

Aristotle on Economics and Ethics

Emel Kahya¹ & Sungsoo Kim¹

¹School of Business-Camden, Rutgers University, Camden, NJ 08102, USA

Correspondence: Sungsoo Kim, School of Business-Camden, Rutgers University, Camden, NJ 08102, USA.

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Abstract

Over the last several decades, we have witnessed seismic changes in corporate America: the increasingly myopic perspective of American managers, the relentless pursuit of short-term paper profit, reckless disregard for the interests of the non-shareholder community, a rise in hedge fund activism, and an ever-increasing use of incentive compensation, which arguably motivates managers to take on riskier investments. By revisiting Aristotle's properties of ethics and economics, and considering their implications for accounting and finance, we try to learn guiding principles of economics, and by extension accounting and finance, from a great philosopher. We then discuss whether we have made progress, stood still, or even retreated from the philosopher's propositions of more than two millennia ago.

Keywords: ethics, Aristotle, accounting/financial profession, economics, business

1. Introduction

In the past few decades, there has been an increasing emphasis on ethics in business – particularly on Wall Street and in the accounting professions. A typical US business school curriculum now includes some components of ethics in its courses, if not an entire ethics course, and there has been increasing attention to professional codes of conduct in the financial and accounting professions. The emphasis on ethics is a direct response to the deteriorating business environment in the US, which is characterized by a relentless pursuit of short-term paper profits by myopic managers, a rise of hedge fund activism zeroing in on corporate control at all costs, outrageous displays of managerial hubris, excessive executive compensation, and empire building, to name a few. In an unrelated but not surprising development, there has been a revival of Aristotle's ethics in moral philosophy in a wider context than the history of philosophy. Some contemporary moral philosophers, who are either disappointed with the problems within the Kantian and utilitarian systems or are interested in a self-contained, theoretical and practical system, have returned to studying and writing about Aristotle's ethics.¹ Aristotle's thinking on ethics has implications for his political – and, consequently, economic – thinking.

Aristotle was born in 384 B.C. at Stageira in Chalcidice, which was part of Macedonia, Greece, and he later became a tutor to Alexander the Great of Macedonia. He was a student of Plato and became one of the most well-known and widely read philosophers. Aristotle was usually cited by the medieval scholars simply as *the* Philosopher.² Dante characterized him as the "*master of those who know,*" with Socrates and Plato at his side. He was the founder of many sciences with his writings on a multitude of topics including logic, philosophy of nature, biology, psychology, metaphysics, politics, ethics, rhetoric and poetics. According to Aristotle, knowledge is of three types: theoretical, practical, and productive.³ Theoretical means "*pursued for its own sake,*" practical means "*as a means to conduct,*" and productive means "*as a means to make something useful and beautiful.*" The practical sciences are politics, ethics, rhetoric and poetics. However, the supreme practical science is politics, and ethics is a part of politics. Aristotle's politics and ethics cover areas that in the contemporary world are considered social sciences.

¹. Rorty (1980), p. 3.

². Schumpeter (1954), p. 88.

³. Ross (1995), p. 195. Sir David Ross (1897-1971) wrote influential books on ethics and is considered the leading Aristotelian of the first half of the twentieth century. He was also the general editor of the Oxford Aristotle translation series.

Aristotle's ideas on economics, which are considered to be the origin of the history of economic analysis,⁴ are largely contained in Book I of *Politica* (abbreviated as "Pol" in the footnotes) and in Book V of *Ethica Nicomachea* ("E.N."). Some authors have also attempted to interpret various passages in *Topica* ("Top") and *Rhetorica*⁵ in economic terms. *Oeconomica*⁶ is a work that contains elements derived from Aristotle, but it is believed to be written by someone familiar with the writings of Aristotle.⁷ Aristotle's influence on economic ideas was strong throughout the Middle Ages. This was made possible by the wider dissemination of his writings, partly through Arab and Jewish philosophers, to the Western Christian world.⁸ The scholastic writers borrowed heavily from the writings of Aristotle. St. Thomas Aquinas (1225-1274 A.D.), the greatest of the scholastics, adapted Aristotle's philosophy to Christian doctrine. Aristotle's ideas on topics such as virtuous life, wealth, private property, retail trade, usury, and just price appeared in St. Thomas's *Summa Theologica*,⁹ and the Aristotelian framework had a strong influence for the next 300 years.

Bell (1967) states that many modern concepts of economics originated with Aristotle. Schumpeter (1954) writes that Aristotle's analysis of money was a major contribution to the theory of money. Kauder (1953) argues that the beginnings of the marginal utility theory can be traced back to Aristotle. Gordon (1964) argues that Aristotle's writings contain not only a utility approach, as Kauder claimed, but also a labor approach to value determination. Finally, Jaffé (1974) traces Edgeworth's contract theory back to Aristotle.

