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Civil economics: definition and strategies for sustainable well-living

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Civil economics: definition and strategies for sustainable well-living

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Abstract

The civil economics paradigm presented in this paper has two main characteristics. First, it identifies the philosophical roots of the limits of our socioeconomic system in the reductionist views of human beings, corporations and value. The three reductionist views not only fail to capture an important part of the reality, but also produce poverty of sense of life (also defined as eudaimonic wellbeing) and of life satisfaction, thereby generating a suboptimal level of wellbeing. The civil economy paradigm proposes an alternative where it is acknowledged that i) part of the individuals depart from purely self-regarding preferences and develop other-regarding and relational skills enabling them to overcome social dilemmas, ii) part of the productive system depart from the profit maximization paradigm and aim to satisfy the interests of a wider range of stakeholders beyond shareholders, and iii) value is, beyond GDP, the stock of cultural, environmental, spiritual and economic resources that a community can enjoy. The second qualifying point of the civil economy paradigm is that it proposes a richer four-hand approach to political economy (as an alternative to the traditional two-hand approach) where actions of the traditional invisible hand of the market and the visible hand of institutions in solving failures are complemented and supported by the complementary action of the two additional hands of grassroot citizens' participation and socially and environmentally responsible companies. In our paper we explain and document that these two additional hands are already at work, thereby confirming that the reductionist hypothesis on individuals and corporations is rejected by empirical evidence.

In the paper we argue that the civil economy paradigm, by increasing social participation and generativity of all actors, has the power of bridging the gap between the current suboptimal and the socially optimal sense of life (well described in the concept of "common good"). We as well provide evidence showing that the paradigm is far from being unrealistic and that its sprouts are already working in several fields of our society, preparing a more thorough transformation and full replacement of the old paradigm at theoretical level that is near to come.

Keywords: business ethics, multidimensional wellbeing, corporate social responsibility.

JEL Classification: A1, B4, P1.

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1. Introduction

Whoever reads, studies or teaches a standard undergraduate microeconomic program can be easily aware that the theory shaping the structure and behavior of our socioeconomic system is heavily unbalanced toward two main goals: the creation of the maximum shareholder wealth and the generation of consumer surplus. In the basic microeconomic theory labour is just a production input and a cost item, to be minimized by any productive unit in order to be efficient and win the competitive race. To put it in a historical perspective, the ideas of moral philosophers that created the consensus of modern economic theory were formed at the end of the 18th century and were heavily influenced by a world of poverty and scarcity. Such world stimulated them to set the goal of addressing this specific problem on the basis of a (reductionist) anthropological premise where human beings were essentially individuals whose utility/felicity could be maximized by providing a wider range and variety of goods and services at the lowest possible prices.

The project was extremely successful since the invisible hand of competition (buttressed by antitrust institutions and rules, given that competition is not the natural instinct of producers but needs to be enforced by proper regulation) progressively created abundance of goods and services at low prices that produced large consumer surplus. And the goal of profit maximization was important to accumulate resources that could be invested to increase productivity and stimulate research and innovation.

Founders of the modern economic thinking were obviously aware of market failures, that is, of the gap between private optimum and social optimum when economic action is left only to market forces. To tackle the problem they created a "*deus ex machina*", the benevolent planner, with the goal and power to solve them. In this way they implicitly considered that a two-hand (market plus institutions) system was sufficient to address the problem.

A deeper limit of this approach was however in its anthropological premises, or, put in other terms, the original goal of mainstream economics needs today to be reoriented, given what already achieved (in terms of productivity and variety of goods available at cheap prices), and the new challenges of the future. This is because the vast amount of empirical studies on the determinants of life satisfaction and sense of life (eudaimonic wellbeing) clearly evidence that the richness of human life, self-fulfillment and human flourishing depend not just on what we purchase but also, and crucially, on the quality of human relationships, spiritual life and, for a crucial part, from the quality and dignity of labour.¹ The crucial importance of life sense for human beings is as well confirmed by the empirical literature on the nexus between eudaimonic happiness and health, where it is shown that poverty of sense of life is a mortality risk factor (Bachelet et al., 2016). In addition to it, the consumer utility maximization paradigm is unable to explain an important part of human behavior concerning identity choices. In this direction new contributions modelling the individual as a purpose searcher before being an utility maximizer are slowly gaining way in the theoretical literature (Chater and Loewenstein, 2016, Akerlof and Cranton, 2000).

A further problem in the traditional paradigm is that the dignity of labour is not necessarily independent from the competitive pressure that lowers prices. When price falls are not determined by technological innovation, we often find reduction of quality and dignity of labour beyond them. Until we will arrive to a point in which production process will be fully mechanized and factories will be without workers, the risk that the second

¹ See among others Frei and Stutzer (2002a, b and c) and Becchetti and Pelloni (2013).

factor contributes to explain low prices will be and remain strong, generating a trade-off between consumer and worker wellbeing.

Based on these introductory premises the goal of civil economics is that of addressing the limits of the current economic thought (and especially the suboptimal outcome it creates in terms of richness of sense of life) by proposing a change of paradigm (Bruni and Zamagni, 2004). In this paper we will illustrate the main characteristics of this change and its straightforward consequences in terms of active citizenship and policy measures that may greatly help to achieve the desired transformation.

Specifically, the difference of the civil economics can be synthesized in two points.

The first point requires us to broaden our minds against anthropological, corporate and value reductionisms: i) human beings need not be *homines economici* (do not have exclusively self-regarding preferences) but can be “*personae*” looking for purpose in life whose relational skills are crucial for individual and social flourishing and whose cooperative, trust and trustworthiness skills are crucial to solve social dilemmas and generate superadditivity; ii) the corporate goal needs not be profit maximization but can be creation of value added in a frame of social, environmental and fiscal responsibility, thereby producing much higher and positive impact in terms of value and life sense; iii) “value”, or the indicator used as a benchmark for political economy, need not be the flow of goods and services sold in a given geographical area but can be a multidimensional wellbeing indicator proxying the stock of spiritual, economic, relational, environmental and cultural goods that a community may enjoy in a given geographical area.

The second distinctive feature of the civil economic paradigm concerns political economy and implies the move from a two-hand to a four-hand approach. Solutions to the problems we are facing (inequality, environmental sustainability, poverty of sense of life) cannot be generated by a system where only two hands (the invisible hand of the market and the visible hand of institutions) are at work. In order to be effective these two traditional hands need a strong support from the third hand of active citizenship and from the fourth hand of sustainable productive organizations. The two qualifying points of civil economics (going beyond individual, corporate and value reductionism and moving from a two-handed to a four-handed political economy approach) are strictly connected with each other since the third hand (active citizenship) implies the rejection of anthropological reductionism and the fourth hand (responsible companies) the rejection of corporate reductionism.

