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Markets, Institutions, and Morality

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Abstract

Critics of the market economy are convinced that markets will inevitably destroy the morality of individual market participants and thus contribute to major economic and social crises. Even Wilhelm Röpke, a great champion of economic liberalism, wrote repeatedly about this danger. This paper tries to retrieve the mechanisms that usually prevent the moral degeneration of the market economy and might rather contribute to some moral dividend in market exchange. As recognized already in Adam Smith's concept of the "impartial spectator" free economic exchange may go well along with private institutions in which individual morality is formed, controlled and adapted to new circumstances. Mainstream economic theory that has for a long time neglected these connections seems to rediscover them and to import the necessary concepts from other social sciences. This may also contribute to a better understanding of what constitutes a Social Market Economy.

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1. Introduction

The topic of this paper was chosen as a response to several observations and considerations:

1) In Germany some recent scandals (such as the Cum Ex deals or the Wirecard bankruptcy) have raised the question whether the market economy might suffer from an inherent moral deficit so that market participants, and in particular managers and owners of firms, are continuously driven towards cheating and fraud.
2) The worldwide debate about the causes of the climate crisis and the best strategies for mitigation is repeatedly dominated by the confrontation between ethical and economic positions that seem hardy reconcilable. The strong moral perspective became obvious in the "How Dare You?" speech in which the Swedish climate activist Greta Thunberg addressed world leaders at the UN Climate Action Summit in September 2019 and blamed them for insufficient actions.

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3) Indirectly related to these public debates is the strong sign of the rich internal debating culture within mainstream economics in the recent approach of the expansion of neoclassical welfare economics based on the assumption of adaptive (individual) preferences (von Weizsäcker 2023). This approach has the potential to integrate important insights from both behavioral and institutional economics into the neoclassical mainstream. And it may also help to analyze the formation and adaptation of morality in liberal economies and societies.

4) The topic of morality and ethics has also left its mark on the curriculum of degree programs in economics. If a German university wants to apply for international (*i. e.* US) accreditation today, it will only be successfully accredited if it can prove that it has included a particular ethics module in the economics curriculum. At Goethe University Frankfurt, for example, this led to the design of a new course titled "Philosophy, Politics and Economics" as part of the B.Sc. Economics & Business. It is expected that with this particular course we will manage to get economics and business students who often complain about too much quantitative work into a more discursive and qualitatively-evaluating mode of learning. And we should also make them reflect whether and to what extent their individual moral attitudes are formed, challenged and changed by the standard economics curriculum.

5) Finally, I owe a lot of my knowledge on this particular topic from discussing with members, doctoral students as well as professors, of the Konrad Adenauer Foundation's Doctoral Program on the Social Market Economy, in several seminars dealing with various aspects of modern market economies, the history of economic thought and the institutional setting of economic activities. In particular, I am very grateful to my dear colleague Gerhard Wegner for many hours of intensive academic exchange. To him I would like to dedicate this paper without, of course, making him in any kind responsible for its content.

Parts of the ideas that I raise in this article have been presented at the occasion of the 17th Wilhelm Röpke Lecture delivered in Erfurt in February 2023. Indeed, I take as a starting point for my analysis the fact that Wilhelm Röpke, who is generally regarded as a great liberal thinker and a fearless defender of the market economy, repeatedly warned in this works of the danger that markets might destroy morality. As morality I very generally understand systems of values, normative rules, or principles, according to which intentions or behaviors are judged to be good or bad, right or wrong. They can include judgements on the justice of income distribution or could even concern norms for peaceful living together with others. In order to reveal the reasons for Röpke's surprising conjecture I will then go very far back into the history of economic thought, even beyond the pessimism of Karl Marx and Friedrich Engels in their Communist Manifesto and the optimism of Adam Smith. I come to present a not particularly well-known German author of the 16th century – Leonhard Fronsperger – who was among the first to proclaim the positive social results of self-interested individual actions as long as they are embedded in a suitable institutional framework. Institutions are for me humanly devised formal or informal structures of rules and norms that shape and constrain individual behavior. They show some persistence and continuity but may also develop, adapt and change over time. I jump back again to the immediate present to discuss why globalized markets have not led to global peace, and what markets can contribute to the solution of the current climate crisis. In both cases I point out the importance of private institutions that can guide individual preferences to a behavior that is compatible with societal moral values. This then brings me to a discussion of the functioning of the "market for virtue," a term introduced by the sociologist Michael Baurmann (2000), that stands for the origin and development of moral values in a liberal society. It can be regarded as an example of the self-correcting institutional mechanisms in a market economy that prevents and mitigates its potential destructive forces and contributes to the accumulation of social capital. In my view this sociological analysis is closely related to an economic research agenda recently laid out by Carl Christian von Weizsäcker (2023) about the "compossibility" of individual adaptive preferences that broadens the scope of traditional neoclassical welfare economics. It comes to the conclusion that free economic exchange may go along well with private social institutions in which individual morality is formed, controlled and adapted. This is very much in line with the concept of a Social Market Economy as it was developed in Germany after World War II. The article ends with a speculative analysis of how these mechanisms will be challenged in digital market society on whose precipice we stand. We currently observe on the one hand the growing market power of big digital enterprises; on the other a collective learning process in business, academia and by state authorities how new market dynamics function, and how – if necessary – they can be best regulated in the interest of society.