The objective of this paper is to revisit the Aristotle's theory of ethics and economics and to reflect them on the present situation in corporate America. By doing so we hope to apply Aristotle's ethics and economics and what's been written in the literature since his days to a well-defined range of economic topics. The paper is organized as follows; we introduce the concept of Aristotle's ethics in Section 2, explore the concept of Economics in Section 3. We offer summary and conclusion in the final Section.

2. Ethics

2.1 Goal of Human Life

Aristotle believes that nature never creates anything without an aim to an end or goal that is good. Man's every action aims at some good. "Every art and every inquiry, and similarly every action and pursuit, is thought to aim at some good; and for this reason the good has rightly been declared to be that at which all things aim."¹⁰ Man has a function in life that will lead to this goal, which Aristotle calls εὐδαιμονία, a word that has been translated as happiness or well-being.¹¹ Man's function in life is to lead a good life that will reach this goal, which is "the good for man." Aristotle analyzes four types of life to discover what the highest/final good is for man: the life of enjoyment, the political life, the life of money-making, and the contemplative life.¹² He first looks at the life of enjoyment and rejects pleasure as the final good because it is suitable for beasts. Secondly, he looks at the political life and considers honor as a candidate to be for the final good. However, honor is given by one man to another, and good must be something that is a man's own and not easily taken from him. Therefore, virtue may be considered the better good. However, Aristotle rejects virtue as the final good because it is compatible with inactivity and misery. He rejects wealth as the final good because it is a means, not an end.

Solomon (2004) develop a theoretical framework which is equivalent to an Aristotelian approach to business to talk about corporations and organizations in general. Although Aristotle is famously known as an enemy of business, he was not only the first economist, but also he might well be called the first business ethicist as well. Following his premises it is not acceptable that we accept the amoral idea that 'business is a business', not really a cliché but an excuse for being socially irresponsible and personally insensitive. (Solomon 2004).

Aristotle's view on money is in stark contrast with the current practices of managers in corporate America. Consider, for example, executive compensation. Insatiable greed drives managers to make 276 times more than the average employee makes¹³ (WSJ, July 7, 2017 page B12, Pay ratio: Flawed but useful tool, Larker and Tayan 2011). This

⁴. Bell (1967), p. 21, and Schumpeter (1954), p. 57.

⁵. *Rhetorica* is a practical manual for the public speaker, and *Topica* is on the art of argument and discussion.

⁶. Anonymous, *Oeconomica*, translated by E.S. Forster in *The Works of Aristotle Translated into English*, W.D. Ross (ed.), v.10, Oxford University Press, London, 1966.

⁷. See W.D. Ross's discussion in *Aristotle*, pp. 13-14.

⁸. Schumpeter (1954), p. 87.

⁹. Bell (1967), pp. 43-49.

¹⁰. 1094^a: The number refers to the paragraph, and the superscript letter refers to the column.

¹¹. *E.N.* 1095^a, 1097^b.

¹². *E.N.* 1095^b-1096^a.

¹³. Larker and Tayan (2011) correctly point out the problems with this ratio (average CEO pay over average employee wages). The Dodd-Frank Act requires this ratio to be disclosed in corporate proxy statements.

exorbitant CEO pay is the exact opposite of Aristotle's rejection of wealth as the final good. This pay difference between CEOs and employees is nowhere close the Aristotle's view of life, virtue and honor. The final good must be desired for its own sake and never for the sake of something else.¹⁴ Aristotle decides that contemplation of truth is the final good.¹⁵ Aristotle's ethics is teleological in the sense that man acts in a certain way in order to get closer to "*the good for man*" and not because certain actions in themselves are seen as right.¹⁶ Moreover, ethical judgments are not universal and precise because they hold only for "*the most part.*" "*We must be content, then, in speaking of such subjects and with such premises to indicate the truth roughly and in outline, and in speaking about things which are only for the most part true and with premises of the same kind to reach conclusions that are no better.*"¹⁷ Aristotle believes that man needs to look at the facts and try to reason to the first principles, using practical wisdom (acquired through a good upbringing and experience). Ethics is a practical science that employs inductive rather than deductive reasoning, rather than emerging from first principles.¹⁸

Using inductive reasoning or, more accurately, practical syllogism¹⁹, Aristotle defines happiness as an activity, not a mere potentiality, of soul in accordance with perfect virtue.²⁰ Happiness requires sufficient external²¹ goods/wealth throughout a complete life and is acquired through learning or training. Happiness is a first principle because we do all the things we do for the sake of happiness. Virtue deserves praise, but happiness is above virtue and, hence, above praise. Since happiness is in accordance with perfect virtue, Aristotle discusses virtue in Books II-VI of *Ethica Nicomachea*.