The rest of the paper is organized as follows. In the second section we discuss how the civil economy paradigm challenges the three reductionist views. In the third section we outline characteristics of the move from the two-hand to the four-hand system. In the fourth section we explain why the vote with the wallet is a crucial lever in the four-hand political economy approach and we explain how it works. In the fifth section we discuss some policy solutions that can boost the civil economy paradigm, fully enhancing its potential in terms of solution of market and institutional failures and achievement of the common good.

2. Three frontiers for the economic paradigm: how civil economics could help solving the new challenges

The goal of the civil economic paradigm is threefold as it aims to broaden our minds against reductionist views of human beings, corporations and what is considered as “value” in the society.

2.1 Anthropological reductionism

With regard to the first (anthropological) reductionism, the recent empirical literature has widely documented that the homo economicus is unhappy,² minority³ and socially harmful. The third point is very relevant for economic theory. Most of economic life is made of social dilemmas. Along this line the various prisoner’s dilemmas, trust (investment) games,⁴ travelers’ dilemmas (Basu, 1994) have modelled the intuition provided, among the first, by Hume with his famous aphorism.⁵ In essence, human life is made of situations of asymmetric information and incomplete contracts in which trust and trustworthiness (two fundamental dimensions of what is called social capital) among individuals with non overlapping competencies may trigger cooperation, avoid abuse of trust and therefore produce superadditivity and socially optimal outcomes.

The solution is however not simple. The individual who chooses to trust accept to run a social risk, since trusting implies putting oneself in the hand of another human being without legal protection.⁶ The image that best resembles the act of trusting is that of the trapeze artist that launches himself in the vacuum, hoping that his mate on the other side will reach out to keep his hand, preventing him to fall on the ground. Trust and trustworthiness are therefore “soft skills” that require specific relational abilities. The empirical literature on trust (Johnson and Mislin, 2011) shows that crucial drivers of it are

² Helliwell, Huang and Wang (2016) show in the 2016 World Happiness Report that gratuitousness is one of the six key factors explaining 75 percent of the differences in life satisfaction among world countries. The homo economicus paradigm does not consider that possibility and therefore is bound to lower level of life satisfactions. Park et al. (2017) show in a neuroscience randomized experiment that individuals being given the task of using the money received for other-regarding purposes activate areas of the brain associated with life satisfaction, while this is not the case for those being given the task of using the money for themselves.

³ Engel (2011) creates a meta-paper using data from 328 different Dictator game experiments held in different countries (for a total of 20,813 observations). He shows that only one third of observation conforms to the homo economicus paradigm concluding that *“While normally a sizeable fraction of participants does indeed give nothing, as predicted by the payoff maximisation hypothesis, only very rarely this has been the majority choice. It is by now undisputed that human populations are systematically more benevolent than homo oeconomicus”*.

⁴ The seminal paper on trust games is that of Berg, Dickhaut and McCabe (1995). The meta-paper of Johnson and Mislin (2011) provides a nice synthesis of experimental results in this literature.

⁵ *«Your corn is ripe to-day; mine will be so tomorrow. It is profitable for us both, that I should labour with you to-day, and that you should aid me to-morrow. I have no kindness for you, and know you have as little for me. I will not, therefore, take any pains upon your account; and should I labour with you upon my own account, in expectation of a return, I know I should be disappointed, and that I should in vain depend upon your gratitude. Here then I leave you to labour alone: You treat me in the same manner. The seasons change; and both of us lose our harvests for want of mutual confidence and security. .»* (Hume Treatise on Human Nature, 1740, book III).

⁶ *“Trust is the investor’s willingness to make herself vulnerable to others’ action”* (Hong and Bohnet, 2007). *“An individual (let’s call her the trustor or investor) trusts if she voluntarily places resources at disposal of another party (the trustes) without any legal commitment from the latter”* (Fehr, 2009).

reciprocity, inequity aversion, strategic and pure altruism, guilt aversion, betrayal aversion and risk aversion. Empirical and theoretical literature also show that they can be helped by the quality of human ties (relational goods)⁷ since, in presence of them, the act of betraying trust has the extra cost of breaking human ties (Becchetti and Pace, 2012). The dynamic context of repeated games also opens the way to several potential strategies that can help to enforce cooperative equilibria, not only in standard but also in evolutionary games where the assumption of rational behavior is removed (Becchetti and Salustri, 2015).

The trust game well explains the microeconomic nexus between social capital and growth. When trust and trustworthiness are in action, forces are joined and superadditivity produces added value. Empirical evidence at national and regional level confirms that the quality of social capital is a crucial ingredient of the wealth of nations and regions (Zak and Knack, 2001).

The above mentioned literature confirms that the homo economicus purely self-regarding rationality⁸ is an inferior form of rationality producing suboptimal results for himself and for the rest of the society. Individuals going beyond anthropological reductionism mix self-interest and other regarding preferences, satisfy better their sense of purpose and their generativity and, if they overcome the “lack of confidence trap” and are able to trigger reciprocity in social dilemmas, they create cooperative networks that produce superadditivity. The research question is whether other-regarding preferences are innate or can be educated and how education and culture can contribute to them. What is certain is that the reductionist paradigm that does not acknowledge their existence is a “dismal outlook” that does not contribute to their development.⁹

2.2 Corporate reductionism

With regard to the second (corporate) reductionism, profit (and/or shareholder wealth) maximization is still the standard goal of productive organizations according to most economic models (and to graduate textbooks). This standard view ignores that large part of productive organizations (ie. consumer, worker and social cooperatives, work reintegration cooperatives, non profit maximizing microfinance institutions, cooperative and community banks and in general all for profit organizations that adopt social and environmental responsibility practices or develop corporate welfare policies) depart from this goal. The profit maximization approach is being challenged in the most recent years even in the cultural environment in which it is born. A straightforward example is (as mentioned in the introduction) the May 2017 number of the Harvard Business Review¹⁰

⁷ Relational goods are defined in the literature as “antirivalrous”, partially excludable local public goods. On the characteristics and debate around relational goods see, among others, Gui (2005), Ulhaner (1989) and Bruni and Stanca (2008). For the role of relational goods in explaining the Easterlin paradox, see Bartolini et al. (2008).

⁸ What we mean here is when individual’s satisfaction/utility grows only for her/his own higher monetary payoffs or availability of desirable goods, and it is in no way affected by wellbeing of others.

⁹ Bauman and Rose (2009) find that economic students are more selfish than other students. Similar results are found by Frank, Gilovich and Regan (1993), Selten and Ockenfels (1998), (Frank and Schulze 2000).

¹⁰ Harvard Business Review, Managing for the long term, May/June 2017.

collecting contributions from various experts that explain why profit maximization can threaten the survival of corporations.

