Milton Friedman	*The Social Responsibility of Business is to Increase Its Profits* The New York *Times Magazine*, September 13, 1970
Craig P. Dunn	*[embedded commentary--inset in italics]*

When I hear businessmen speak eloquently about the "social responsibilities of business in a free-enterprise system," I am reminded of the wonderful line about the Frenchman who discovered at the age of 70 that he had been speaking prose all his life. The businessmen believe that they are defending free enterprise when they declaim that business is not concerned "merely" with profit but also with promoting desirable "social" ends; that business has a "social conscience" and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers. In fact they are--or would be if they or anyone else took them seriously--preaching pure and unadulterated socialism. Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades.

> *Friedman here immediately assumes the reader is convinced, as Friedman himself is, that socialism in all its forms is necessarily evil. This may or may not be the case. In terms of distributive justice--an issue neither explicitly addressed nor intended as an outcome within the free-market model--in certain instances socialism has some clear advantages. We do not generally, for example, let the market determine who receives the scarce resources of transplantable organs--we rely on a 'command economy,' or at least a hybrid of capitalism and socialism. So too with child adoption. While the free-market does a masterful job of creating aggregate wealth, a benefit each of us enjoy, the system also reinforces and in fact exacerbates wage and class distinctions. As for the claim that businessmen were 'unwitting puppets' of 'intellectual forces' ...if I had that much power over the minds of businessmen, I would have my own 'Pinky and the 'Brain' cartoon series...but I would be ruling the world by now...*

The discussions of the "social responsibilities of business" are notable for their analytical looseness and lack of rigor. What does it mean to say that "business" has responsibilities? Only people have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but "business" as a whole cannot be said to have responsibilities, even in this vague sense. The first step toward clarity in examining the doctrine of the social responsibility of business is to ask precisely what it implies for whom.

> *Friedman here suffers from the very malady he sees endemic in discussions of the 'social responsibility' point of view--analytical looseness and lack of rigor. In the first sentence, Friedman speaks of social responsibilities, while in what follows he simply speaks of responsibility. This is not a meaningless distinction, for implied in Friedman's argument is the notion that because businesses are not moral persons, they cannot therefore have responsibilities. This is true enough if Friedman were speaking of moral responsibility: since businesses are not moral persons, they can have no moral responsibility. However, Friedman's argument lacks rigor in that he never carefully distinguishes between moral and social responsibility. While it may be true enough that institutions, including business, carry no moral responsibilities, one can not conclude from their lack of moral personhood that institutions have no social responsibilities. In The Elements of Moral Philosophy, Rachels provides readers with a useful definition of social contract theory: "Morality consists in the set of rules, governing how people are to treat one another, that rational people will agree to accept, for their mutual benefit, on the condition that others follow those rules as well." While seeming to deal only with the actions of persons, the notion of the social contract can easily and legitimately be extended to institutions as well. If, for example, one of these contractual rules were that individuals not knowingly harm one another, this dimension of the social contract would be in force within society at large--and would place legitimate social (although not necessarily moral, in spite of the first word in Rachels' definition) responsibilities on the conduct of business by owners and managers alike.*

Presumably, the individuals who are to be responsible are businessmen, which means individual proprietors or corporate executives. Most of the discussion of social responsibility is directed at corporations, so in what follows I shall mostly neglect the individual proprietors and speak of corporate executives.

In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom.

Of course, in some cases his employers may have a different objective. A group of persons might establish a corporation for an eleemosynary purpose--for example, a hospital or a school. The manager of such a corporation will not have money profit as his objectives but the rendering of certain services.

In either case, the key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them.

> *Friedman is careful to note that the corporate executive has direct responsibility to his employers, the shareholders. He is also careful to argue that this is not necessarily the manager's sole responsibility; there is, after all, the duty to conform to the basic rules of the society. It is not clear if the latter is a moral responsibility or a social responsibility--i.e., if it is a duty the manager has as a moral person, or if it is a duty the manager has as a result of institutional obligation. I think we can safely conclude Friedman intends the former. In either case, however, Friedman emphasizes the concept of agency in arguing that the manager's most direct obligation is to conduct the business in accordance with the desires of shareholders. Friedman is here reinforcing the free-market view that 'desires' are not the appropriate subject of moral scrutiny. If shareholders 'desire' profit, so be it; if consumers 'desire' high-fat foods, or environmentally-destructive products, or sex-for-hire, so be it. While I might like to think that shareholders 'desire' more than profit--that many are concerned about the social consequences attending the creation of corporate wealth--I am not that naive. I simply point out that this is a matter for empirical verification--something I have never known a corporate manager to do. Finally, be it noted that agency has historically been invoked as an excuse for a number of questionable moral practices--including the extermination of Jews by Nazis. As a society we are increasingly dissatisfied with the claim often proffered in such circumstances that the individual(s) most directly involved in such atrocities were merely following orders. Are not orders appropriately questioned? A more sophisticated analysis would give some clearer direction as to the circumstances which might permit--or even require--managers to override their fiduciary responsibility to shareholders.*

Needless to say, this does not mean that it is easy to judge how well he is performing his task. But at least the criterion of performance is straight-forward, and the persons among whom a voluntary contractual arrangement exists are clearly defined.