2.2 Virtue and Vice

Virtue is of two kinds: moral virtue, which is acquired by habit, and intellectual virtue, which is acquired by learning.²² Moral virtue is neither natural nor unnatural. Man is born with a capacity (potential) for it that needs to be realized by doing virtuous acts by habit; therefore, its name (*θικῆ*) is a variation of *θος* (habit). "[B]y doing the acts we do in our transactions with other men," Aristotle says, "*we become just or unjust*"²³ Moral virtue is a state of character, not a faculty or passion,²⁴ and is a disposition to choose the mean. The acts cannot be described precisely because what is good for man is not fixed but is contingent on circumstances and on subject matter.²⁵ However, these acts must avoid excess and defect, because things are destroyed by excess and defect and preserved by the mean.²⁶ This doctrine of the mean appears in many areas of Aristotle's philosophy. Aristotle writes, "*Virtue, then, is a state of character concerned with choice, lying in a mean, i.e. the mean relative to us, this being determined by a rational principle, and by that principle by which the man of practical wisdom would determine it.*"²⁷ We find hedge fund activism egregiously violates Aristotle's principle of avoiding excess and honoring the mean. Once they locate a fray (a target firm), they act as a group (known as a "wolf pack") to acquire enough shares to take over control, effectively numbing the incumbent managers. In an effort to keep their jobs managers of targeted firms contact "White Knight" fund who in turn demands higher return for helping them to fend off hostile takeover. There is not a shred of virtue in the whole process.

The mean is what separates virtue from vice. The extremes, deficiency and excess, are opposed to each other and to the mean, and the mean is opposed to the extremes.²⁸ Aristotle is not talking about an arithmetical mean: He writes, "*To the mean in some cases the deficiency, in some the excess is more opposed*"²⁹; moreover, the mean is grasped by "perception" and not by reasoning. The mean is "*relative to us,*" and individual and particular circumstances need to be

¹⁴. *E.N.* 1097^a.

¹⁵. *E.N.* 1177^a.

¹⁶. Ross (1995), p. 196.

¹⁷. *E.N.* 1094^b.

¹⁸. *E.N.* 1095^b.

¹⁹. Since Aristotle is not dealing with a science, some such as Spengler or Ross may argue that Aristotle is using dialectical (practical) syllogism (Spengler, 1955, p. 372; Ross, 1995, p. 225).

²⁰. *E.N.* 1097^a-1102^a.

²¹. External in the sense of not relating to body or soul, goods relating to soul are "*most properly and truly goods*" (*E.N.* 1098^b, *Pol.* 1323^a). "*[I]t is for the sake of the soul that goods external and goods of the body are eligible at all, and all wise men ought to choose them for the sake of soul, and not the soul for the sake of them*" (*Pol.* 1323^b).

²². *E.N.* 1103^a-1109^b.

²³. *E.N.* 1103^b.

²⁴. *E.N.* 1105^b-1106^a.

²⁵. *E.N.* 1094^b.

²⁶. *E.N.* 1104^a.

²⁷. *E.N.* 1107^a.

²⁸. *E.N.* 1108^b.

²⁹. *E.N.* 1109^a.

taken into consideration in a situation involving a moral virtue. The mean is hard to attain, and sometimes the extreme that is less erroneous may be chosen as a second best (the lesser of the two evils) in particular cases.³⁰

When are we responsible for our actions? When actions are voluntary, blame and praise attach, but when they are involuntary, pardon and sometimes pity are deserved. Involuntary actions are performed (1) under external compulsion, and (2) due to ignorance.³¹ Ignorance that excuses us is not ignorance of what is good for man, but ignorance of particular circumstances of the action. Furthermore, as Aristotle stated in his definition above, moral virtue implies that the action is done by choice. Choice (προαίρεσις)³² is voluntary but is not the same as voluntary. We choose among the things in our power after deliberation.³³ Aristotle reasons that choice is a deliberate desire for things in our power. We are responsible for bad as well as for good actions.³⁴

2.3 Virtue of Justice

Using his own theory of virtues and vices and the doctrine of the mean, which is central to his “ethics,” Aristotle discusses specific moral virtues in Books III-V of *Ethica Nicomachea*. He examines the following moral virtues: courage, temperance, virtues concerned with money, virtues concerned with honor, the virtue concerned with anger, virtues of social intercourse, a quasi-virtue (bashfulness) and justice.³⁵

Book V of *Ethica Nicomachea*, which is on the virtue of justice, also contains Aristotle’s ideas on economics. He begins with a definition of justice: “[A]ll men mean by justice that kind of state of character which makes people disposed to do what is just and makes them act justly and wish for what is just; and similarly, by injustice the state which makes them act unjustly and wish for what is unjust.”³⁶ Since justice is a virtue, like all other virtues, it is a state of character and a disposition to choose the mean. Aristotle then distinguishes between two forms of justice: universal and particular. Universal justice is concerned with what is lawful and unlawful. Particular justice is concerned with what is fair and unfair. Aristotle argues that justice in the former sense is a complete virtue, because law governs all actions of men and enforces all virtues. Justice in the latter sense, which is his main concern, is a “part” virtue because it is concerned only with things that concern the “good man”: honor, prestige, money, safety.³⁷ According to the doctrine of the mean, a just man takes the right amount, not too much and not too little, of these things that are good in themselves but not always good for a particular person. The current practice of managerial compensation couldn’t be more appropriate here to make a point. We see Aristotle’s universal justice at work, not a particular justice here in the context of managerial compensation. Aristotle talks about two different kinds of particular justice: distributive and corrective/remedial. Distributive justice is concerned with the distribution of wealth and honor among the citizens of the state, which is in stark contrast with CEOs making more than 200 times of employees. Remedial/corrective justice is concerned with both voluntary and involuntary transactions between two parties. Transactions are voluntary if “the origin is voluntary” and consist of transactions such as sales, purchases, and loans. Involuntary transactions are those involving fraud or force, such as theft, murder, and assault. Justice in exchange – or commercial justice – is a third form of particular justice, according to Ross. According to others, e.g., Grant or Burnet,³⁸ it is better to consider it a form of corrective justice dealing with rightful transactions (those not involving fraud or force at any point).