These contributions emphasize what is today the strongest point of attack to corporate reductionism: its inefficiency also in terms of corporate self-interest. The goal of maximization of shareholder wealth implies that the interest of one stakeholder (the shareholder) comes before that of all other stakeholders (workers, consumers, suppliers, local communities). In this respect profit maximization, by definition, creates an additional source of corporate risk represented by the likelihood of conflicts with other stakeholders (Freeman, 1983). When shareholders are shortsighted, or are highly impatient (have high intertemporal discount rates), this problem is exacerbated since their strategies may threaten corporate survival in the long run. This is why letters of investment funds to companies warning about aggressive strategies that endanger sustainability are becoming more and more frequent.¹¹ A further profit maximization paradox that clearly demonstrates that the reductionist view produces gaps between private and social optimum is that of banks maximizing shareholders' wealth. If they do so, they will never find it optimal to lend to small sized borrowers, given that per unit fixed screening and monitoring costs are too high with respect to interest payment revenues on small loans. Up to the paradox that banks that maximize profits are no more banks (at least if we consider their traditional role of lending to the small business segment that accounts for the vast majority of productive units).

The corporate model for the civil economy paradigm is therefore represented by a company that creates value in a socially, environmentally and fiscally sustainable value. Such company contributes much more to wellbeing and its prevalence is therefore desirable from a social point of view. While nowadays there is widespread consensus on the importance of corporate environmental sustainability (and a lot of pressure on it from institutions, investment funds and the civil society), the challenge on social responsibility is still far from being solved and the brand new frontier of corporate responsibility is fiscal responsibility. As is well-known social responsibility involves relationship with workers and human rights for suppliers' employees, while fiscal responsibility relates to corporate decisions not to pursue aggressive tax dodging strategies. The latter typically involve profit shifting from countries where revenues are produced to tax heavens where companies have subsidiaries. The welfare loss of such practices are immense since tax dodging subtracts resources to welfare where they are needed. Evidence of tax dodging is more and more widespread with new rules on country-by-country-reporting (CBCR) (now compulsory in the US extractive industry and in the EU banking industry). CBCR data collected from the largest 20 European banks (Oxfam 2017)¹² clearly show that tax dodging

¹¹ An interesting example to understand this point can be taken From Financial Times, OCTOBER 28, 2016 where it is said that "Aggressive tax avoidance raises risks for investors Regulatory pressure has increased the financial implications of tax planning" For years, executives have defended these tax arrangements on the basis that they are legal. Some have even argued that they have a responsibility to shareholders to minimize tax liabilities Nordea Asset Management, the €300bn Nordic fund house, has written to a number of companies, including Alphabet and Apple, to warn that pressure from regulators and governments has increased overall risk for investors. The pressure for concrete regulatory changes will no doubt continue to raise regulatory risk for companies who prioritize aggressive tax practices in their financial strategies. The risks related to aggressive tax practices have raised investor uncertainty"

¹² Oxfam, 2017, Opening the vaults. The use of tax havens by the biggest European banks.

creates biases on statistics on productivity across countries with bank employees in Cayman Islands (but also in Luxembourg and Ireland) appearing to have unreasonably high productivity levels compared to those of countries that suffer tax dodging practices.

An important novel characteristic of the economic scenario is the growing market pressure against corporate reductionism.¹³ A crucial dimension on which the struggle between old and new paradigm is played is managerial compensation. In the profit maximization paradigm managers have high share of variable pay tied to profit related performance variables. This implies that, when the value added “cake” does not grow, performance targets triggering bonus payments can be achieved only by reducing the “slices” of the other stakeholders. These managerial compensation policies are therefore highly likely to reduce stakeholders’ wellbeing and enhance distributional conflicts in times of slack. What is needed from this point of view is a reform introducing social and environmental responsibility indicators among performance targets. In this way managers deserve their bonus only if they demonstrate to increase corporate profits without cutting wellbeing of the other stakeholders.¹⁴

To conclude with the second reductionism, the pressure for higher life sense and the increased perception of reputational risks from non-socially and environmentally responsible conduct in globalized economy is pushing companies toward a hybridization of their nature. Profit maximizing companies become progressively companies that look also at their socio-environmental impact beyond profits while, at the same time, not for profit organizations facing reduced state support progressively move toward integration of some profit activities. The two models meet in the middle where poverty of sense and richness of money meets with poverty of money and richness of sense.

2.3 Value reductionism

The third reductionism concerns the definition of what is value for a society. The implicit point of the reductionist view in economics has been that the pursuit of economic growth automatically implies higher wellbeing. As a consequence, GDP is also a synthetic sufficient measure of community wellbeing. The well-known Kennedy 1968 speech to the

¹³ According to Eurosif (2016) investment funds, that “vote with the wallet” simply introducing exclusion criteria, grew in Europe by 22 percent between 2014 and 2016, managing professionally around 48 percent (over 10 trillion euros) of European financial assets. According to the US SIF (2016) in the United States the amount of the SRI assets (Sustainable, Responsible and Impact) increased its value more than 30 percent only between 2014 and 2016 (\$6.57 trillion to \$8.72 trillion in two years) managing around one fifth of the financial market. The novel initiative Montréal Carbon Pledge, coordinated by the UN-supported Principles for Responsible Investment, is probably the best example that confirm the increasing role of SR funds. In 2016 around \$310 trillion of assets were gathered and managed by the initiative under the requires of “commit to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis”, providing a new field of application of the vote with the wallet.

¹⁴ See on this point, among others, the Guidelines on Ethical Shareholder’s engagement of Etica sgr a primary Italian sustainable investment fund (<https://www.eticasgr.it/download/guidelines-on-active-shareholder-engagement/>).

students of the University of Arkansas¹⁵ is a good rhetoric illustration on why this approach is misled. Kennedy lists a series of factors contributing positively to GDP and negatively to wellbeing, followed by a series of factors contributing positively to our wellbeing but being “invisible” to GDP. A recent confirmation of this measurement problem is the decision of most European statistical institutes to include drug, smuggling and prostitution revenues in the computation of domestic GDP. The well-known Easterlin paradox re-proposes the problem from a different perspective by illustrating the decoupling between GDP per capita and the share of very happy individuals in the US in the second post-war period.¹⁶

The push for going beyond the reductionist view in the definition of “value” comes not only from “unorthodox” social scientists, but much more from policymakers becoming progressively more aware that GDP growth is neither a sufficient, nor a necessary condition to win elections. In an imaginary dialogue the policymaker in charge asks to the social scientist “how much GDP growth do I need to win the elections and remain in charge?” The answer of the social scientist is that the question is misled since the crucial driver of re-election is the expected difference in voters’ life satisfaction in case of her/his win or loss. As is well known, this difference depends on many different wellbeing dimensions (health, quality of relational life, quality of the environment, education, safety, quality of services), and on the complex interplay between achievements and expectations (with the challenger always having an advantage in raising expectations and the incumbent an advantage in raising fears for change). A main lesson drawn from studies on (job, customer, life) satisfaction is that the reductionist approach, just looking at objective indicators, misses that management of expectations is a hidden crucial variable affecting individual choices. The same economic wellbeing (which obviously plays a very large role) is quite imperfectly proxied by per capita GDP since there can be a big gap between the latter and disposable income after paying for basic goods such as health and education. This point is clearly shown by 2015 Ireland elections where the government in charge lost them with a rate of GDP growth higher than 6 percent that did not correspond to an actual improvement of economic wellbeing of the majority of voters. Even though defeats of ruling parties may depend also on other factors such as the capacity of challengers of raising positive expectations on their win, policymakers have learned the lesson of the GDP-wellbeing paradox and pay increasingly more attention to the satisfaction of their “customers”, that is, to wellbeing of voters.