2. Wilhelm Röpke and the Danger of Markets Destroying Morality

Wilhelm Röpke is rightly regarded as a great champion of liberalism in the 20th century. More concretely, one should see him as a representative of a European neoliberalism. That would be fitting if the term were not charged by the fact that it is today exclusively equated with Anglo-American neoliberalism, which deliberately negates major and historically significant differences to its European counterpart. The story of Röpke's life – the promising start of his academic career with an appointment to the University of Jena in 1924 as the youngest professor in Germany; prestigious offers from the Universities of Graz and Marburg; then persecution in Germany after 1933 that forced him to leave his home country immediately; 4 years of exile in Turkey; and finally a new home in Switzerland, from where he intensively followed and commented on German economic policy after 1945 – makes him an academic who was both attentive to criticizing undesirable developments in economics and politics as well as devising suitable countermeasures.

His analyses of the war-related international economic disintegration, which was already recognizable before the outbreak of World War II, date from the early 1940 s. He described what we are discussing again today in terms of rapid deglobalization. He saw the break-up of supply chains and the drying up of trade flows that had built up over many years and whose disappearance contemporary observers could hardly imagine. Röpke's plea for a rapid resumption of global economic exchange after the end of the war, combined with the creation of a workable set of rules, a well-organized institutional order for the world economy, are worth reading again today.

He aimed to prove how much prosperity in Europe has always been based on intensive cross-border exchange within, and beyond, the continent.

By the end of World War II Röpke had published his impressive book titled *Civitas Humana: Basic Questions of Social and Economic Reform* ([1944] 1946). At its core, the book deals with the question of how the great catastrophes of the 20th century – world wars and major economic crises – could have come about. How could they occur after, at least in Western Europe, the "good old days," a long period of peace and growing economic prosperity? Röpke identifies as one of the causes for these events the "massification" (*Vermassung)* of individuals who were detached from their traditional ties; he speaks of "processes of decomposition and dissolution in the spiritual-moral sphere, in the soul of each individual, in his or her upbringing and development, in the family itself, in teaching, in ethical orientation, in science and art, and in the imponderable regions of valuing, believing and worshipping" (*ibid.*, 246; translation by the author).

If we consider that all these processes took place in a time when – from the middle of the 19th century until 1914 – capitalism and the free market economy had become the dominant economic order in all advanced economies, it cannot come as a surprise that the great liberal Röpke regarded the market as a great "destroyer of morality[…]that presupposes moral reserves outside the market economy" (Röpke 1942, 86, translation by author). The issue that seems to have concerned Röpke deeply, and it is of concern again today whether this destructive force of the market represents, as critics of the market economy have always claimed, an inherent law of nature. Does the market therefore inevitably and systematically destroy morality? Or are those incidents in the market economy that are judged to be immoral an unpleasant side effect that can be brought under control through appropriate measures? What may be responsible for the (alleged) immorality of the market economy? And what are the potential consequences for liberal regulatory policy to secure the proper functioning of markets over time?

3. The (Alleged) Immorality of the Market Economy – Fact or Fiction?

2023 is the year of some important anniversaries. Economists the world over will remember the birth of Adam Smith 300 years ago. The Scottish founding father of canonical classical economics stands, of course, for the optimism that by means of a "commercial economy" the wealth of a nation and of all its citizens can be increased. In Germany – and especially in Frankfurt – we will commemorate 175 years of the National Assembly in the *Paulskirche.* And we should also not forget that 175 years ago Karl Marx and Friedrich Engels published the Communist Manifesto. Both the *Paulskirche* and the Communist Manifesto were reactions to a major economic crisis, on the one hand the last great agricultural crisis in old Europe, and on the other hand already one of the first economic crises of the industrial age. Both crises in the middle of the 19th century seemed to contradict the Smithian optimism of the 18th century (James 2022, 47 ff).

The Communist Manifesto offers an exciting view of the ambivalence of development of a dynamic market economy. On the one hand, Marx and Engels talk about the enormous increases in prosperity that could be realized through the release of the productive forces in the global market. On the other hand – as also later with Röpke – there is talk of the dissolution of traditional ties, massification and, of course, proletarianization, onto which Marx and Engels then focus their hopes in overcoming capitalism and ushering in a new economic order. Even though there is no explicit moral evaluation in the Manifesto, the moral failures of the market economy are seen as a fact.