Of course, the corporate executive is also a person in his own right. As a person, he may have many other responsibilities that he recognizes or assumes voluntarily--to his family, his conscience, his feelings of charity, his church, his clubs, his city, his country. He may feel impelled by these responsibilities to devote part of his income to causes he regards as worthy, to refuse to work for particular corporations, even to leave his job, for example, to join his country's armed forces. If we wish, we may refer to some of these responsibilities as "social responsibilities." But in these respects he is acting as a principal, not an agent; he is spending his own money or time or energy, not the money of his employers or the time or energy he has contracted to devote to their purposes. If these are "social responsibilities," they are the social responsibilities of individuals, not business.

What does it mean to say that the corporate executive has a "social responsibility" in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers. For example, that he is to refrain from increasing the price of the product in order to contribute to the social objective of preventing inflation, even though a price increase would be in the best interests of the corporation. Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law in order to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire "hardcore" unemployed instead of better qualified available workmen to contribute to the social objective of reducing poverty.

> *Friedman makes an interesting claim here: that social responsibility necessarily comes at the expense of the interests of employers, or shareholders. This is a fairly common belief--that economic returns and social returns are inherently at odds with one another. But is this always and everywhere the case? Numerous examples might be offered of companies which simultaneously pursue profit while respecting their social responsibilities; the Business Enterprise Trust has documented a host of these. To cite only one example, 3-M has saved over $100M through its 3-P (Pollution Prevention Pays) program. None of the efforts were either legislatively mandated nor a matter of social custom or contract. Yet 3-M raised the bar, and is finding both economic and ecological benefits in the process. I would also argue that Friedman has chosen the easy examples here; he is apparently hesitant to address the toughest issues, such as the*

responsibility American companies might have for the health impacts on Taiwanese employees related to the exportation of toxic and/or hazardous waste, e.g. lead-acid batteries. Issues of modest price raises or hard-core unemployment pale in comparison to the tragedy of international human rights violations.

In each of these cases, the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his "social responsibility" reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees, he is spending their money.

The stockholders or the customers or the employees could separately spend their own money on the particular action if they wished to do so. The executive is exercising a distinct "social responsibility," rather than serving as an agent of the stockholders or the customers or the employees, only if he spends the money in a different way than they would have spent it.

But if he does this, he is in effect imposing taxes, on the one hand, and deciding how the tax proceeds shall be spent, on the other.

Friedman here invokes an interesting metaphor, which is used throughout the remainder of his treatise. It is a metaphor of private taxation, carried out at the behest of corporate managers. It is correctly acknowledged that the spending of corporate assets by managers is only a problem to the extent that managers exercise their discretion in a manner which is at odds with the interests of those constituencies which the manager represents--just as the spending of public monies by bureaucrats is only a problem to the extent that bureaucrats exercise their discretion in a manner which is at odds with the interests of citizens. But who are the constituencies to whom managers owe some duty? One would think Friedman would argue they are shareholders, since he has previously stated managers have a direct or primary obligation to owners. However, Friedman is not content to stop here; he mentions the interests of customers and employees as well. Read the passage carefully: Friedman goes so far as to explicitly state--not merely suggest by implication--that managers are agents of customers and employees as well as of shareholders. What is the source of this agency? Is it through conformance to the "basic rules of the society, both those embodied in law and those embodied in ethical custom"? It does not seem so. Is it through *a more generalized notion of social responsibility? This appears to be what Friedman is arguing; after all, he has invoked a social--and peculiarly pubic policy--metaphor to develop his position on managerial responsibility.*

This process raises political questions on two levels: principle and consequences. On the level of political principle, the imposition of taxes and the expenditure of tax proceeds are governmental functions. We have established elaborate constitutional, parliamentary and judicial provisions to control these functions, to assure that taxes are imposed so far as possible in accordance with the preferences and desires of the public--after all, "taxation without representation" was one of the battle cries of the American Revolution. We have a system of checks and balances to separate the legislative function of imposing taxes and enacting expenditures from the executive function of collecting taxes and administering expenditure programs and from the judicial function of mediating disputes and interpreting the law.