¹⁵ « The GDP also includes air pollution and cigarette advertising, and ambulances to clear our highways of carnage in the weekends. GDP puts locks on doors, house and prisons for those who seek to force them [...]. It includes television programs that enhance violence to sell violent products to our children. It grows with the production of napalm, missiles and nuclear warheads, includes research to improve the dissemination of the bubonic plague, grows with the equipment police uses to quell riots, and still increases when ashes build popular slum. GDP takes no account of the health of our families, of the quality of their education, or of the joy of their leisure time. [...] It does not include the beauty of our poetry or the firmness of family values, the intelligence of our debate or the honesty of our public servants. Does not take account of justice in our courts, nor of fairness in relations between us all. GDP does not measure neither our wit nor our courage, neither our wisdom nor our learning, Neither our compassion nor our devotion to our country. It measure everything, in short, except that which makes life truly worth living. It can tell us everything about America, but not if we can be proud to be Americans».

¹⁶ For the literature on the happiness paradox see, among others, Veenhoven et al. (1993), Blanchflower and Oswald (2004), Frey and Stutzer (2002), Stevenson and Wolfers (2008), Bartolini et al. (2008) and Easterlin and Angelescu (2009).

The way out from value reductionism is however extremely challenging from a methodological point of view since it opens the way to the construction of multidimensional wellbeing indicators. Crucial choices are those of the selection of proper dimensions and of aggregation weights (Becchetti and Semplici, 2017). In spite of all these difficulties, it is all the more evident that the frontiers of methodological research and political interests coincide and are the measurement of value beyond GDP. This is happening both at macroeconomic level, where multidimensional wellbeing measures are more and more used as benchmarks for economic policies, and at microeconomic level where analyses on SROI (social return on investment) are increasingly used to screen and finance investment not only for institutional but also for private lenders. This change is stimulated by the development of an increasing supply of investment funds looking for social impact and not just financial return maximization.¹⁷

An interesting institutional process toward the use of multidimensional wellbeing indicators at country level is that realized in Italy with the creation of BES. Following the suggestions of the Sen-Stiglitz-Fitoussi commission the Italian National Statistical Institute (ISTAT) started in 2012 the process of creating a set of multidimensional wellbeing indicators (134 indicators in 11 domains) called BES (*Benessere Equo e Sostenibile*). The approach followed was innovative, not only in terms of outcome but also of process. The first step was the decision of representatives of different stakeholders of the Italian society about the relevant wellbeing domains. In the second step, a commission of experts worked to identify proper indicators for each selected domain. In the third step, selected indicators were discussed and validated by the stakeholders' representatives. From then on, every year ISTAT updates the statistical outlook of Italy based on BES indicators, and correspondent indicators at city level (URBES) have been created. A further crucial step has been the approval in 2016 of a law voted by all parties asking to the government to present data on the impact of the Financial Law (*Documento di Economia e Finanza*) on a selected group of BES indicators. Italy has started doing it in 2017, with the financial law document incorporating forecasts of its impact on a very limited set of BES indicators such as disposable income, job participation, income inequality and CO2 emissions (see Table 1). This crucial change is triggering a more extended and all round debate on the impact of government policies on wellbeing and gives policymakers original insights on the impact of their choices on carbon intensity and economic wellbeing of voters (better proxied by household disposable income than by GDP). The debate could shed light on so far unexplored links between policies and wellbeing indicators. A relevant example is the impact of health expenditure, often measured only on government budget and not on life expectancy. An in-depth analysis on this point could help us to know more on the trade-off between the two goals and the wellbeing costs or benefits, in terms of longer life spells, of changes in health policies and expenditure.

3. The political economy of civil economics: from a two-handed to a four-handed approach

The mainstream political economy paradigm is two-handed. The invisible hand of the market reconciles (via competitive pressure) the self-interested profit maximizing appetites of producers with low and affordable prices of goods and services that improve consumer surplus. Even in oligopolistic models price competition leads much fewer competitors to the same perfect competition outcome (in Bertrand models). When the market fails due to the presence of public goods, externalities, asymmetric information, entry barriers, etc. the

¹⁷ See on this point Guidelines for active shareholder engagement from Etica sgr (<https://www.eticasgr.it/download/guidelines-on-active-shareholder-engagement/>).

visible hand of the institutions steps in and reconciles the divide between private and social optimum with taxes or regulation (Pigouvian taxes being a classical example of it). It must however be remarked that the same functioning of the first (invisible) hand is far from being the spontaneous result of *laissez faire* policies, since the instinct of producers is collusive and not at all competitive. The functioning of the invisible hand therefore requires strong pro-marked institutions such as antitrust authorities and a strong and independent judicial system ensuring the rule of law.

The limit of the two-handed approach is that it is too demanding toward the “*deus ex machina*” of the second institutional hand (which is required as well for the proper functioning of the first hand as seen above). In order to bridge successfully the gap between private and social optimum institution leaders must perform a “triple dead jump”, since they are expected to be i) benevolent – ie. having the goal of maximizing wellbeing of the population, provided that such goal can be in some way defined at least with reference to the median voter -, ii) fully informed and iii) so strong to escape the regulatory capture of lobbies that often have more power and monetary resources than they have.

The point made by the civil economics paradigm is that the two-hand system often fails to achieve the proposed goals since institutional failures are as common as market failures (and the “triple dead jump” is hard to be performed successfully). The wide literature of contract theory starts from the principle that interests of individuals and institutions diverge and that optimal contract clauses need to be devised in order to eliminate such divergence (Bolton and Dewatripoint, 2005). However, perfect rules and enforcement systems that can fully solve the problem are hard to be found. The civil society proposed alternative is a four-hand system where the two hands of markets and institutions are not eliminated, but complemented by the complementary work of a third hand (active citizenship) and a fourth hand (socially responsible productive organisations). The existence and action of the third and fourth hands indicate by themselves a rejection of the anthropological and corporate reductionisms discussed in sections 2.1 and 2.2. This is because active citizens “vote with their wallet”, being willing to pay extra money for social and environmental features of products and/or participate and volunteer to manage local public goods, while socially responsible productive organisations depart from the shareholder wealth profit maximization logic. These organisations instead aim at creating added value that is more equally divided among shareholders and care about the social and environmental impact of their action.