2.4 Practical Wisdom and Rational Principle

Aristotle discusses intellectual virtues in Book VI of *Ethica Nicomachea*. It is necessary to examine intellectual virtue in order to understand “practical wisdom”³⁹ and “rational principle” (sometimes called “right rule”), which are

³⁰. *E.N.* 1109^b.

³¹. *E.N.* 1110^a-1111^a.

³². Ross (1995) explains that προαίρεσις is a difficult word to translate. Sometimes “intention,” “will,” or “purpose” will be more suitable translations. More appropriately, it is preferential choice.

³³. *E.N.* 1111^a-1113^b.

³⁴. *E.N.* 1114^a - 1114^b.

³⁵. One of the very few positive developments in corporate America is the increasing emphasis on corporate social responsibility in the last decade or so. Empirical research reports mixed evidence on whether corporate social responsibility is motivated by a true corporate desire to be responsible or by managers’ opportunistic abuse of shareholders’ funds. In either case, the increase in responsible actions by corporations is a definitely positive development in Aristotle’s context.

³⁶. *E.N.* 1129^a.

³⁷. *E.N.* 1129^b-1130^b.

³⁸. Ross (1995), p. 241.

³⁹. ρθὸς λόγος, “right reason” or, as Ross (1995) translates it, “right rule”; others (e.g., Thomson 1998) Translate it as “right principle.” φρόνησις and σοφία are translated as practical wisdom and philosophical wisdom, respectively.

mentioned in the definition of virtue.⁴⁰ Intellect, which is the part of soul that “*grasps a rule or rational principle*,” is divided into the contemplative (theoretical) and the calculative (practical or productive). The object of the former is invariable and admits of no contingency, whereas the object of the latter is variable truth that corresponds with right desire and admits of contingency. Aristotle argues that there are five states of mind by which these two parts of intellect will reach truth. These intellectual virtues are science, intuitive reason, (philosophic) theoretical wisdom, art, and practical wisdom.⁴¹

Aristotle defines practical wisdom as “*a true and reasoned state of capacity to act with regard to the things that are good or bad for man*.”⁴² A man of practical wisdom is able to deliberate about things that are conducive to the good life in general. In Book X, Aristotle decides that the life of contemplation is the good for man. Aristotle argues that practical wisdom and political wisdom are the same state of mind, but they are different in essence. Practical wisdom secures the good of the individual, whereas political wisdom secures the good of the state.⁴³ Men of practical wisdom are good at managing households and states. Since practical wisdom is gained by experience, young men may have theoretical wisdom but not practical wisdom.

3. Economics

3.1 The State and the Household

In *Politica*, Aristotle is in search of the ideal state. Book I of *Politica* is concerned with household management (οικονομία), since Aristotle regards that as the management of the smallest part of the city-state (πόλις). Aristotle believes that the state, which represents political association, is the highest/final form of association. Since every association is established with an aim to some good, the state aims at the highest good.⁴⁴ The household, which is the most basic association, is founded upon the two relations of male and female, of master and slave. The aim of this association is to satisfy men’s daily needs. The association of households, the village, satisfies a wider range of needs. Aristotle’s characteristic teleological view that the “*nature*” of a thing is its final form/end, and the final form/end is good, is obvious in his discussion and reasoning. The state aims to satisfy all the needs of men and offers them the good life. The state is self-sufficient, which is the natural end of associations; like all natural ends, it is also the best.⁴⁵ Hence, man by nature is a “*political animal*” whose superiority over other “*political animals*” such as bees is proven by the fact that he is the only one with the gift of speech.⁴⁶

Property, goods, exchange and money play a large part both in household management and, ultimately, in city-state management. Aristotle’s ideas on the topics are strongly affected by his two important beliefs on society and the purpose of human life. The first is his belief in a hierarchical society where free citizens are at the top, free but economically dependent craftsmen/tradesmen are in the middle, and “*natural slaves*” are at the bottom. Second, he disapproves of retail trade and the pursuit of unlimited wealth, since he believes that only a limited amount of wealth is necessary to fulfill the purpose of life and live good life. The greed manifested by hedge fund managers in this country goes directly against this proposition. Right before the liquidity crises of 2008, the top 5 hedge fund managers earned more than all S&P 500 firms’ CEOs combined (Lim et al. 2016)

3.2 Property

“Property is a part of the household, and the art of acquiring property is a part of the art of managing the household; for no man can live well, or indeed live at all, unless he is provided with necessaries.”⁴⁷ Hence, Aristotle is concerned with the acquisition of property/wealth only in connection with providing the necessary goods so that the head of household will be able to live the good life as a citizen. The good of the individual can’t be attained until the good of city-state has been attained. In accordance with the doctrine of the mean, Aristotle believes that “the amount of property which is needed for a good life is not unlimited.”