Here the businessman--self-selected or appointed directly or indirectly by stockholders--is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds--all this guided only by general exhortations from on high to restrain inflation, improve the environment, fight poverty and so on and on.

The whole justification for permitting the corporate executive to be selected by the stockholders is that the executive is an agent serving the interests of his principal. This justification disappears when the corporate executive imposes taxes and spends the proceeds for "social" purposes. He becomes in effect a public employee, a civil servant, even though he remains in name an employee of a private enterprise. On grounds of political principle, it is intolerable that such civil servants--insofar as their actions in the name of social responsibility are real and not just window-dressing--should be selected as they are now. If they are to be civil servants, then they must be elected through a political process. If they are to impose taxes and make expenditures to foster "social" objectives, then political machinery must be set up to make the assessment of taxes and to determine through a political process the objectives to be served.

This is the basic reason why the doctrine of "social responsibility" involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses.

> *First, questions at the level of political principle. Friedman seems to be arguing here that we can't rely on managers to make political decisions, because there are no countervailing powers to restrict the exercise of managerial discretion. Let us remember that Friedman, as with others holding to conservative libertarian moorings, is mistrustful of government. This makes the argument here presented especially curious, for a logical extension of Friedman's logic would lead to the conclusion that public bureaucratic decision-making is to be preferred to decision processes implemented within the unregulated private sector. Hmmm... Friedman is correct that the social responsibility doctrine takes explicit recognition of the political nature of business decision-making. As early as 1932, in their treatise entitled The Modern Corporation and Private Property, Berle and Means recommended that organizational decision processes evolve into a 'purely neutral technocracy.' This conclusion was based upon their argument that under conditions of separation of ownership from control managers can not be relied upon to faithfully discharge their duties to shareholders. Neo-classical economists and agency theorists alike have extended this reasoning, but all hold in common the belief that managers are not trustworthy. One remedy for such 'moral hazard' is to explicitly involve affected stakeholders in managerial decision-making at the highest levels of the organization. Many German companies, for example, subscribe to the principle of co-determination, which requires employee representation on corporate Boards. Call it socialism if you will; the pertinent question is, is this a good policy? Does it have the effect of leading to a good society, rather than merely a wealthy one?*

On the grounds of consequences, can the corporate executive in fact discharge his alleged "social responsibilities"? On the one hand, suppose he could get away with spending the stockholders' or customers' or employees' money. How is he to know how to spend it? He is told that he must contribute to fighting inflation. How is he to know what action of his will contribute to that end? He is presumably an expert in running his company--in producing a product or selling it or financing it. But nothing about his selection makes him an expert on inflation. Will his holding down the price of his product reduce inflationary pressure? Or, by leaving more spending power in the hands of his customers, simply divert it elsewhere? Or, by forcing him to produce less because of the lower price, will it simply contribute to shortages? Even if he could answer these questions, how much cost is he justified in imposing on his stockholders, customers and employees for this social purpose? What is his appropriate share and what is the appropriate share of others?

And, whether he wants to or not, can he get away with spending his stockholders', customers' or employees money? Will not the stockholders fire him? (Either the present ones or those who take over when his actions in the name of social responsibility have reduced the corporation's profits and the price of its stock.) His customers and his employees can desert him for other producers and employers less scrupulous in exercising their social responsibilities.

This facet of "social responsibility" doctrine is brought into sharp relief when the doctrine is used to justify wage restraint by trade unions. The conflict of interest is naked and clear when union officials are asked to subordinate the interest of their members to some more general purpose. If the union officials try to enforce wage restraint, the consequence is likely to be wildcat strikes, rank-and-file revolts and the emergence of strong competitors for their jobs. We thus have the ironic phenomenon that union leaders--at least in the U.S.--have objected to Government interference with the market far more consistently and courageously than have business leaders.

> *So on to political consequences. This argument depends for its force largely on the claim that corporate managers are ill-equipped to make tough allocation decisions. Yet this is largely what managers do: decide how, on what basis, and to what direct purpose to apply the scarce corporate resources of land, labor and capital. While the ambiguities attending controlling inflation might be daunting to even the best trained macro-economist--how many of us <u>really</u> understand how Alan Greenspan develops monetary policy?--why ought not managers to be subject to simpler prescriptions along the lines of those imposed by professions on their membership, such as that they not knowingly do harm? Recent notable cases of moral lapses on the part of corporate leadership--Dow Corning, for example--suggest that managers who simplify their decision processes to a single-minded profit objective do so to their own peril...and to the peril of the companies they manage, and to the peril of the owners whose interests they represent. And--it is news to me that union leaders have raised more vociferous objections to Government interference with labor markets than have corporate managers.*

The difficulty of exercising "social responsibility" illustrates, of course, the great virtue of private competitive enterprise--it forces people to be responsible for their own actions and makes it difficult for them to "exploit" other people for either selfish or unselfish purposes. They can do good--but only at their own expense.