The four-hand approach is gaining momentum as it can be seen by comparing the old UN Millennium Development Goals¹⁸ with the new UN Sustainable Development Goals.¹⁹ The latter take into account much more than the former participation of the civil society, as it can be seen by the same definition of goal 12 (responsible consumption and production) and goal 17 (partnership for the goals). The latter clearly implies that the overall process for the achievement of the goals implies a close partnership among institutions, corporations and active citizenship.²⁰ This important change in perspective has been

¹⁸ <http://www.un.org/millenniumgoals/>.

¹⁹ <http://www.un.org/sustainabledevelopment/sustainable-development-goals/>.

²⁰ The Eurobarometer (2013) survey asks to a representative sample of respondents from 28 EU countries who are the actors they believe should take the leading role in influencing corporate actions: “citizens through their purchase decisions” is the answer with the highest frequency (49 percent), followed by “management of companies” (40 percent), “public authorities” (36 percent) and “trade unions” (28 percent). This ranking suggests that citizens are aware of the vote with the wallet power they have with their consumption decisions.

fostered by the same characteristics of environmental goals (reduction of waste, decarbonisation) where success in achieving targets requires active participation from citizens in terms of changes in life styles that can obviously be eased by proper taxes or regulation.

Current economic dynamics are already the result of the four hands in action, whether we consider it desirable or not, thereby raising new questions related to the definition of goals of action of the two new actors in the four-hand system. If it is true that institutions may not be benevolent, and that rules may not always be able to create proper incentives enabling them to pursue social goals, it is nonetheless true that goals of active citizenship and responsible corporations are not necessarily in line with desirable social goals. The recent emergence of the debate on post-truth (Higgins, 2016) and on outcomes of elections and referendum have made many authors wonder whether public opinions are aware of their own interests, or they can be diverted toward other directions. Education and culture will be therefore crucial in the future for a proper functioning of the four-hand approach.

4. The vote with the wallet as a crucial level of the four-handed political economy approach

The potential of the vote with the wallet is as immense as hardly exploited. If citizens have a common vision of what is socially and environmentally sustainable, and if they keep that vision into account when consuming and saving, they can use their consumption and saving choices as a vote with the wallet. By doing so, they can award with their consumption choices companies being at vanguard in the three-sided efficiency of creating economic value in a socially and environmentally responsible way (or in the four-sided efficiency that adds to the first three, the novel dimension of fiscal sustainability described section 2.2). If this is the case, the supply side of the economic system will necessarily accommodate demand tastes and social and environmental responsibility will emerge as a competitive feature in the market. The vote with the wallet is pragmatic and an act of long-sighted self-interest that gives to the same market mechanisms a role to address market failures. It is pragmatic because it simply suggests to reveal preferences through consumption and savings for those companies that are already competitive in the market, while being at the same time at top levels of social and environmental responsibility, and it is not, on the contrary, proposing an utopic solution that is out of reach, or far from being realistic.

It is as well an act of long-sighted (collective) self-interest because voters with the wallet need not do it for altruism or other-regarding reasons. Buying a green or environmentally sustainable product is good for their own health, buying a product from a company that creates good jobs is good for their own working perspective and buying a product from a company that avoids tax dodging is good since it does not subtract tax resources that can finance local welfare. Self-interest in voting with the wallet is however limited by the multiplayer prisoner's dilemma features of its social dilemma structure (Becchetti and

Salustri, 2015). As in all social dilemmas, there is a social rationality that is superior to the individual rational homo economicus conduct, even though lack of trust and trustworthiness may prevent the socially optimal solution from being achieved. The superior long-sighted self-interest therefore consists of the capacity of overcoming the social dilemma to achieve a cooperative solution that, for each individual, is Pareto superior to the Nash equilibrium outcome. We will go in depth on this point in the section that follows.

The vote with the wallet is paradoxically a way to solve market failures through market mechanisms. In this sense, it is the opposite of an anti-market stance. It is a mechanism giving to the market roles and qualities that go beyond the mere realization of efficiency gains. To understand why consider the well-known Edgeworth box explaining how the market exchange allows a couple of consumers to improve their conditions by moving from their endowment to a new (Pareto superior) allocation of resources obtained via exchange of goods (Figure 2). From an intuitive point of view, it is almost trivial that the opportunity to exchange makes everyone better off: if two individuals decide to execute a transaction, they do it because they at least expect to have a utility not lower than before the transaction. Considering that transacting is not without costs, they therefore decide to exchange because they expect transaction gains to be higher than transaction costs. Imagine however in the Edgeworth box a starting point very close to the left-down corner of the box (as in Figure 2). Such starting point implies a strong inequality in endowments of the two available goods between transactors. The exchange solution (still very close to the left-down corner) is still Pareto improving for both, but it inevitably reflects the inequality of starting conditions. To make two limit examples in this respect, even a kidney sale or child prostitution are still "efficient" market transactions since they may make transactors better off, provided that they voluntarily participated to the bargain. However, these two extreme transactions are likely to create scandal and contribute to worsen market reputation. The reason is that the market has provided also in this case efficiency gains, but it has failed to address the strong inequality of starting conditions, thereby leading the transactor on the weakest (down-left) side in the Edgeworth box to accept (and even to desire) to exchange at such poor conditions. In synthesis, the market can address efficiency but not inequality problems. The vote with the wallet overcomes this traditional market limit by creating transactions where the goal is not just efficiency, but also contribution to solve the starting inequality conditions and produce positive social and environmental impact.

Two typical critiques to the vote with the wallet approach are that market prices should just perform an allocative (efficiency gain) role, while redistribution and other social goals should be pursued by benevolent institutions. In this way, again, the reductionist theory (in search of an unattainable and unrealistic first best) claims the intervention of a *deus ex machina* with a "triple dead jump" (see section 3) that, beyond being unrealistic if expected from local institutions in global economies, has also the effect of hampering participation and generativity of the civil society and corporations. In addition to it, in global economies national or local institutions are far from the scale required to enforce optimal rules. The vote with the wallet therefore becomes an instrument through which the civil society may perform

a vicarious action. Interesting examples are models of Besley and Ghatak (2007) analyzing competition of companies “retailing public goods” and Becchetti and Solferino (2011). The latter present a case of oligopolistic competition between a fair trader and a profit maximizing incumbent in a model of horizontal differentiation. The two compete in prices and ethical location and bring the system closer to the global social optimum, vis-à-vis the action of a domestic benevolent planner that does not internalize wellbeing demands of foreign workers or citizens.

In addition to it, the birth and the development of a market where citizens vote with the wallet responds to the demand for purpose and participation of all citizens. As it is clear from the literature of procedural utility (Frey and Stutzer, 2005), individuals are much happier when they participate to the solution of a problem than when the problem is solved from the top or from third parties, even when solutions would be exactly the same in the two cases. More and more, we must become accustomed in the future to an economy where competitive advantage does not mean just producing high quality/low price products and services, but also producing goods and services that satisfy demand for purpose and experience and have a symbolic or political meaning, ie. “generative” goods, or goods that contribute positively to wellbeing of other human beings or to the achievement of social and environmental goals.