⁴⁰. *E.N.* 1107^a.

⁴¹. Definitions:

Science: demonstrative knowledge of the necessary and eternal

Intuitive reason: knowledge of the principles from which science proceeds

Theoretical/philosophic wisdom: the union of intuitive reason and science

Art: knowledge of how to make things

Practical wisdom: knowledge of how to secure the ends of human life

⁴². *E.N.* 1140^b.

⁴³. *E.N.* 1141^b-1142^a.

⁴⁴. *Pol.* 1252^a.

⁴⁵. *Pol.* 1252^b.

⁴⁶. *Pol.* 1253^b.

⁴⁷. *Pol.* 1253^b.

Aristotle distinguishes between natural and unnatural modes of acquiring property. The natural mode takes the form of acquiring goods from the land.⁴⁸ The unnatural mode involves exchange where the goal is money and profit. Again, using his principles of natural teleology, Aristotle argues that animals by nature and instinct acquire their “goods” from the land, and by analogy man also acquires goods naturally from the land. Therefore, certain modes of acquiring property, such as hunting, fishing and farming, are natural. Nature provides a bare livelihood to all when they come into existence and throughout their lives. Plants exist for the sake of animals. “Now if nature makes nothing incomplete, and nothing in vain, the inference must be that she has made all animals for the sake of man.”⁴⁹ Aristotle continues his argument with his belief that by nature there are those who are meant to rule and those who are meant to be ruled. Therefore, war (or piracy) against those who are natural inferiors is a natural way to acquire property.

Aristotle also discusses ownership and use of property. He looks at three possibilities: private ownership of land, common use of produce, (2) common ownership, private use, and (3) common ownership, common use.⁵⁰ He rejects common ownership for a number of reasons. Among them, if people do not both work and share equally, there will be resentment between those who work much and get little and those who work little and get much. However, Aristotle also believes that people are not all equal, so they should not have equal possessions. We can easily trace the roots of modern capitalism back to Aristotle. The essence of capitalism is to introduce fair competition and to generate property rights, since people will not work harder unless they are allowed to keep the fruits of their labors. This is perfectly demonstrated by the tragedy of the commons⁵¹, where common ownership miserably fails to motivate people to work harder. Aristotle recognizes that “fair” means “not equal,” a basis for capitalism. Common property may create disputes and quarrels. He advocates the first option again for a number of reasons. When there is private ownership, everybody will tend to their own business rather than wasting time with quarrels and disputes. Private ownership of property gives more pleasure than common ownership. It allows the great pleasure of helping and sharing with friends, and it gives an opportunity to show the virtue of liberality in the matter of property. He sums up this point as follows: “For, although every man has his own property, some things he will place at the disposal of his friends, while of others he shares the use with them.” Aristotle’s arguments for private ownership are not economic, but they are similar to his argument that only a limited amount of wealth is necessary for the good life.

3.3 Exchange and Value

Aristotle makes his famous distinction between “*value in use*” and “*value in exchange*” to explain barter and exchange for money, and under what conditions they may be considered natural.⁵² He was the first to make this distinction, writing, “*For example, a shoe is used for wear, and is used for exchange; both are uses of the shoe.*” One who gives a shoe in exchange for money or food to one who wants a shoe, does indeed use the shoe as a shoe, but this is not its proper or primary purpose, for a shoe is not made to be an object of barter. The same may be said of all possessions, for the art of exchange extends to all of them, and it arises at first from what is natural, from the circumstance that some have too little, and others too much. Hence, we may infer that retail trade is not a natural part of the art of getting wealth; had it been so, men would have ceased to exchange when they had enough. In the first community, indeed, which is the family, this art is obviously of no use, but it begins to be useful when the society increases.⁵³ Barter and exchange for money are natural as long as the purpose/end is to satisfy natural needs by acquiring necessary goods to lead the good life. When money and profit become the end, instead of acquiring goods for self-sufficiency, then it is unnatural and there is no limit. This is a typical example of the law of comparative advantage, an economic theory about the work gains from trade for individuals, firms or nations that arise from differences in productivity and technological progress. Aristotle admonishes, however, that one should engage in trade for self-sufficiency, not for profit or money.