My Frankfurt colleague Werner Plumpe has described the history of capitalism as the history of a permanent revolution and found the very appropriate title *The Cold Heart* (Plumpe 2019) for it. The title not only alludes to Wilhelm Hauff's fairy tale from the early 19th century, which describes the clash between traditional economic and moral concepts in the Black Forest and the modern exploitation methods by capitalist Dutch timber merchants. It also draws attention to the remarkable fact that even if market exchange had made mass consumption possible for broad layers of the population, enabling them to raise their standard of living and to escape poverty, this is often not understood as a moral dividend. On the contrary, many critics have condemned the market economy as cold-hearted and inherently immoral.

And this is still the case today as Storr and Choi (2019) have documented. If one looks at the effects of the latest wave of worldwide globalization since 1990, one finds that, at least until the outbreak of the pandemic and war in Europe, absolute poverty in the world has decreased significantly (Kharas and Dooley 2022). For the period 1990–2015, all indicators in all regions clearly show this development. China and India have been the most successful countries, benefitting the most from a growing international division of labor. Countries in Latin America and Africa that showed only little progress in the fight against poverty are typically those that did not rely on the wealth-creating forces of open markets. Nevertheless, many critical contributions demonize globalization as a great evil that has caused economic crises, poverty and climate change. And they point out a potential moral deficit of market-based societies (Sandel 2020).

So why is increasing prosperity through a market economy considered unjust and immoral, even though the material successes are impressive, and no other economic system has been able to show similar sustainable successes over the long term? It must have something to do with the fact that the connection between the pursuit of selfish interests in market exchanges and the outcome in the form of general prosperity is incomprehensible to many critics.

At first glance, this connection sounds absurd or at least illogical or implausible. Nevertheless, it stands at the very beginning of economics as a science. Adam Smith formulated it as follows: “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. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages” ([1776] 1976, I, iii) And Johann Wolfgang Goethe, who showed great interest in Smithian thought, famously confronts the title character in his tragedy *Faust* in the same spirit with a "part of that power which always seeks evil and always creates good" (Binswanger 1986).

The critics' moral reproach of the market economy thus lies at its core in the pursuit of one's own self-interest that is practiced and promoted on the market. They persistently refuse to understand that and why the pursuit of the self-interest of many leads to a good or even better result for all. But what is the logical alternative: Can only what is individually well-intentioned – in terms of a definition of good established by general moral norms – lead to a good social outcome?

This alternative was, and is until today, a vision of moral values and behavior that corresponds to the medieval ideas of life, both societally and economically. It is therefore strongly related to a less liberal and static world of life with little regard to individuality and with clear dogmatic guidelines for everyday actions. When we rightly criticize the illiberality of such dogmatically-constituted societies in other parts of the world today, we often forget the great historical learning process that European societies have gone through to ensure a life of tolerance and diversity, not only legally but also mentally. It is worth exploring the steps in intellectual reasoning that this collective learning has taken.

Some first step towards overcoming the medieval moral concepts and their effects on economic activities occurred during the Reformation in the 16th century. It is therefore no coincidence that a German Lutheran, Leonhard Fronsperger from Ulm in Upper Germany, published a small booklet in 1564 called "Praise of Self-Interest" (*Lob deß Eigen Nutzen*) in which he also morally defended individual orientation towards one's own interests, more than 200 years before Adam Smith (Klump and Pilz 2021; 2023a). For Fronsperger, one important explicit reference is the Greek philosopher Bryson of Alexandria whose text "*Oikonomikoc*" on the principles of managing a big household or estate had survived in fragments collected by Johannes Stobaios in the 5th century (Klump and Pilz 2023b, 14 ff.) that was translated into German in the midst of the 16th century. Bryson like other classical writers had recognized and defended the diversity in individual abilities and skills, even if in principle everyone might be able to learn everything. But given that one's individual life span is limited, one must accept that each individual makes self-interested use of one's own abilities in the best possible way. The common good is consequently promoted like in classical economics through a distinct division of labor. In Fronsperger's view, given the diversity in individual abilities and skills, self-interested action should not be condemned from a moral point of view as long as it is constrained in three ways: by natural laws as well as by state laws and – here a remnant of the medieval fear of hell and purgatory still appears – by the self-interested pursuit of "spiritual goods," with the help of which an eternal life in paradise can be acquired. In modern terms, one could perhaps also here speak of individual conscience, which controls the moral content of selfish actions. Fronsperger also follows Bryson in describing how the division of tasks leads to a network of strongly interrelated activities. In this context both use the metaphor of a chain that only functions if all parts hold together in a firm manner.