> *There is ample evidence in the managerial, neo-classical and agency literature that private competitive enterprise does <u>not</u> make it difficult for managers to 'exploit' other people for their selfish purposes. In fact, the very people who are the easiest to exploit are those individuals to whom Friedman argues managers have the most direct and primary duty--the shareholders. Managerialists speak of breaches of trust; neo-classical economists speak of managerial shirking; agency theorists speak of opportunism. In all cases, some explanation is offered as to why the corporate form persists when it allows for managerial inefficiency--representing an expense to corporate owners. It is well known that managers appropriate corporate resources for their own selfish ends through engaging in on-the-job consumption. CEOs have been roundly criticized for exacting excessive salaries from Boards of Directors--Boards whose membership in very many cases has been carefully orchestrated by corporate managers. If control of managerial discretion is "the great virtue of private competitive enterprise"--I am left to wonder what the <u>lesser</u> virtues of the system might be.*

Many a reader who has followed the argument this far may be tempted to remonstrate that it is all well and good to speak of Government's having the responsibility to impose taxes and determine expenditures for such "social" purposes as controlling pollution or training the hard-core unemployed, but that the problems are too urgent to wait on the slow course of political processes, that the exercise of social responsibility by businessmen is a quicker and surer way to solve pressing current problems.

Aside from the question of fact--I share Adam Smith's skepticism about the benefits that can be expected from "those who affected to trade for the public good"--this argument must be rejected on the grounds of principle. What this amounts to is an assertion that those who favor the taxes and expenditures in question have failed to persuade a majority of their fellow citizens to be of like mind and that they are seeking to attain by undemocratic procedures what they cannot attain by democratic procedures. In a free society, it is hard for "evil" people to do "evil," especially since one man's good is another's evil.

This latter argument is an interesting one. Let us look at the assumptions undergirding Friedman's argument. Both democracy and capitalism respect personal liberty; therefore, these organizational schema are to be preferred to other available alternatives. Within a democratic system, the majority set the rules--or so Friedman argues. But democracy--and capitalism--is more than majority rule. Democracy is majority rule coupled with respect for minority rights. The <u>exclusive</u> focus on the collective will of the majority would as easily allow for the dismissal of the entire Judicial branch of government as it would of corporate social responsibility. I would hope that a democratic society would use judicial means to prohibit unjust employment discrimination, to use just one example, even if the majority of the populace favored such bias. Simply stated, the majority are sometimes wrong. The final sentence is baffling, both in its denotative and connotative aspects. It does not seem particularly difficult to this commentator for "evil" people to do "evil" in a free society. Furthermore, to claim that one man's good is another's evil implies there exist no universal moral standards serving to guide human conduct. It is not clear just how the two clauses of this sentence are logically connected.

I have, for simplicity, concentrated on the special case of the corporate executive, except only for the brief digression on trade unions. But precisely the same argument applies to the newer phenomenon of calling upon stockholders to require corporations to exercise social responsibility (the recent G.M. crusade, for example). In most of these cases, what is in effect involved is some stockholders trying to get other stockholders (or customers or employees) to contribute against their will to "social" causes favored by activists. Insofar as they succeed, they are again imposing taxes and spending the proceeds.

The situation of the individual proprietor is somewhat different. If he acts to reduce the returns of his enterprise in order to exercise his "social responsibility," he is spending his own money, not someone else's. If he wishes to spend his money on such purposes, that is his right and I cannot see that there is any objection to his doing so. In the process, he, too, may impose costs on employees and customers. However, because he is far less likely than a large corporation or union to have monopolistic power, any such side effects will tend to be minor.

It is at this juncture that Friedman introduces the problem of market failure, suggesting that the downside of the exercise of corporate social responsibility is that corporations holding monopolistic power can impose

> *their social agenda, rather easily overriding the interests of employees and customers. No news here. What is interesting is that Friedman feels the need to resort to market failure as a defense for his position. The argument offered is that for both sole proprietors as well as corporations operating in a free-market, the negative side effects of socially responsible business behavior are likely to be minor. One of the basic tenets of the free-market system is that there <u>are</u> a large number of buyers and sellers--i.e., there are no monopolies. So...within a free-market system, the costs imposed on employees and customers by corporate socially responsible behavior are minimal. Sounds like an argument in <u>favor</u> of socially responsible corporate behavior...*

Of course, in practice the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for those actions.