4.1 Potential and limits of the vote with the wallet

If the vote with the wallet has this great potential of transformation why not everyone votes with the wallet?

To address this question consider the inequality that follows

$$\pi\beta + \alpha - c > 0 \tag{1}$$

the inequality, when being positive, illustrates a case in which the consumer prefers the sustainable vis-à-vis the conventional product. The inequality has three fundamental components. The last component (c) is the price gap between the sustainable and the conventional product, and its negative sign suggests that may work in favour of the latter. A notable exception is however in finance where “ethical” investment funds have risk adjusted returns not significantly different from those of conventional funds²¹.

The second component (α) adds up if individuals experience a “warm glow” when buying the responsible product. This component is therefore related to other-regarding preferences that may or may not exist, are heterogeneous across individuals, but have been widely

²¹ Becchetti et al. (2015) and Nofsinger and Varma (2014).

investigated and documented by the behavioral literature.²² The first component of the inequality is composed of two elements (π and β) and measures the “political” effect of the vote with the wallet on the change in behavior of the company selling the conventional product. The easiest example is that, if everyone votes with the wallet in favor of environmental sustainability by buying green products, all companies will decide to produce more environmentally sustainable products, thereby generating a positive externality (or reducing a negative externality) on all citizens. The problem with this last component is that the externality term (β) (representing corporate change toward social and environmental sustainability) is multiplicative in the share (π) of consumers voting with the wallet. If only one consumer does it, the effect on the change in corporate behavior is negligible and the positive externality is not generated. If, on the contrary, (π) is close to one, everyone votes with the wallet and the externality effect will be maximum.

Becchetti and Salustri (2015) show that, when this inequality is the same for a large number of consumers, as it is the case in mass consumer markets, we are in a typical multiplayer prisoners’ dilemma where coordination failure and free riding lead to the suboptimal non cooperative equilibrium for reasonable parametric values of α , β and c . To explain the point simply, it would be good for all if everyone consumes the responsible product. However, in absence of a coordinated action, the dominant strategy for consumers is that of buying the conventional product. Everyone therefore does it and participants are all worse off because the positive externality is not produced. This implies that voting with the wallet is a long-sighted act of “social rationality” or social self-interest. As in all social dilemmas social rationality is superior to individual rationality. If individuals find ways to coordinate their actions and cooperate they choose the strategy (buying the sustainable product) that allows them to reach a solution that is Pareto superior, that is, a solution that is better for each of them, compared to the strategy that is optimal from the point of view of individual rationality (buying the conventional product). Said otherwise in game theoretical language, the Nash equilibrium of the game is that in which everyone buys the conventional products, but such equilibrium is Pareto dominated by that where everyone buys the responsible product. The homo economicus, myopically self-interested approach leads however to the Nash equilibrium. In this sense, we understand why the nobel Amartya Sen calls the homo economicus a “social idiot”, that is, an individual without other-regarding preferences and incapable of cooperative skills, and therefore unable to attain the socially optimal equilibrium that would be better for him as for everyone else.

²² The literature review on other-regarding preferences could be summarized by the results on the existence of elements of (positive and negative) reciprocity (Rabin, 1993) inequity aversion (Fehr and Schmidt, 1999, and Bolton and Ockenfels, 2000), other-regarding preferences (Cox, 2004), social welfare preferences (Charness and Rabin, 2002), and various forms of pure and impure (warm glow) altruism (Andreoni, 1989 and 1990).

The main issue is therefore how to make individuals aware of this potentially immense power and how to help coordination of a multiplicity of individual actors toward the cooperative strategy (at least in cases in which there is widespread consensus on what should be done, such as on environmental friendly products). Several possibilities in the literature have been explored to solve this kind of social dilemmas. Among them Fehr and Gächter (2000) consider the role of private punishment, Masclet et al. (2003) and Noussair and Tucke (2005) that of nonpecuniary sanctions, Nikiforakis and Normann (2008) the effectiveness of punishment and Anderson and Putterman (2006) and Carpenter (2007) the price of punishment. In the section that follows, we explain how the cooperative solution may be achieved with a balanced budget system of subsidies (taxes) that affect the payoff differential between defection and cooperation strategies, as shown by Falkinger et al. (2000) and Becchetti et al. (2015).

Given the characteristics of the game and of the vote with the wallet inequality in (1), it is no wonder that the main progress in this domain has occurred in finance, with the rapid development of sustainable investment funds that vote with the wallet by fixing a threshold of social and environmental responsibility for admissible stocks in the universe of investable companies (see footnote 13). For two main reasons. First, it is demonstrated that risk adjusted returns of sustainable investment funds are not significantly different from those of conventional funds, provided that the universe of investable stock is large enough to avoid costs of missed diversification (see footnote 21). Second, the problem of aggregation of individual citizens willing to vote with the wallet is much easier to solve in financial markets where financial intermediaries perform the role of aggregating savings. An individual buying a sustainable coffee votes only for her/himself and finds it hard to coordinate with hundreds or thousands other individuals willing to do the same. An individual willing to vote with the wallet with her/his savings finds in responsible investment funds an intermediary that aggregates decisions and choices of ten of thousands savers with the same opinion.

5. Some practical policy solutions

An interesting example on how the lever of the vote with the wallet may be applied for the design of new policies aimed at achieving socially desirable goals is that of sustainable development. The research field is very rich and mainly deals with supply side analyses, with focus on burden sharing of emission abatement across sovereign countries or effect of carbon taxes and environmental domestic policies on growth (e.g., Annichiarico et al. 2017; Arif and Dissou, 2016; Carfi and Schilirò, 2012). The literature on demand side policy instruments is less developed and deals with a few specific instruments (such as green taxes/subsidies and personal carbon trading schemes) (Antoniou and Strausz, 2014; Sall and Gren, 2012; Bartocci and Pisani, 2013).

Becchetti and Salustri (2016) illustrate four feed-in tariff like mechanisms that overcome the race-to-the-bottom problems of supply side carbon taxes (delocalization from countries with higher carbon taxes) and, in general, coordination problems in carbon abatement among sovereign states.

The common characteristic of all these mechanisms is that of taxing consumers choosing the conventional product and subsidizing those choosing the sustainable product. All mechanisms are balanced budget since resources for subsidizing responsible consumers are taken from those extracted from conventional consumers. The mechanisms are easily implementable because they rely on parameters that can be easily calculated and are on the demand side, thereby overcoming the race-to-the-bottom problems that may arise in integrated global markets when a single country decides to improve social and environmental production standards in his geographical area. The two authors demonstrate that liquidity constraints and heterogeneity of consumers' preferences and evaluation of the externality make the application of these mechanisms more complex but still feasible.