200 year later Adam Smith, who owned a copy of Stobais' collection in his library, presented a related moral control mechanism for self-interested actions: the "impartial spectator." With this concept, which is at the core of his moral philosophy (Raphael

2009), Smith meant the individual's ability to observe herself or himself from a superior perspective in interaction with others. This involuntarily creates a bond with others who are affected by one's actions, a kind of social moral framework for self-interest:

> When he [*i. e.*, every man] views himself in the light in which he is conscious that others will view him, he sees that to them he is but one of the multitude in no respect better than any other in it. If he would act so as that the impartial spectator may enter into the principles of his conduct, which is what of all things he has the greatest desire to do, he must, upon this, as upon all other occasions, humble the arrogance of his self-love, and bring it down to something which other men can go along with. They will indulge it so far as to allow him to be more anxious about, and to pursue with more earnest assiduity, his own happiness than that of any other person. Thus far, whenever they place themselves in his situation, they will readily go along with him. In the race for wealth, and honours, and preferments, he may run as hard as he can, and strain every nerve and every muscle, in order to outstrip all his competitors. But if he should justle, or throw down any of them, the indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of (Smith [1759] 2002, II, ii, 2.1).

This quote is famous for Smith's recourse on sources from Stoic philosophy, notably the use of the metaphor of a sportif race that Cicero has ascribed to Chrysippos and that was also used by Fronsperger 200 years earlier in a related context (Klump and Pilz 2023a). But it also shows that for Smith there is no irresolvable contradiction between self-interested action in the marketplace and personal attachments to moral standards in living with others. However, these no longer result (only) from unchanging religious precepts, but (also) from a social learning process that is not self-evident but requires time and effort.

It should not be overlooked that Smith also has a critical view on some aspects of the division of labor and the commercial society. Thus, for instance, he conjectures that merchants always conspire against the public interests and are prone to influence legislation in their own interests (see Smith [1776] 1976, I, x-xi), and that workers in the system of the division of labor become stupid and unable to be good citizens (*ibid.*, V, i). Röpke (1937, 63 ff.) pointed out similar dangers. Furthermore, Smith remains skeptical with regard to the "big companies" at his time, like the East India Company, since investors are only interested in their dividends and managers tend to act in their own monetary interests (Smith [1776] 1976, V, I, e). These aspects motivate him to recommend state regulations that should stabilize the market system in the long run, be it by an efficient competition policy or by a public system of education. Both proposals make him an important precursor of ordoliberal thinking in the 20th century (Klump and Wörsdörfer 2010).

If we return again to the many critics of the market economy who accuse it of an excess of self-interest and an inherent lack of morality, they always refer to the dissolution of stable social structures at its core in which the moral conscience of an "impartial observer" could emerge. Karl Marx and Friedrich Engels saw it this way when they described the social consequences of capitalism in the Communist Manifesto as follows: "All fixed, fast-frozen relations, with their train of ancient and venerable prejudices and opinions, are swept away, all new-formed ones become antiquated before they can ossify. All that is solid melts into air, all that is holy is profaned, and man is at last compelled to face with sober senses, his real conditions of life, and his relations with his kind" ([1848] 2008, 38).

As we have seen, Wilhelm Röpke was also obsessed by the fear of individual isolation triggered by massification. This massification prevents the development of a moral compass and instead drives the individual into the clutches of collectivist mass organizations that are run and controlled by the state and in which ideologies – and not morals – are taught. The developments in Italy, Germany, and the Soviet Union were a warning example for him in his time.

4. Does Trade Promote Morality (and Even Lead to Peace)?

In these days – after more than a year with a bloody war in Europe – one cannot talk about market and morality without raising the question of why the long phase of international economic integration that we have experienced since 1990 has not also led to more peace in the world. This question was also asked when the first major phase of globalization ended in a world war in 1914. At that time, too, the promise of the market economy had been different. At the time of Adam Smith, people were still convinced that the newly forming "commercial society" would also amount to the end of the wars of the old feudal age. Self-interest of many in the secure enjoyment of wealth that was earned on the market should make peace a natural choice. And the awareness that the free international movement of goods and capital – the *doux commerce* – was needed to promote prosperity for all concerned should make war look completely irrational.

Similar considerations came up in the context of the rapidly growing trade relations of Western countries with Russia and China. The formula of *Wandel durch Handel* – "change through trade" – was not fundamentally wrong, as it has led to many personal relationships across borders, in which trust could develop, change could begin, and prosperity could grow. But why did this not lead to a more peaceful world, why is "peace through trade" so difficult to achieve? Heinz Kurz, a colleague from Graz, has recently pointed out that the thesis of peace through trade suffers from the fact that it is almost naïvely unrealistic at various points. Above all, it negates the fact that in societies with long militaristic traditions, learning to live together peacefully is not a short-term but a long-term phenomenon. It also overlooks the fact that as long as remnants of feudal structures exist, the market system is not everywhere. And we also find out again today that international exchange does not function well without a set of rules to prevent the exploitation of market power. Working on and with this set of rules is also a civilizing process that does not come about on its own, but must be learned and practiced by all participants.