To illustrate, it may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects. Or it may be that, given the laws about the deductibility of corporate charitable contributions, the stockholders can contribute more to charities they favor by having the corporation make the gift than by doing it themselves, since they can in that way contribute an amount that would otherwise have been paid as corporate taxes.

In each of these--and many similar--cases, there is a strong temptation to rationalize these actions as an exercise of "social responsibility." In the present climate of opinion, with its widespread aversion to "capitalism," "profits," the "soulless corporation" and so on, this is one way for a corporation to generate goodwill as a by-product of expenditures that are entirely justified on its own self-interest.

It would be inconsistent of me to call on corporate executives to refrain from this hypocritical window-dressing because it harms the foundation of a free society. That would be to call on them to exercise a "social responsibility"! If our institutions, and the attitudes of the public make it in their self-interest to cloak their actions in this way, I cannot summon much indignation to denounce them. At the same time, I can express admiration for those individual proprietors or owners of closely held corporations or stockholders of more broadly held corporations who disdain such tactics as approaching fraud.

> *And the problem with fraud is??? Friedman is here asserting a moral claim, which is certainly inconsistent with the overall tenor of his argument against socially responsible behavior.*

Whether blameworthy or not, the use of the cloak of social responsibility, and the nonsense spoken in its name by influential and prestigious businessmen, does clearly harm the foundations of a free society. I have been impressed time and again by the schizophrenic character of many businessmen. They are capable of being extremely far-sighted and clear-headed in matters that are internal to their businesses. They are incredibly short-sighted and muddle-headed in matters that are outside their businesses but affect the possible survival of business in general. This short-sightedness is strikingly exemplified in the calls from many businessmen for wage and price guidelines or controls or income policies. There is nothing that could do more in a brief period to destroy a market system and replace it by a centrally controlled system than effective governmental control of prices and wages.

The short-sightedness is also exemplified in speeches by businessmen on social responsibility. This may gain them kudos in the short run. But it helps to strengthen the already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces. Once this view is adopted, the external forces that curb the market will not be the social consciences, however highly developed, of the pontificating executives; it will be the iron fist of Government bureaucrats. Here, as with price and wage controls, businessmen seem to me to reveal a suicidal impulse.

> *When all else fails, resort to an ad hominem argument. This is as blatant a breach in logic as one is likely to find, and needs no further denunciation. With respect to the claim that corporate socially responsible behavior is likely to be a lightning rod for governmental regulators, one could more persuasively argue to a conclusion exactly the opposite of that arrived at by Friedman. Corporate misbehavior tends to impose costs on society-- negative externalities which are borne by ordinary citizens. Public agencies oftentimes seeks reparations for these unintended*

consequences of corporate activity; in fact, beyond seeking a remedy for past harms the motivation for much governmental regulation has been the prevention of future corporate malfeasance. Corporate socially responsible activity is more likely to result in <u>avoidance</u> of regulation, rather than to provide the impetus for such regulation.

The political principle that underlies the market mechanism is unanimity. In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they need not participate. There are not values, no "social" responsibilities in any sense other than the shared values and responsibilities of individuals. Society is a collection of individuals and of the various groups they voluntarily form.

The political principle that underlies the political mechanism is conformity. The individual must serve a more general social interest--whether that be determined by a church or a dictator or a majority. The individual may have a vote and say in what is to be done, but if he is overruled, he must conform. It is appropriate for some to require others to contribute to a general social purpose whether they wish to or not.

Unfortunately, unanimity is not always feasible. There are some respects in which conformity appears unavoidable, so I do not see how one can avoid the use of the political mechanism altogether.

But the doctrine of "social responsibility" taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collective doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means. That is why, in my book *Capitalism and Freedom*, I have called it a "fundamentally subversive doctrine" in a free society, and have said that in such a society, "there is one and only one social responsibility of business--to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

It is not clear that the social responsibility doctrine would reduce every decision to a political decision. But if by this Friedman means that in all our *affairs, as moral persons, we ought to be concerned with the collective good...this would not be a bad thing. What it means to be moral is to live one's life with explicit reference to a concept of the good. Absent such a concept, life itself loses both purpose and thereby meaning. Ultimately, pursuit of the good society is an individual quest with personal meaning for each of us. It may be that it is only in the search for the collective good that we liberate ourselves...*