Developing implementable demand side mechanisms is of foremost importance given the well-known difference with supply side mechanisms. Coordination failures on supply side mechanisms (ie. burden sharing of abatement costs) are among sovereign agents and therefore cannot be solved by the imposition of a tax/subsidy scheme from a supranational entity at a higher hierarchical level that has enforcement power on players. On the contrary, on the demand side, coordination failures (such as the multiplayer prisoner's dilemma of our vote with the wallet problem) can be solved since there is a superior entity (the sovereign state) that has enforcement power on players (individual consumers). And policy measures as those proposed above do not create race-to-the-bottom effects that endanger domestic economies since they apply to both domestic and foreign companies selling in that country.

For a simple intuition on the advantage of these fiscal policy measures using the lever of the vote with the wallet consider the well-known scheme of the Pigou tax. As is well-known the scheme presents the classical market failure. The optimal private equilibrium is given by the crossing of private costs and marginal benefits of pollution and implies a level of pollution much higher than the social optimum (identified by the horizontal projection of the crossing of social costs and marginal benefit of pollution). The reason is that productive units do not internalize in its costs the negative externalities of the damage that pollution produces on the environment and on the local community (a damage that is much stronger than in the Pigou's age given the growing importance of tourism revenues). The classical Pigou tax solution implies the design of a carbon tax that forces the private corporation to internalize the externality, making the private cost schedule steeper and equal to the social cost line. The alternative is a law that forces corporations to produce no more than the socially optimal amount of pollution. However, these two supply side solutions (in the sense that they are

both intended to affect the supply of pollution) may produce in globally integrated economies the paradoxical effect of a “race to the bottom”, with corporations moving to countries with lower carbon tax. And the coordination among carbon taxes of different sovereign states is difficult due to the lack of a hierarchically over-imposed authority that can impose it.

This is why demand side solutions can be easier to implement. If consumers vote with the wallet, they implicitly raise the marginal cost of polluting of the private corporation, obtaining the same result of the Pigou tax. If the government designs as well the proper feed-in-tariff in terms of balanced budget tax/subsidy schemes, the impact on consumers’ decisions may be much stronger, and the alignment of private and social costs of consumption may be successfully achieved. A properly designed balance budget scheme is that where consumers buying less environmentally sustainable products pay an extra tax and revenues from that tax are divided among those buying the more environmentally sustainable product. This scheme is not protectionist since it does not favor products coming from a specific country. It has however the power of reducing the gap between private and social costs of pollution and to increase the value that can be created when companies internalize environmental externalities improving their environmental impact. Similar mechanisms have started being implemented in countries such as France, Italy and Portugal (Cansino, 2010). In the same direction, it has been proposed that green consumption taxes are among the best options to overcome problems of supply side environmental taxation (Albrecht, 2006) using the scheme of a 15/30 percent tax rate on conventional and sustainable products and lists products that can fall in the two categories.²³ Tailoring domestic consumption taxes in a way to produce desired effects on socially and environmentally sustainable creation of economic value is still at its origin, but appears, for the reasons explained above, a promising field of action.

²³In three European countries (France, Italy and Portugal) the VAT rate was reduced for green electricity. In the case of France there was a reduction of 5.5% for those buying basic products related to improvements, changes and installation in residential buildings that incorporate technology based on solar power, wind power, hydroelectric power and biomass. In Italy a reduced tax rate (10%, rather than the usual 22%) was introduced on sales and services related to wind and solar power generation, as well as on investments in green electricity distribution networks. Finally in Portugal, in spite of the 23% general rate, a reduced tax of 12% was introduced for buying systems which generate green electricity. In all these countries the idea was to introduce a tax incentive reducing the tax rate, loading the final cost of the operation on the government spending.

6. Conclusions

The reflection set forth in this paper considers how the standard economic paradigm is by far suboptimal in terms of generativity, life flourishing and life sense, where the latter have been widely demonstrated as being crucial drivers of quality of life. We therefore face a great potential of improvement for our living in society if we address its two main fallacies. The first fallacy (that we identify in this paper in the “dismal outlook” of the three reductionist views of human being, corporations and value) lies in assuming that individuals and corporations should just pursue their own self-interests without any interest or drive for social goals. The second (political economy) fallacy is the belief in a two-hand system, where the invisible hand of the market and the visible hand of a fully informed benevolent planner are called to bridge the gap between social optimum and private optimum generated by the interaction of fully self-interested individuals and productive units. The two main limits of this political economy approach are that we are very far from observing benevolent planners in the reality and that, even though they would exist, the two-hand system would result extremely poor and suboptimal in terms of generativity, since it would not involve a wider participation of the civil society and corporations to the design and implementation of social goals. In the 2014 Nielsen’s “Globally Conscious Consumer” 67% percent of the 28,000 individuals interviewed in 56 countries say that they would prefer to work in a socially responsible company. This is a precious anecdotal evidence showing that individuals are sense searchers and not utility maximisers. Consequently, a world where individuals and corporations do not pursue social goals and the latter are left to the action of a benevolent planner is a world poor of sense, and far below the potential of life satisfaction and life flourishing demanded by world citizens.

The social and economic reality in our days is already departing from that benchmark and moving toward a civil economic paradigm, in direction of higher generativity and participation. Individuals strive and fight to give sense to their economic life, starting from their consumption and saving up to their working choices.

In the last decades we as well assisted to big progress in the research in economics and social sciences beyond the three reductionist views of human being, corporation and economic value. The anthropological reductionism of the homo economicus has been challenged and rejected by empirical tests, in both lab and field experiments of behavioral economics (see footnote 22 and, more in general, section 2.1). The analysis of human behavior in many game theoretical situations has shown that many other motivations of human action beyond self-interest affect individual choices under monetary incentives. Among them, the role of reciprocity, inequity aversion, various forms of pure and impure altruism have been demonstrated as being very relevant. The literature on corporate social responsibility (considered in the past a violation of the dogma of profit maximization) is also flourishing and the literature on multidimensional wellbeing indicators is growing as well.

In the past, our society has been conceived as being populated only by purely self-regarding individuals that strived to escape from poverty. A system of profit maximizing productive units made them (and ourselves) richer by selling an increasing variety of good and services at affordable prices. In this world, work was made of fatigue and was at most neutral in terms of satisfaction, but it was important to earn a wage that allowed individuals to be happier by consuming goods.

The future will more likely be a world where new generations will fight to increase their life sense and generativity, and will demand purpose and participation even in their choices of consumption, saving, work and leisure. Successful entrepreneurs will therefore be those progressively more able to sell bundles of products with richer life sense and experiences embedded in them. The civil economics paradigm described here illustrates the potential directions of progress from the old to the new paradigm.