Finally, it is also ignored that there is obviously the expectation that trade should not promote the peacefulness of individuals who trade, but of states, or of those politically responsible who decide on war and peace. Their interests, however, are not necessarily to be satisfied in economic categories, but follow the categories of power, dominance, and historical greatness. As long as there are no or only weak links between the spheres of economic and political actions and decisions – because, for example, there is no democratic linkage of the political leadership to the economic interests of the entire population – the trust in peace through trade remains illusory.

This leads me to the conclusion that change through trade – and also peace through trade – can work, but not automatically and not immediately, but in a longer process that has to be channeled through suitable institutions. And these institutions certainly include a well-developed civil society in which citizens' interests can be articulated against the official interests of the state. To the extent that all institutions of such a civil society are suppressed and eliminated, hopes for any change through trade also disappear.

The institutions that I talk about here also include companies that can pursue their own business objectives rather than state-imposed ones. For such companies and the individuals working in them, the perspective of international trade is of course significant, not only to realize trade profits and to benefit from the transfer of know-how, but precisely also to integrate into international networks and to participate within such networks in the transfer of values of the international community. It should therefore not, or at least not only, be the exchange between states that conveys values, but this conveyance can only be successful if it also involves the companies active in international markets. Private companies – perhaps with the exception of those that produce military weapons and are therefore the closest related to state-institutions – will almost certainly prefer peace over wars that would only destroy their capital investments, the human capital of their employees, and the wealth of their clients. If private companies can fulfill this function of promoting not only the exchange of goods and services, but also the transfer of values it is irrational not to make use of it. Maybe this irrationality is again a characteristic of the political agenda setting compared to economic reasoning.

A current example may illustrate my concerns in that perspective. Only recently, my colleague Andreas Freytag from Jena, together with the chairman of the Africa Association of German Business, Stephan Liebing, has quite rightly criticized the new Africa strategy of the Federal Republic of Germany (Freytag and Liebing 2023). When it was presented by the Minister of Economic Cooperation and Development the strategy document talked a lot about the importance of feminism for development, but it said little or nothing about trade and business contacts that might help to promote the role of women in traditionally paternalistic societies. However, the intensive promotion of economic exchange is extremely important for the communication – and not for the state octroy – of feminist and other values and would undoubtedly be more sustainable than well-meaning, yet ineffective government documents.

5. Do We Need Moral Guidelines from the State for Climate Change?

In the context of the climate crisis, too, we find a lot of statements that see its cause in the lack of moral standards of the market economy. Individual self-interest should then inevitably lead to the ruthless exploitation of nature and ultimately to climate catastrophes. These could therefore only be stopped if self-interested action is completely prevented, *i. e.* if the market economy is abolished. Alternatively, one could perhaps be satisfied with imposing restrictive moral standards of behavior on consumers and producers alike. Of course, it is crucial who develops such standards, who sets them, and how they are enforced. The call for imposed moral standards suffers always from the suspicion of paternalism. This means that some small group – be it a bureaucracy, a political party or a self-declared elite – imposes restrictions on a broad public that is considered to be unable to act rationally in its own interest.

Market-based regulatory policy sees things quite differently. Governmental regulatory policy has to respond to obvious market failures by setting an appropriate framework for market activities. It refrains from imposing moral restrictions, but lets prices indicate obvious scarcities so that individual actions are incentivized to overcome them. This has been occurring in the EU since 2005 with the establishment of its Emission Trading System (EU ETS), which now regulates more and more closely the emissions of CO2 by means of certificates for which a fee is charged. The price development of the certificates is intended to provide an incentive for the market to lower the demand for carbon-intensive products and at the same time to develop more climate-friendly products and processes. The EU ETS has not only been a successful first step of bringing major parts of European industry on a path towards more sustainable development; it recently has been extended so that it will in the near future also include the buildings and road transportation sectors, both being responsible for a significant amount of greenhouse gas emissions. A first sight, regulations like the EU ETS have nothing to do with morality. They rather demonstrate the efficiency with which such economic incentive systems steer rational, individual action in the desired direction. However, and this is an obvious weakness of many economic models, the market is seen as an anonymous collection of individuals. The development and consolidation of morality in exchange with others is thus completely ignored.

If we consider that the level of associated structures, *i. e.* the actions of companies, banks, citizens' initiatives, political parties, *etc.* lies between the state's regulatory framework and the market then one gains a much more differentiated perspective. For it is in this intermediate space between the state and the market that preferences for what is morally acceptable and what is not are formed, solidified and changed. And precisely where changes in preferences are important, developments in this intermediate space are clearly more effective and sustainable than state-imposed moral rules. While individuals pursue the latter without real inner conviction and thus inefficiently, the moral standpoint found in dialogue with the community promises particularly efficient changes in behavior because they are also actually accepted.