Aristotle discusses distribution and exchange in Book V of *Ethica Nicomachea*, where the “*just*” price referred to by many writers⁵⁴ is partially explained. Distributive justice requires distribution of common goods in accordance with geometrical proportion based on “*merit*.”⁵⁵ The definition of merit is not fixed, but it could be free status, noble birth, excellence, etc. In the case of a partnership, it will be the relative contribution of funds by partners. If the first person is A and the second one is B, then they should receive portions C and D, respectively. The portions C and D should be

⁴⁸. *Pol.* 1256^a-1256^b.

⁴⁹. *Pol.* 1256^b.

⁵⁰. *Pol.* 1263^a-1264^b.

⁵¹ The *tragedy of the commons* is used to describe a situation within a publicly shared resource system where individual users acting independently according to their own self-interest behave contrary to the common good of all users by depleting or spoiling that resource through their collective action.

⁵². *Pol.* 1257^a-1257^b.

⁵³. *Pol.* 1257^a.

⁵⁴. See Wilson (1975) for an extensive discussion.

⁵⁵. *E.N.* 1131^a-1131^b.

such that $(A/B) = (C/D)$ and, then, $(A/C) = (B/D)$. If they are not equal before the distribution, then they should not receive equal shares. Also, since $[(A+C)/(B+D)] = (A/B)$, they should be in the same relative positions after the distribution. Therefore, justice is a mean between giving A more than his share and giving B more than his share.

Corrective justice, unlike distributive justice, requires the treatment of two parties as equals, $A=B$, and therefore should be in accordance with arithmetical progression, which Aristotle calls “*arithmetical proportion*.”⁵⁶ One party, A, is assumed to have a gain of C so that he is at a position of $A+C$. The other party, B, is assumed to have the same amount, C, of loss, so that he is at a position of $B-C$, or $A-C$, since A and B are equal. Then corrective justice requires transferring the portion C from A to B. “[T]he just is intermediate between a sort of gain and a sort of loss, viz. those which are involuntary; it consists in having an equal amount before and after the transaction.”⁵⁷

Justice in exchange or commercial justice requires reciprocity in accordance with proportion, or proportionate equality of goods exchanged.⁵⁸ Aristotle uses an example in which A is a builder, B is a shoemaker, C is a house, and D is a shoe. There is no reason the “worth” of one’s product should not be more than that of the other’s. In order to have a just exchange, they must be equated and be comparable. How the worth/value is measured is not clearly stated. However, the fact that generally people who are different and unequal are involved in an exchange is emphasized. Some writers interpret this as a labor approach to value determination.⁵⁹ Proportionality is implied to be set by reference to the parties involved. “The number of shoes exchanged for a house [or for a given amount of food] must therefore correspond to the ratio of builder to shoemaker. For if this be not so, there will be no exchange and no intercourse. And this proportion will not be effected unless the goods are somehow equal. All goods must therefore be measured by some one thing...”⁶⁰ Aristotle argues that the actual unit is demand, but money has become representative of demand. He uses the word ‘demand’ in the sense of want or need. This leads some writers to infer that Aristotle implies a utility approach to value determination.⁶¹ If men do not need each other’s goods at all or equally, there will either be no exchange or the exchange will not be just. The proportionality needs to be set before the exchange so that each party will not set a high price for his own goods and a low one for the other’s. Then, each party will get the mean, i.e., not too much not too little. Aristotle seems to advocate prices (values in exchange) fixed in terms of money. Then, exchange of goods for money will take place when only one party needs goods. The party that doesn’t need the goods then will know for sure that in future he can acquire whatever goods he needs using money. What process sets prices? Law or convention? Aristotle is not clear on what process sets or fixes prices. In Aristotle’s system, the purpose of exchange is to redistribute from ones with excesses (surpluses) to ones with deficiencies in external goods needed for the good life by receiving or paying “just” compensation, not the type of executive compensation in this country. The word, “Just” compensation reminds us of the corporate earnings management practices, where managers artificially adjust reported earnings, through the use of “Cookie Jar” accounting, to maximize their personal gains.⁶²

Aristotle also gives two detailed examples of people who became wealthy by creating monopolies. He says this may be useful to people “*who value the art of getting wealth*” and to statesman who should be aware of this financial device, since a state may also practice it when in need of money. One of his examples is the self-serving one of a poor philosopher, Thales the Milesian, which shows that a philosopher has the wisdom to become wealthy but has higher goals in life.⁶³

Kauder (1953) argues that the beginnings of the marginal utility theory can be traced back to Aristotle. Kauder claims that Aristotle reasoned that economic goods “*derive their value from individual utility, scarcity and costs*” and, also, that Aristotle had some understanding of the law of diminishing utility and the theory of imputation based on loss calculation, a utility theory of value. These claims are based on Kraus’s interpretation of some quotations from Book VII of *Politica* and Book III of *Topica*.⁶⁴ In *Politica*, Aristotle is talking about economic goods when he discusses

⁵⁶. E.N. 1132^a.

⁵⁷. E.N. 1132^b.