Figure 1. Edgeworth box and gains from trade in presence of highly unequal starting conditions

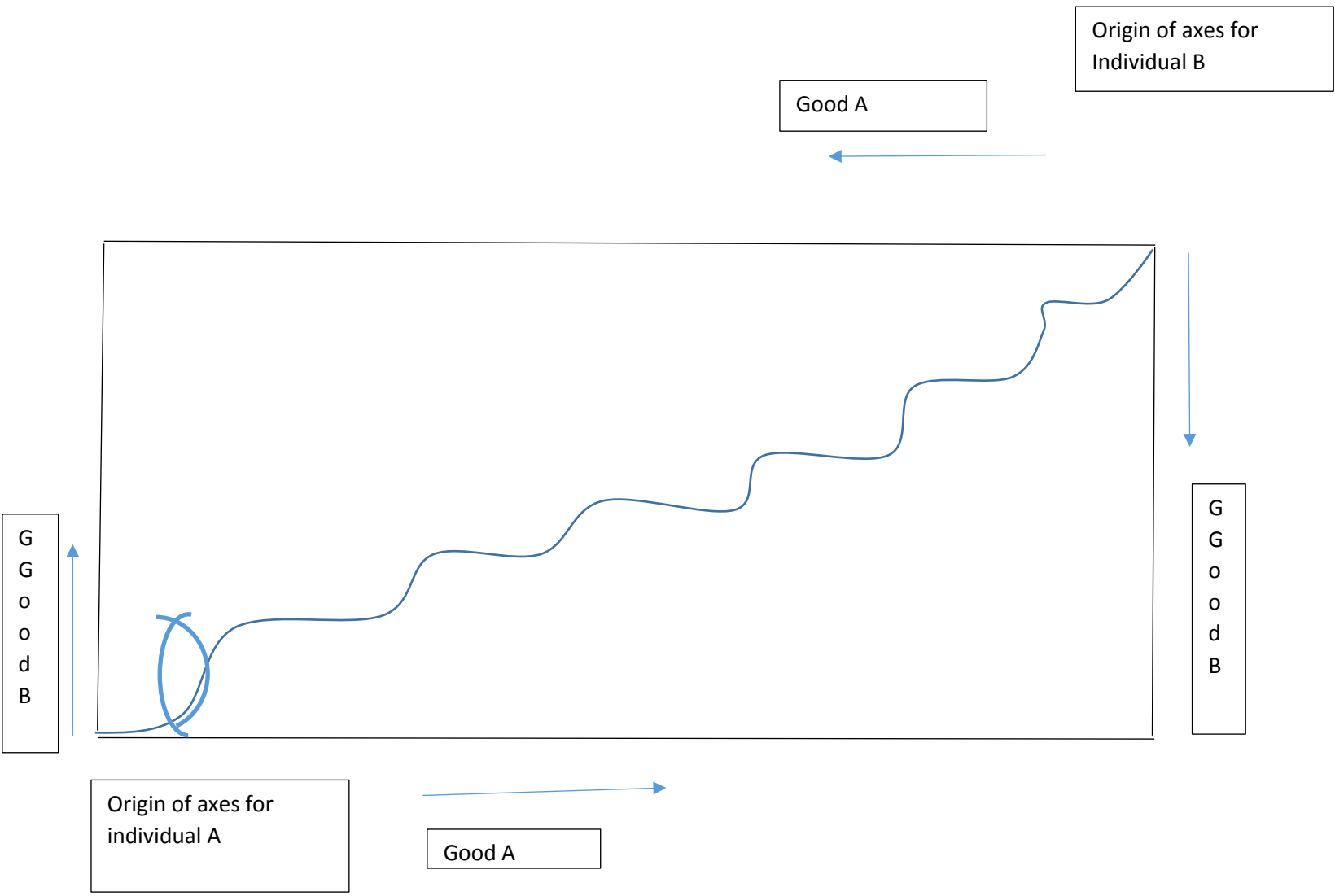


Figure 2 The role of the vote with the wallet in solving the Pigouvian tax problem

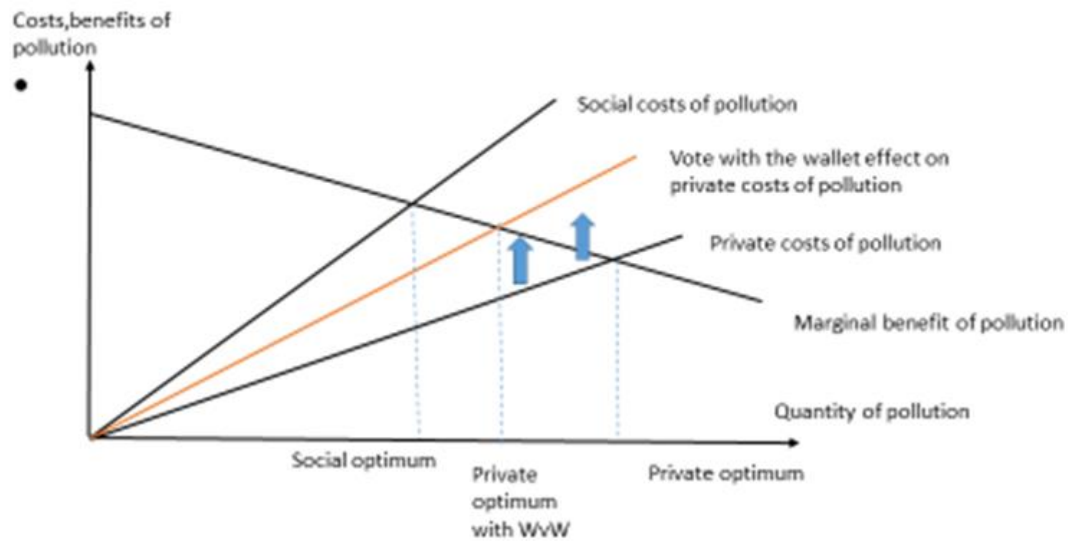


Table 1. The Italian government document on Economics and Finance and its projected effects on selected wellbeing indicators

BES wellbeing indicators											
	Final			Trend				Programmatic			
	2014	2015	2016	2017	2018	2019	2020	2017	2018	2019	2020
Average annual income available (thousand euros)	21.2	21.4	21.7	22.2	22.7	23.2	23.8	22.2	22.8	23.3	23.9
Non-attendance rate at work	22.9	22.5	21.6	21	20.6	20.2	19.5	21	20.5	19.9	19.2
Men	19.3	19	18.2	17.8	17.5	17.2	16.8	17.8	17.4	17	16.4
Women	27.3	26.8	25.9	25	24.4	23.8	23	25.1	24.3	23.6	22.7
Income inequality index	6.8	6.4	6.4	6.2	6.1	6	6	6.2	6	5.9	5.8
CO2 and greenhouse emissions (tonnes)	7	7.2	7.4	7.5	7.5	7.5	7.6	7.4	7.4	7.5	7.5
GDP per head (thousand euros)	25.4	25.6	25.9	26.2	26.4	26.7	27	26.1	26.4	26.7	27
Source: MEF elaboration on ISTAT data											

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