Here again, it is worth pointing out another example for an interesting and promising institutional innovation. An important result of the German G7 Presidency is the initiative announced at the end of 2022 to establish a climate club to achieve the Paris goals. As a forum of states, the climate club aims to help drive decarbonization in the industrial sector, further develop measures to reduce emissions, and limit the risks of companies relocating to countries with less stringent climate regulations. Committed developing and emerging countries that join the club are to be supported in consistently driving forward the transformation of their industries with the goal of climate neutrality (Wolff and Tagliapietra 2021).

The climate club focuses on industrial decarbonization. Here, the exchange on international framework conditions for industrial decarbonization is to be strengthened in order to accelerate the work on common standards, methodologies and strategies for important industrial sectors. Common frameworks should ensure that investments are made in sustainable industrial technologies, that the demand for green products is expanded, and that climate-hostile lock-in effects in fossil production processes are avoided.

The goal of rapid decarbonization and instruments that are used by the involved states to achieve it are undoubtedly good and correct; but in terms of implementation, the climate club will only be successful if it induces all relevant actors in the participating states, producers and consumers alike, to change their behavior. Price increases for emission-intensive products are the most important means to achieve this in markets. But in order to achieve a change in the valuation of sustainability – and thus a moral dividend of the liberal economic and social system – it will be necessary to form climate clubs not only between states but also to involve private players. There must therefore be associations of those who are voluntarily willing to give special rewards for efforts to achieve ambitious sustainability goals.

One may think here, for example, again of private companies that come together with others in alliances to pursue sustainability goals. One example for common standards that are agreed upon in such an alliance are the so-called Equator Principles (Wörsdörfer 2015). These principles are intended to serve as a common baseline and risk management framework for financial institutions to identify, assess and manage environmental and social risks when financing major infrastructure projects worldwide. Meanwhile, more than 130 financial institutions have joined the initiative. Even if there are no clear regulations for non-compliance it could be shown that it is the force of peer pressure that has a strong impact on the adoption of the principles and leads to self-regulation (Contreras *et al.* 2019). One could also mention financial institutions in this context that, through new financing instruments, create opportunities for capital providers with special sustainability preferences to be brought together with investors who fulfil these preferences in a feasible way (Hinsche and Klump 2023). In my view, current developments show that such private climate clubs are already highly effective, even if they do not (yet) cover all economic sectors in the same way.

6. Institutions and Morality in Liberal Society

The examples from the field of green finance show that the question of the appropriate place of morality in the market economy cannot simply be answered in the sense that the market provides efficiency and the state provides morality by, for example, correcting the distribution of market incomes. Gustav Schmoller, one of the important pioneers of state social policy in Germany, developed such a vision in a famous essay (Schmoller 1881) in which the state, like the Hegelian *Weltgeist*, ensures ever more justice in the world. Certainly, state structures are needed to regulate and enforce general norms of behavior. But they should refrain from too much direct intervention in individual actions or even direct guidance of individual values and preferences. But how can one then expect morality to develop in and sustain a market economy?

Must we not, in Röpke's sense, always be afraid of the market as a destroyer of morality?

Here it is now worth taking a closer look at what Röpke considered important for the reorganization of the state, society, and the economy after World War II. As already mentioned, he spent the last period of his life in Switzerland and one gets the impression reading his published writings that many things about Switzerland impressed him very much, in particular the decentralized organization of the state and a certain smallness in its economic structure. In general, he sees large companies as the greatest enemies of a functioning market economy because of their market power. And he is also, as was already mentioned, particularly critical of state-controlled mass organizations that replace private forms of association. In *Civitas Humana* (Röpke [1944] 1946) he develops a general principle of decentralized organization that he terms the "principle of subsidiarity," taking up a central notion of Catholic moral philosophy: "This means that from the individual to the central state, the original right lies on the lower level and each higher level only takes the place of the next lower level in a subsidiary way, if a task reached beyond the area of the last one. The result is a sequence of stages from the individual via the family and the commune to the canton and finally the central state, a sequence which at the same time limits the state itself and opposes it to the rights of the lower stages with their inviolable sphere of freedom." And shortly after he calls subsidiarity "… a program that is itself one of the essential conditions of a healthy state, which sets the necessary limits for itself and maintains its own health, strength and stability by respecting the spheres that are free of state interference" (*ibid.*, 179 ff.)

It is obvious that Röpke considers subsidiarity as an important principle for the organization of the state, but also for the economy. He praises the federal organization of the Swiss Republic and also its small-scale economic structures populated by small and medium-sized firms, the so called *Mittelstand*, instead of few dominant monopolists. He is much less explicit, however, on the subsidiary organization of society at the level of associations, parties and networks where moral behavior could develop in interaction with others, and without a state decreeing it from above. He talks only briefly (*ibid.*, 178) about a collective principle of state organization ("*genössischer Staat*") and praises the traditional family as an important pole of resistance against massfication and collectivation (*ibid.*, 210 f.), but he says remarkably little about the dynamics of private associations in general. This is a pity, as it seems to me that these social structures play a central role for the formation of moral behavior of individuals and are therefore important prerequisites for the stability of a liberal market economy with a certain moral dividend.