⁵⁸. E.N. 1133^a-1334^a. Aristotle refers to this reciprocal proportion as “*principle of compensation*” when discussing private versus common property (*Pol.* 1261^a).

⁵⁹. Ross (1995) elaborates on this “*reciprocal proportionality*” by using the time it takes to make each product even though he admits that Aristotle does not explicitly use time.

⁶⁰. E.N. 1133^b.

⁶¹. E.g., Kauder (1953), Spengler (1955).

⁶² This is the term coined by a former SEC chairman, Arthur Levitt, in his address. Managers get more compensation, or pay less taxes, or get fresh financing from utilizing Cookie Jar accounting.

⁶³. *Pol.* 1259^a.

⁶⁴. “[W]hereas external goods have a limit, like any other instrument, and all things useful are of such a nature that where there is too much of them they must either do harm, or at any rate be of no use, to their possessors” (*Pol.* 1323^b). “Moreover, judge by the destructions and losses and generations and acquisitions and contraries of things: for things

“external goods,” which are tools/means for the good life. While having too many external goods has no use and may cause harm, goods of the soul do not have a limit. However, is Aristotle really talking about economic goods in *Topica*? Kauder, citing pruning hook and the saw, states that “*The context makes it quite clear that Aristotle applies his argument to economic goods.*”⁶⁵ The examples cited are the only ones that can be called straight economic goods among the many examples Aristotle used; in general, he is rather talking about “good things” such as courage, temperance, health, happiness.⁶⁶ According to Aristotle’s classification, these are mostly goods of body and soul. Spengler (1955) questions Kauder’s argument that Aristotle anticipated the theory of imputation with his writings in *Topica*. He uses passages from *Topica* and *Rhetorica* to support his argument that in *Topica*, Aristotle writes on the art of argument and discussion, and his views are not significant for economic analysis. Spengler believes that Aristotle does not develop his economic ideas in *Politica* and *Ethica Nicomachea* using his views from *Topica*. Gordon (1964) argues that Aristotle’s writings contain not only a utility approach, as Kauder claims, but also a labor approach to value determination. He also employs passages from *Topica* and *Rhetorica* to support his argument.

Schumpeter (1954) claims that Aristotle attempted but failed to develop a theory of exchange value or price in market exchange. Other authors, such as Wilson (1975), emphasize that Aristotle was not attempting to perform an analysis of market exchange but rather was concerned with acquisition in a non-market context.⁶⁷ Therefore, his analysis is important only in a historical context and irrelevant in today’s market economy. Polanyi (1957) argues that Aristotle had an understanding of market exchange, which was in its earlier stages of development, but rejected it in favor of non-market exchange for acquisition of goods necessary for the good life. Lewis (1978) agrees with Polanyi and advances that argument by discussing the incompatibility of acquisition of necessary goods for the good life and anxiety created by market exchange. Lewis believes that uncertainty of acquisition guided Aristotle in considering what natural or unnatural mode of acquisition is.⁶⁸ Lewis goes on to argue that the requirements and standards set by friendship and citizenship on non-market exchange are very difficult to live by; therefore we find it difficult to do business with friends.

3.4 Money and Interest

Money means coinage to Aristotle. Money becomes useful when goods cannot be carried around or stored to be bartered when needed. “*For the various necessities of life are not easily carried about, and hence men agreed to employ in their dealings with each other something which was intrinsically useful and easily applicable to the purposes of life, for example, iron, silver, and the like.*” Money must be a commodity like others and have a value separate from its monetary function. Aristotle explains that at first, value was measured by weight and size, and later stamps were used to mark value without the necessity of weighing each time. Aristotle argues that coined money became important only by convention or law as a medium of exchange and that it is not natural. It can be replaced by another commodity if users decide to do so; then it will be worthless in acquiring the necessities of life.

When discussing justice in exchange or commercial justice, Aristotle introduces money as a measure of value of goods exchanged. “It is for this end that money has been introduced, and it becomes in a sense an intermediate; for it measures all things, and therefore the excess and the defect.” Money makes possible indirect exchange of goods. Goods may be exchanged for money when only one party needs goods. Since money, a store of value, can later be exchanged for goods, it facilitates future exchanges. Aristotle admits that the value of coined money fluctuates as well, but not as much as the value of other goods. Therefore, Aristotle explicitly or implicitly characterizes money as a store of value, a measure of exchange, and a medium of exchange. Schumpeter (1954) writes that Aristotle’s theory of money, which he

whose destruction is more objectionable are themselves more desirable. Likewise also with the losses and contraries of things; for a thing whose loss or whose contrary is more objectionable is itself more desirable. With generations or acquisitions of things the opposite is the case: for things whose acquisition or generation is more desirable are themselves also more desirable...” (Top. 117^b).

“*[A] thing is more desirable if, when added to a lesser good, it makes the whole a greater good. Likewise, also, you should judge by means of subtraction: for the thing upon whose subtraction the remainder is a lesser good may be taken to be a greater good, whichever it be whose subtraction makes the remainder a lesser good*” (Top. 118^b).

