanation are of considerable importance.

⁴ These are, according to Hayek, the Rules of Law that contain the rules of the private law, criminal law, and rules laid down in constitutions and the Bills of Rights.

⁵ Woodward (1998, p. 143) comes to the same conclusions: “In short, humans inherit innate inhibitions,

mediated psychologically by early childhood experience, and dependent also on neurophysiological integrity, over which are laid cultural norms and the capacity for reasoning (and rationalization)."

⁶ The possibility of deviation depends on the degree of reputation as Hayek (1979, p. 204; Fn.48) says: "Though present morals evolved by selection, this evolution was not made possible by a license to experiment but on the contrary by strict restraints which made changes of the whole system impossible and granted tolerance to the breaker of accepted rules, who may have turned out a pioneer, only when he did so at his own risk and had had earned such license by his strict observation of most rules which alone could gain him the esteem which legitimized experimentation in a particular direction."

⁷ The criteria mentioned show Hayek as a fellow of rule utilitarianism. See especially Yaeger (2001, ch. 4).

⁸ Hayek (1988, p. 13) "For instance, although learnt, morals do not necessarily always operate as explicit rules, but may manifest themselves, as do true instincts, as vague disinclination to, or distastes for, certain kinds of actions."

⁹ An interesting critique of this concept comes from Lucas (1998, p. 60): "Businessmen do have some, although only limited, room for making decisions; they are not being irrational if they take into consideration a wider range of concerns than simply maximizing immediate individual profit; and their legal duties do not exhaust their obligations generally. In deciding what to do, and justifying their decisions afterwards, there are a variety of reasons, for and against, the different courses of action open to them, these reasons not being necessarily confined to maximizing profits while keeping within the law."

¹⁰ The Johnson & Johnson Credo is a often-cited example.

¹¹ Hayek (1978, p. 8) argues that human beings follow three types of rules of behavior whereby rules that are consciously set by government form a minority. In his own words, these are "(1) rules that are merely observed in fact but have never been stated in words; if we speak of the 'sense of justice' or the 'feeling for language' we refer to such rules which we are able to apply, but do not know explicitly; (2) rules that, though they have been stated in words, still merely express approximately what has long before been generally observed in action; and (3) rules that have been deliberately introduced and therefore necessarily exist as words set out in sentences."

¹² Hayek (1944/1994, p. 243) shows the problem:

"In a small community common views on the relative importance of the main tasks, agreed standards of values, will exist on a great many subjects. But their number will become less and less the wider we throw the net; and, as there is less community of views, the necessity to rely on force and coercion increases."

¹³ On May 9, 2002, Lord Bauer would have received the Cato Institute's Milton Friedman prize "for the advancement of liberty." Lord Bauer died May 3, 2002.

¹⁴ Hayek (1979, p. 108). Hayek stresses that, "if such attempts to transplant democracy are not to fail, much of that background of unwritten traditions and beliefs, which in the successful democracies had for a long time restrained the abuse of majority power, will have to be spelled out in such instruments of governments for the new democracies."

¹⁵ Hayek (1979, p. 109). The main concern is a division of powers between the two representative bodies with two distinctive functions. For this, Hayek claims a legislative and governmental assembly is needed. Only if the two bodies have completely different tasks they do not become a tool to assist in the achievement of particular ends.

¹⁶ Hayek (1967, p. 168) states that "values can always be tested only in terms of other values. . . . The test (of universalizability, E.G.) is thus in the last resort one of the compatibility or non-contradictoriness of the whole system of rules, not merely in a logical sense but in the sense that the system of actions which the rules permit will not lead to conflict."

¹⁷ Hayek (1976, p. 117) "In such a game nobody 'treats' people differently and it is entirely consistent with respecting all people equally that the outcome of the game for different people is very different."

¹⁸ Hayek (1973, p. 12) "Or, to put this differently, our adaptation to our environment does not exist only, and perhaps not even chiefly, in an insight into the relations between cause and effect, but also in our actions being governed by rules adapted to the kind of world in which we live, that is, to circumstances which we are not aware of and which yet determine the pattern of our successful actions."

¹⁹ Hayek (1976, p. 104) criticizes the last seven articles of the Universal Declaration of Human Rights: "It is evident that all these 'rights' are based on the interpretation of society as a deliberately made organization by which everybody is employed. . . . We have seen that rules of just conduct which apply to everybody alike but subject nobody to the commands of a superior can never determine what particular things any person is to have."

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