The social structures formed by private associations with its diverse connections of individuals who are not just waiting in complete isolation to be taken over by mass state organizations are something that is completely missing both in the Communist Manifesto, but also in most models of modern mainstream economics. That is true in spite of the Smithian idea of the impartial spectator acting within a social setting already having pointed in this direction. But it is precisely this individual action within a social institutional network that is essential when it comes to forming and living central moral standards. It constitutes what has, since the seminal contribution of Robert Putnam (1993), been called the social capital of a society. And this social capital should, if possible, be expanded in parallel with the growth of real capital and income. If this parallel expansion does not occur, then one might expect economic conflicts and crises to develop that originate in an insufficient level of moral standards. However, if this expansion does occur, markets are able to generate a particular moral dividend that helps to stabilize the functioning of liberal economy and society.

The market economy may destroy traditional ties, as correctly described by Marx and Engels. At the same time, however, it opens up diverse opportunities for new social contacts. This is, by the way, an insight that one can already find in the work of Adam Smith, as Maria Pia Paganelli has only recently pointed out: "Markets are indeed *doux*, not because they make better people or more virtuous people, but because they soften our spirit, substituting one set of virtues with another. One is not better than the other—one is more appropriate to the specific circumstances than the other" (2020, 6). This aspect of liberal societies, to enter into or dissolve social ties beyond the market and the state, seems to me to be something that modern economic theory and traditional German ordoliberalists have both so far neglected. It does come up eventually when there is talk of the social capital of a society or of social norms, but its influence on the morality of the market economy and the possibility that even a moral dividend could be earned on the market has so far remained rather opaque. It might then also be worthwhile to examine related social sciences where the discussions on these topics are traditionally much more intensive.

The sociologist Michael Baurmann, for example, describes the freedom to associate with others as a central concern of liberalism alongside competition with others on the market. In such associations, the individual brings in his or her moral claims and also experiences confirmation or criticism from them; in any case, he or she uses them to stabilize his or her own moral position. This creates what Baurmann (2000) calls a "market of virtue."

> From this point of view, it is of fundamental importance that in modern liberal societies not only has the market been liberated from fetters and barriers of all kinds and citizens have the freedom to engage in individual economic activity, but also that voluntary associations, self-determined union into communities and cooperative enterprises have experienced such "liberation" – whether in the form of commercial enterprises to raise material profit, economic or political associations to represent idealistic purposes, or social communities in which the "internal goods" of communal practice as such are central (*ibid.*, 646; translation by the author).

As a consequence, one can deduce for regulatory policy that it is not only the conditions for a dynamic, flourishing market economy which must be created and preserved, but also the conditions for an active and flourishing civil society. In liberal society, scandals like those involving cum ex deals or the Wirecard bankruptcy will never be prevented with absolute certainty; but it should be possible to create an awareness for the values that a society wants to preserve and defend in the economic sphere.

One very promising attempt to integrate the formation and modification of values, including those with a normative perspective on distribution, into the body of mainstream economic theory can be found in a not yet published manuscript by Carl Christian von Weizsäcker (2023). The author challenges the traditional view that individual preferences are inherently stable and fixed. This view has been vividly defended by many mainstream economics because it has been regarded as essential for the assumption of rational decision-making of individuals and therefore as a cornerstone of neoclassical welfare economics. Von Weizsäcker now develops a new view that relies on adaptive preferences that may change over time and is able to show that even with adaptive (and thus changing) individual preferences under certain conditions the basic axioms of neoclassical welfare economics still hold. Societal cohesion of individuals within a community requires, however, that even changing preferences remain "compossible" – meaning that they do not contradict fundamental community rules and guarantee the peaceful functioning of all social interactions. In the same way as technical innovations are able to expand the productivity of given resources and lead to a general increase in wealth – even if some actors may suffer an individual loss – developments in compossible individual preferences can expand the scope of social capital in a society:

> Social preferences consistent with individual freedom within the range of compossibility of rights not only refer to eventual material outcomes of government decisions, but also to the form in which any change takes place. The decision to implement some project A may be motivated by the expected material outcome. […] But further changes as a consequence of the reaction of free citizens on the implementation of project A are then "preferred" by society over the non-implementation of project A, simply because they take the form of the interaction of free citizens – independent of the material outcome (*ibid.*, 177).

Von Weizsäcker does not study or explain in much detail the process of how preferences develop, adapt and change, but we can imagine that he has some kind of learning process in mind that works through continuous contacts and communications within social institutions of any kind.