⁶⁵. Kauder (1953), p. 639.

⁶⁶. Aristotle also writes, “*a greater number of good things is more desirable than a smaller, either absolutely or when the one is included in the other, viz. the smaller number in the greater*” (Top.117^a). Could this be interpreted as indifference curves? (Spengler (1955)).

⁶⁷. This view gained more acceptance as a better interpretation of Aristotle’s writings.

⁶⁸. Pol. 1258^b.

calls the Metallist Theory of Money, prevailed until the end of the nineteenth century and beyond, and “*is the basis of the bulk of analytical work in the field of money.*”⁶⁹

Aristotle argues that retail trade, which he also calls an unnatural form of wealth-getting, arose out of the use of coined money for exchange. The most unnatural and “*hated*” form of wealth-getting is usury,⁷⁰ which makes profit from money itself alone and has no natural purpose. Interest (τόκος) “*is applied to the breeding of money because the offspring resembles the parent.*”⁷¹ This condemnation of interest was continued by earlier scholastic writers such as St. Thomas Aquinas.⁷² St. Antonine (Antonio Pierozzi; 1389-1459 A.D.) was the first scholastic writer who clearly stated a case for interest payment and started the outlines of a theory of interest.⁷³ The interest and fee revenues earned by the banking industry in this country are in the tens of billions of dollars, and US public corporations pay about one-third of their operating income as interest expenses, according to current *Compustat* data. It is a legitimate cost of doing business in the modern economy, yet it goes against Aristotle’s teaching.

4. Summary and Conclusions

Aristotle’s philosophy was explicitly systematic, and similar threads and ideas appeared in his writings on various topics. There has been an interest in his writings over the centuries – especially since the twelfth century. His writings, including those on economics, have been interpreted, reinterpreted and sometimes misrepresented. The problem is partly due to Aristotle’s vagueness in some of his writings, and partly due to writers concentrating on few passages without taking into consideration his total system of philosophy. In some cases, the resulting discussions reflect the writers’ individual preconceptions and convictions more than Aristotle’s intended meaning. What is agreed upon is that Aristotle’s writings are considered to be the starting point of the histories of many modern fields, including ethics and economics.

In Aristotle’s system, politics is the supreme practical science, and ethics and economics are integral parts of politics. Hence, Aristotle’s ideas on ethics have important implications for his ideas on economics. Aristotle’s ethics is teleological in the sense that man acts in a certain way in order to get closer to “*the good for man*” and not because certain actions in themselves are seen as right. Man’s function in life is to lead the good life that will reach the goal of “*the good for man,*” i.e., happiness or well-being. Moreover, ethical judgments are not universal and precise, because they hold only for “*the most part.*” Moral virtue is a state of character and is a disposition to choose the mean. The mean is what separates virtue from vice. The mean is hard to attain, and sometimes the extreme that is less erroneous may be chosen as a second best in particular cases. The mean is determined by the right rule in accordance with practical wisdom, and a man of practical wisdom “*perceives*” what the ethical standard is. Practical wisdom, which is gained through good upbringing and experience, secures the good of the individual, whereas political wisdom secures the good of the state, which is taking priority over the individual.

Aristotle believes that the state is the highest form of association and, therefore, aims at the highest good. The state aims to satisfy all the needs of men and offers them the good life. The household is the most basic association and aims to satisfy a man’s daily needs. Men of practical wisdom are good at managing households and states. Property, goods, exchange and money play a large part both in household management and, ultimately, in city-state management. Aristotle’s ideas on the topics are strongly affected by his two important beliefs on society and the purpose of human life. The first is his belief in a hierarchical society where free citizens are at the top, free but economically dependent craftsmen/tradesmen are in the middle, and “*natural slaves*” are at the bottom. Second, he disapproves of retail trade and the pursuit of unlimited wealth since he believes that only a limited amount of wealth is necessary for the purpose of life and the good life.

Over the last several decades, we have been witnessing seismic changes in corporate America: the myopic perspective of American managers, the relentless pursuit of short-term paper profit, reckless disregard for the interests of the non-shareholder community, a rise of hedge fund activism, and an ever-increasing use of incentive compensation, which arguably motivates managers to take on riskier investments, to name just a few. By juxtaposing Aristotle’s principles of ethics and economics with contemporary business ethics, we attempt to propose some guiding principles for economics, and by extension, for accounting and finance, from a great philosopher. By no stretch of imagination have we made any progress, in the spirit of Aristotle’s ideals, in more than the last two millenniums.

⁶⁹. Schumpeter (1954), p. 62-63.

⁷⁰. *Pol.* 1258^b.

⁷¹. τόκος literally means “offspring.”

⁷². “[A]bout A.D. 325 usury was forbidden to the clergy only, by the end of the twelfth century it was forbidden to the laity. It was declared absolutely illegal in 1311 at the Council of Vienna” (Bell, 1967; p. 44).

⁷³. Schumpeter (1954), p. 105.

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