One is reminded in this context of the "strength of weak ties" that Mark Granovetter (1973) has pointed out. Institutions that rely on strong ties among their members, such as orthodox religious groups, have a tendency of becoming resistant to adaption and change, because they try to ignore intellectual exchange with the outside world. The advantage of institutions with weak ties is therefore the continuous and open communication with others that help to form, adapt, criticize, and stabilize individual preference, and notably those that constitute basic norms of social interactions. Like markets for economic goods, weak-tie institutions combine possibilities of an opting in for the exchange of ideas with the opportunity of opting out and searching for alternatives if the "compossiblity" of individual preferences with the group preferences is no longer given. Opting out is, however, costly and will therefore remain rather the exception than the rule so that some persistence and stability in social preference formation is guaranteed.

Looking at the individual formation of social norms that define a society's morality within private associations and networks can also help to understand better what constitutes and what should constitute a Social Market Economy. When this term was coined shortly after the end of World War II (Müller-Armack 1946) it was meant to signal that the market economy should be aware of its embeddedness in liberal society. It does not only consist in the efficiency of the market in solving problems of scarcity. Nor does it consist only of public social policy to overcome market failures. Rather, it relies very centrally on the fact that between market and state – or, to quote Wilhelm

Röpke ([1958] 1961) again, beyond supply and demand – there is the level of free private associations in which moral positions in individual preferences are formed, consolidated, and changed. For von Weizsäcker (2023) in his analysis of adaptive individual preferences the idea of a Social Market Economy is realized by continuous political support for limited state interventions that mitigate obvious market failures as well as for a progressive scheme of income taxation that redistributes market incomes in a way that can secure social cohesion and peace. Baurmann (2000) concludes that a liberal market economy can only persist if it is able to support a social network structure of private association that can articulate, discuss and adapt individual concepts of morality. In the same way as markets function best if they operate under a regime of competition the market for virtue also needs opportunities for workable competition – or, if one wants to use the categories used by Hirschmann (1970), opportunities for exit and voice – in order to sustain loyalty among group members.

7. Conclusions

In this article I have outlined how Wilhelm Röpke's fear that markets might inherently behave as destroyers of morality can be qualified and even refuted. In a liberal ecosystem, markets may even be able to gain a moral dividend if the institutional structure of society and economy allows for the formation of private associations that help to form, adapt and develop individual preferences concerning moral behavior. This form of embeddedness of economic actions within dynamic social networks is something that has already been observed and underlined in the moral philosophy of Adam Smith, but also in the founding ideas for a Social Market Economy in Germany after World War II. It has been neglected, however, by most of modern mainstream economists, but it might gain momentum in the field of economics in the future if the theoretical considerations around the concept of adaptive individual preference are further developed and explored.

Looking into the future, one interesting and challenging research question will certainly be how and to what extent an increasing digitalization of social contacts impacts the stabilization of moral values within liberal society. Early contributions to this debate seemed to prove a positive contribution of internet-based communication on social capital formation (Pénard and Poussing 2010), but negative effects have also been identified (Neves 2013). Without an immediate personal relationship, private associations might lose their potential of creating a moral dividend. With no costs for exit and a search for alternatives, institutions with strong and weak ties alike may become fundamentally unstable. This would then, as it was feared by Wilhem Röpke, lead to some new forms of individual isolation and motivate states to promote new forms of collective mass organizations. The new wave of technical innovations would then induce massive destruction of social capital and increase the danger of both economic and social crises.

The time of pandemic-related restrictions was a good test for the pros and cons of pure online communication. Initially welcomed by many and also seen by some companies as an instrument for permanently reducing the costs of expensive office infrastructure, today a different, or at least a strongly differentiated assessment, is spreading. Personal contact, or at least the possibility to engage in regular intervals, is gaining in importance, not least because it is important to experience corporate values and to experience them in the truest sense of the word. It is probably too early to generate a reliable empirical assessment of the current situation, but some indicators seem to point to a renaissance of the desire for personal meetings, which is very positive with a view on the formation and stabilization of morality within private associations.

At universities, it was really gratifying after the end of pandemic restrictions to be able to interact again directly with students in lecture halls and seminar rooms. And I am convinced that outside universities and firms too the interest to meet physically is increasing again, even if the newly installed opportunities for online meetings will remain part of the overall tool set for interacting and communicating in the future. The new technologies would then more and more be integrated efficiently into the accumulated social capital without causing a long-lasting disruption in social bonds and moral values. One important condition for this optimistic scenario to set in would, of course, be ongoing competition in markets, and notably a competitive framework for the major digital companies. This brings us back ultimately to one of the major concerns of Wilhelm Röpke, namely how to restrict the market power of big monopolistic firms. And in contrast to what had happened before World War II one finds today very powerful and active anti-trust authorities worldwide that have also adapted their regulatory norms to the new dynamics of digital markets. This collective learning process among business leaders, academic advisors and state regulators may also be regarded as an indication how open liberal societies are able to deal with new market challenges and develop new institutional responses.

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